Custody, Collateral and Client Money Regulation in the post-crisis world: a comparative study

Michael David Huertas, LL.M., MBA
Solicitor-Advocate (England & Wales), Solicitor (Ireland), Rechtsanwalt (Germany)

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Queen Mary University of London
School of Law
Centre for Commercial Law Studies

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Statement of Originality

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Abstract

The foundation of any capital market is its infrastructure, including its arrangements for the “collateral ecosystem” (the regulatory, institutional and operational arrangements for collateral, custody, client assets and client money). Capital market infrastructure should work in an integrated fashion so parties can transact seamlessly on a level playing field instead of a patchwork.

That is not the case today. In particular, no uniform single EU-wide collateral ecosystem exists. While EU Directives and Regulations have improved individual aspects of the ecosystem, they have been applied unevenly across the EU and often unintegrated with one another. As Member States transposed EU Directives into national law, they did so in national terms and national institutions. This is even the case with the UK and Ireland, despite closely linked markets and legal systems, divergences do exist.

Such divergences create “conceptual gaps” and “conceptual translation risks” in protection market participants receive, especially where they document, transact and/or hold assets in different jurisdictions. This creates risk, including those specific to collateral assets, as well as transaction costs.

This thesis proposes new metrics to identify measure and manage risks specific to the collateral ecosystem including those stemming from conceptual gaps and conceptual translation risks. A comparative law analysis between respective rules, and divergences, at the EU, Irish and UK level demonstrates some of these issues and proposes policy options.

Economically, the most effective measure would involve harmonising the laws and regulations affecting the EU’s collateral ecosystem, ideally along the lines of the most commonly used regime adapted on a “jurisdiction-agnostic” basis. Politically, however, such an approach is likely to encounter severe challenges. The question is whether EU-27 policymakers, given the UK’s changing relationship with the remaining bloc, will move the discussion on fixing the plumbing from "too big to reform" to "too important to miss".
Acknowledgements

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GLOSSARY OF KEY TERMS

References in this thesis to legislation, rulemaking and policymaking instruments are references to consolidated versions of such instruments, including as re-enacted, and shall include all subordinate measures made under that provision, as in force in the respective jurisdictions as at 14 December 2019 unless indicated to the contrary. References to websites are as “accessed on 8 and 14 December 2019”.

Unless the context otherwise in this thesis requires, words in the singular shall include the plural and in the plural shall include the singular.


**BUSI** Banking Union supervised institution.

**Brexit** The UK ceasing to be an EU-MS and ceasing to be subject to any transitional arrangements that substantively treat the UK as an EU-MS of the EU.

**CAR** Refers to the “Client Assets Rules” that apply in Ireland comprised of the following legislative and (non-legislative) regulatory instruments:

- Central bank (Supervision and Enforcement) Act 2013 (Section 48(1) (Investment Firms) Regulations 2017;
- Investor Money Requirements Guidance 2018, Central Bank of Ireland; and
- Guidance on Client Asset Regulations for Investment Firms.

**CASS** The Client Asset Sourcebook\(^1\) of the UK FCA’s Handbook\(^2\).

**CBI** Central Bank of Ireland, as NCA in Ireland that also participates in the Banking Union.

**CCP** An entity that interposes itself between the two sides of a transaction, using novation mechanics to become the buyer to every seller and the seller to every buyer. CCPs are tasked with clearing transactions by netting offsetting contractual positions and corresponding collateral delivery obligations by taking both sides of a transaction and thus

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\(^1\) Available, as at the version of 1 November 2019, here: [https://www.handbook.fca.org.uk/handbook/CASS.pdf](https://www.handbook.fca.org.uk/handbook/CASS.pdf) (accessed 2 November 2019)

\(^2\) For a more general discussion on the missed opportunity of the EU, most recently in terms of CMU, to not itself adopt a similar approach taken by EU policymakers in terms of the UK’s Financial Services Handbook, please see M.D: Huertas “The Phasing Out of the UK’s Financial Services Handbook: a Missed Opportunity for the EU’s Single Rulebook and the Capital Markets Union Project?” which first appeared in 2016 in Vol.31 Journal of International Banking Law & Regulation, Issue 1.

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is in theory supposed to provide, assuming it has enough capital and a sizeable default fund to cover losses resulting from defaults of its users, a stability and liquidity buffer.

CDD 2017/593  

CDR 2017/565  

Client Assets  
Means financial instruments belonging to a client of a regulated firm that a firm receives, holds or controls on behalf of the client in the course of carrying out MiFID business. NB these items may have specific meanings under CDD 2017/593 and CDR 2017/565 (and the MiFID II/MiFIR Regime more generally, which defines this as “client financial instruments” and together with Client Money as “assets”) as well as CASS and CAR and the meanings may be subject to divergences between those respective regimes.

Client Money  
Means money of any currency i.e., cash, belonging to a client of a regulated firm which a firm receives, holds or controls on behalf of the client in the course of carrying out MiFID business. NB these items may have specific meanings under CDD 2017/593 and CDR 2017/565 (and the MiFID II/MiFIR Regime more generally which defines this as “client funds”) as well as CASS and CAR and the meanings may be subject to divergences between those respective regimes.

CMU  
The EU’s Capital Markets Union project originally launched in 2015, which was scheduled to be completed 2019 (i.e., CMU 1.0) and which, in the EC’s legislative cycle of 2019-2024 is supposed to be “re launched” as CMU 2.0.

Collateral Assets  
Means any Client Assets and/or Client Money, which belongs to a client of a regulated firm that is held and/or controlled under the terms of any security interest or any other security arrangement. NB these items may have specific meanings under CDD 2017/593 and CDR 2017/565 (and the MiFID II/MiFIR Regime more generally) as well as CASS and CAR and the meanings may be subject to divergences between those respective regimes.

Collateral Ecosystem  
The regulatory, institutional and operational arrangements for collateral, Custody, client assets and client money that apply in the EU due to EU and national level legislative and non-legislative rulemaking instruments and supervisory expectations.

Collateral Value  
Refers to the market terminology for the fair market value of a Collateral Asset determined either by appraisal or by estimation of a proxy. It itself can be netted to account for aggregate gains on collateral assets held by it versus aggregate losses that have been provided by the calculating entity as collateral provider to other market participants.

NB Collateral Value, when use more broadly herein, is separate to the concepts set out in the “Liquidity Coverage Ratio” (LCR) and the “Net Stable Funding Ratios” (NSFR), which apply to certain firms that qualify as “institutions” for purposes of the EU’s CRR/CRD IV regulatory regime, as amended. It should be noted that the NSFR and LCR both recognise and value asset quality and liquidity value on the assumption that unencumbered, high-quality assets that can be securitised or traded, and thus can be readily used as collateral assets to secure additional funding or sold in the market, do not need to be wholly financed with stable funding.
### CLS
CLS, as a settlement method refers to the settlement system run by CLS Bank International (CLS Bank), which is a specialised U.S. headquartered credit institution set up to settle eligible FX transactions on a Payment versus Payment basis designed to eliminate settlement risk. This operates on the premise that CLS acts as a central clearer, which allows multilateral netting but operates on the basic principle that funds on one leg of the transaction are not released to the recipient counterparty unless the other counterparty has paid funds to be deposited. Settlement is intraday and with finality as payments are made using central bank money. Membership of CLS Bank and participation in the CLS system is split between settlement members who are shareholders of CLS Bank, these are mostly market makers or other financial institutions, and user-members who are sponsored by settlement members. Transactions flowing from user members must be routed through settlement members. Clients and/or relevant settlement intermediaries of CLS Bank user or settlement members may use CLS through those members.

### CREST
A UK based CSD that forms part of Euroclear and is regulated and operates in accordance with the UK’s Uncertificated Securities Regulations 2001 (SI 2001/3755) as supplemented by the various CREST Rulebooks.

### CSD
A Central Securities Depository is an entity that holds securities (i.e., financial instruments) and enables securities transactions to be cleared and settled. Physical securities may be immobilised by the depositor or securities may be dematerialised i.e., they exist solely in electronic form/book entry records. A CSD maintains accounts for the participating intermediaries to whose intermediary accounts the relevant securities are credited. Intermediary accounts are maintained for market participants i.e. for both client investors or client intermediaries, who in turn may maintain further accounts. This creates a chain of accounts from CSD level through intermediaries to ultimately the end user i.e., the investor.

### CSDR
Central Securities Depository Regulation.

### CNS
CNS is commonly meant to refer to settlement using a centralised automated system to settle “compared” transactions and maintain an efficient flow of security and money balances. CNS merges a previous unsettled position into the next settlement period’s settling transactions. This is subject to potential systemic risks due to the compounding contagion effect where incoming funds are relied upon to make onward payments to counterparties.

### Custody
Means the safeguarding and administering of Collateral Assets. NB these items may have specific meanings under CDD 2017/593 and CDR 2017/565 (and the MiFID II/MiFIR Regime more generally) as well as CASS and CAR and the meanings may be subject to divergences between those respective regimes.

### Custodian/Depository
Means a provider of Custody and other safekeeping/depository services.

### Collateral Upgrade
See definition at Para. 2.48.
**Transaction (CUTs)**

**DLT**
Distributed Ledger Technology.

**DvP**
Delivery versus Payment means the simultaneous, final, irrevocable and immediately available exchange of securities and cash on a continuous basis throughout the day.

**EBA**
European Banking Authority.

**EBU**
The EU’s Banking Union, comprised of the SSM and the Single Resolution Mechanism which applies to participating EU-MS – at the time of writing the Eurozone-19.

**EC**
European Commission.

**ECB**
European Central Bank.

**ECB-SSM**
ECB acting in its role at the head of the SSM.

**ECJ**
Court of Justice of the European Union.

**EIOPA**
European Insurance and Occupational Pensions Authority.

**EMIR**
Regulation (EU) No. 648/2012 on OTC derivatives, CCPs and trade repositories.

**ESA**
The European Supervisory Authorities (EBA, ESMA and EIOPA).

**ESFS**
ESAs plus NCAs.

**ESMA**
European Securities and Markets Authority.

**ETD**
Derivatives that are exchange-traded via what MiFID terms a trading venue.

**EU**
European Union.

**EU-27**
EU-27 Member States.

**EU-FCD**

**EU-MS**
Means the EU Member States.

**Eurosystem**
Means the ECB and National Central Banks of those EU-MS that have adopted the euro.

**EU-SFD**
Directive 98/26/EC.

**FCA**
The Financial Conduct Authority, as NCA in the UK (which, in accordance with the UK’s Financial Services Act 2012, from 1 April 2013 replaced the Financial Services Authority).
Financial Risk

Generally any type of risk associated with the financial performance of a financial transaction (not necessarily the Collateral Asset arrangements underpinning it) that may include (but is not limited to):

- Credit risk;
- Counterparty risk;
- Funding (incl. interest rate risk);
- Liquidity risk;
- Market risk;
- Model risk; and
- Wrong-way risk.

FMI

Financial Market Infrastructure.

FMIP

A provider of FMI services.

G-20 Pittsburgh Commitments

A set of agreed reforms agreed between the G-20 in respect of various sectors, including financial services.

GFC

Global Financial Crisis that started in 2008.

Giovannini Barriers

The Giovannini Barriers refers to those items that were flagged in the First Giovannini Group Report published in 2001 and the Second Giovannini Group Report published in 2003. The so-called “Giovannini barriers” describe the main obstacles to efficient cross-border clearing and settlement in Europe, whether legal, fiscal, or linked to market practice.

The ECB maintains a list on how it considers that the Giovannini Barriers are overcome by both T2S and CSDR.

The Giovannini Barriers are sometimes supplemented by the “EPTF Barriers”, as first published in the EC’s European Post-Trade Forum Report dated May 2017 (See also figures in the Endnotes).

Goldplating

The EC defines this as "an excess of norms, guidelines and procedures accumulated at national, regional and local levels, which interfere with the expected policy goals to be

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4 See: [http://www.g20.utoronto.ca/analysis/commitments-09-mitsubishi.html](http://www.g20.utoronto.ca/analysis/commitments-09-mitsubishi.html)

For information on what it has meant for the UK, see Library Standard Note 3328, “Gold plating” and EU Law in the UK”, 16 December 2004. Equally, see UK Government’s “General Principles” on incorporating EU law, as agreed in 2010, in the following Library of House of Commons Standard Note 5943.9

Haircut/Overcollateralisation

The terms “Haircut” and “Overcollateralisation” have no definitive legal meaning (unless defined in a given context) and in the market describe, in relation to valuation of collateral assets, the same concept. They are also used interchangeably and concurrently10.

Economically, they both address, in the case of the Haircut the difference between the market value of the Collateral Asset and the amount the Collateral Asset is supposed to secure. This reflects the perceived riskiness of the assets. Overcollateralisation reflects risk mostly in the collateral asset, but can also be used to gauge the amount of extra collateral (over the threshold – assume 100% for ease) that is required to cover the risks perceived by the collateral taker in respect of the overall exposure.

Hence, a ‘risk free’ asset may have a lower Haircut value and thus have a lower Overcollateralisation level than for example a junk bond. Historically these values have looked at market value, credit and liquidity risks of the collateral asset but not necessarily the other components that make up Coll-RR themselves.

The degree of Overcollateralisation is important, as in some circumstances this extra might be at risk of loss to the collateral provider upon an insolvency (or an event with analogous effect) of the collateral taker.

Herstatt Risk

Also referred to a “principal risk” means the risk of loss of the full value of the asset delivered, as well as the mitigants. The closure of Bankhaus I.D. Herstatt on 26 June 1974 led to the concept of settlement risk (related to FX trading) being refined to include the concept this risk and equally led to DvP becoming commonplace across a number of transaction types.

HQLA

High-Quality-Liquid-Assets refers to Collateral Assets that are cash or near-cash, highly-rated assets that can be converted into cash at little or no loss of value in private markets. The term HQLA while originally introduced as part of EU prudential requirements (LCR and NSFR – see definition of Collateral Value) is used in market terminology to describe such types of assets and HQLA may attract a market premium. For the BCBS’ understanding of HQLA see para. 24 and seq. in BCBS 23811 and subsequent publications.

ICSD

International CSD. Whereas CSDs were primarily created to serve their domestic market, ICSDs were created in the 1970s to settle Eurobonds, i.e. international bonds denominated in a different currency from that of the country in which they are issued. Over the years, ICSDs have extended the scope of their services to cover all types of internationally traded financial instruments, including equities and investment funds. Currently, there are two ICSDs operating in the European Union: Clearstream Banking Luxembourg and Euroclear.

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9 See: http://researchbriefings.files.parliament.uk/documents/SN05943/SN05943.pdf
10 And can, due to incorrect or imprecise use, also lead to CTR just in the same way as a non-legal use of ‘pledge’ can drive risk.
11 See: https://www.bis.org/publ/bcbs238.pdf
Bank in Belgium. Both hold a banking license and provide settlement in different currencies.

**Ireland**

Means the Republic of Ireland.

**Irish-FCARs**

Means S.I No. 626/2010 – European Communities (Financial Collateral Arrangements) Regulations 2010\(^\text{12}\)

**LEI**

Legal Entity Identifier.

**LBIE**

Lehman Brothers International Europe Limited, which filed for insolvency on 15 September 2008 thus precipitating the credit crunch phase of the GFC.

**Mandatory Collateralisation**

Means the legal and/or regulatory requirement to provide but also accept Collateral Assets in respect of a counterparty either bilaterally or via a CCP.

**MiFID I**

Directive 2003/39/EC – repealed and replaced by MiFID II.

**MiFID II**

Directive 2014/65/EU.

**MiFIR**


**The MiFID II/MiFIR Regime**

MiFID II and MiFIR as well as relevant delegated legislative and non-legislative instruments.

**NCA**

National Competent Authority in an EU-MS.

**Non-Financial Risk**

Generally taken to mean any risk type that is not a Financial Risk (despite NFRs being able to have financial loss outcomes) and may include, but is not limited to:

- Conduct risk;
- Cyber and IT-risk;
- Documentation risk;
- Legal risk;
- Operational risk;
- Regulatory risk;
- Reputational risk;
- Strategic risk;
- Third-party risk;

OJ

Means the Official Journal of the EU.

OTC

Over-the-counter – which refers, primarily to derivatives that are traded bilaterally not on an “execution venue” – as such term is defined in the MiFID II/MiFIR Regime.

Regulation

Means an EU legislative instrument in the form of a Regulation that are binding in their entirety and directly applicable in all EU-MS and self-executing and thus do not require EU-MS to undertake any implementing measures. See also Art. 299 Treaty of Functioning of the EU.

RTGS

Real time gross settlement is commonly meant to mean settlement using transfer systems where transfer of money or financial instruments takes place between counterparties in real time and on a gross basis. Settlement by this method has been a mainstay of modern financial markets and payment systems. RTGS mitigates systemic risks by passing through obligations and typically requiring collateralisation of unsettled exposures.

Securities Financing Transaction (SFT)

SFTs, for purposes of the SFTR include:

- a repurchase transaction (Repo) - which is the sale of an asset(s) versus cash payment with the legal obligation to repurchase the fungible asset(s) from the second party at a different price at a future date or (in case of an open repo) on demand. If the seller defaults during the life of the repo, the buyer can sell the asset(s) to a third party to offset his loss. The asset therefore in effect acts as collateral and mitigates the credit risk that the buyer has to the seller;

- securities lending (SecLend) - which is a temporary exchange of securities for acceptable collateral between a lender and an approved borrower. The transaction is often facilitated by a lending agent;

- a buy-sell back transaction or sell-buy back transaction; and

- a margin lending transaction, which is intended primarily to capture the collateralisation of financial instruments in the context of prime brokerage activities.

Segregation

Segregation of Collateral Assets refers to the process whereby a regulated firm, whether as part of Custody, or holding (or arranging the holding of) such Collateral Assets separate to those of assets of that regulated firm. This may include ringfencing of Collateral Assets from their own assets by using separate (internal/external) accounts and/or the placing of Collateral Assets with an appropriately permitted third party.

Segregation can also be on the basis of any combination of an:

- Individual Segregated Client Account which contains Collateral Assets of a single client; or

- an Omnibus Segregated Account where a single account holds Collateral Assets of a number of clients (usually of the FMIP or its member).
SFCA A Security Financial Collateral Arrangement pursuant to the EU-FCD whereby the collateral provider retains ownership rights in the Collateral Assets while establishing a security interest for the collateral taker. This approach provides for asset protection for the collateral provider as the Collateral Assets are still held in its name but is established under control rights for the collateral taker.


Single Market Means the EU’s single/internal market for financial services, which refers to the EU as one territory without any internal borders or other regulatory obstacles to the free movement of capital, and services.

Single Rulebook Means the collection of EU legislative, regulatory and policymaking instruments, where these exist, that collectively, as a common framework of Directives and Regulations, govern the financial markets sectors (and thus the Collateral Ecosystem) across the entire EU and its Single Market.


SPoR Means the collection of ESA and ECB-SSM’s Supervisory Principles on Relocations, originally aimed at firms relocating due to Brexit but increasingly used as a soft-law instrument to amend existing rules for all non-EEA firms.

SRIs Settlement Relevant Intermediaries.

SSM The Single Supervisory Mechanism of the Banking Union.

SSS Securities Settlement Systems

As described by the ECB on its website:


“When investors buy and sell securities the security and payment need to change hands – a process called securities settlement. TARGET2-Securities, or T2S, is a safe platform where the exchange can happen simultaneously, i.e. where delivery versus payment is possible.

Safer and more efficient securities settlement: T2S revolutionised securities settlement in Europe because it brought an end to complex cross-border settlement procedures and the problems caused by different settlement practices among countries. Instead, with T2S we have a common platform on which securities and cash can be transferred between investors across Europe, using harmonised rules and practices. Currently 20 European countries use T2S. Banks pay for securities on the platform using the account they have with their central bank, so the money used to settle transactions is central bank money. As a result, transaction risk is greatly reduced.”

T2S was created inter alia by Guideline ECB/2012/13 of 18 July 2012 on TARGET2-Securities OJ L 215, 11.8.2012, p. 19, also available under http://www.ecb.europa.eu/ecb/legal/pdf/l_21520120811en00190029.pdf. ECB’s Governing Council decided to develop T2S to provide CSDs with a shared technical platform to settle securities transactions in euro and other currencies using ‘central bank
money’ (from accounts held at Eurosystem Central Banks). T2S is not a CSD. Hence, the CSDs, which may adhere to T2S on a voluntary basis in order to benefit from settlement in central bank money, will maintain contractual and commercial relations with their customers, to whom they will continue to directly provide all the CSD services, such as settlement services, corporate actions and Custody services. The creation of a common platform will lead to the full standardisation of processes, resulting in significant economies of scale, eliminating settlement risks and assisting credit institutions to optimise the management of their liquidity and securities. T2S acts as important catalyst for the single market for financial services, with a positive impact on European economic growth, thereby supporting the Lisbon strategy. In particular, T2S contributes to these goals by eliminating the risks still affecting the settlement of cross-border securities transactions, helping banks to optimise their collateral and liquidity management and promoting diversification and risk-sharing. See: http://www.ecb.europa.eu/paym/t2s/html/index.en.html

TARGET2

As described by the ECB on its website: https://www.ecb.europa.eu/paym/target/target2/html/index.en.html:

“TARGET2 is the real-time gross settlement (RTGS) system owned and operated by the Eurosystem. Central banks and commercial banks can submit payment orders in euro to TARGET2, where they are processed and settled in central bank money, i.e. money held in an account with a central bank.

TARGET2 settles payments related to the Eurosystem’s monetary policy operations, as well as bank-to-bank and commercial transactions. Every five days, TARGET2 processes a value close to the entire euro area GDP, which makes it one of the largest payment systems in the world. More than 1,000 banks use TARGET2 to initiate transactions in euro, either on their own behalf or on behalf of their customers. Taking into account branches and subsidiaries, more than 52,000 banks worldwide and all their customers can be reached via TARGET2. In response to changing market demands, the Eurosystem has launched a review of its RTGS services. The objective is to consolidate the technical and functional aspects of TARGET2 and T2S, with the aim of improving efficiency and reducing operating costs.”

TTCA

A Title Transfer Collateral Arrangement pursuant to the EU-FCD under which a collateral provider transfers full ownership of Collateral Assets to a collateral taker for the purpose of securing or otherwise covering the performance of relevant financial obligations. As the property of the collateral taker these Collateral Assets will be protected and segregated externally in the same way as any other assets belonging to the collateral taker.

Two-Way Collateralisation

Means the provision by Party 1 to Party 2 of Collateral Assets and the concurrent provision by Party 2 to Party 1 of Collateral Assets. Prior to the GFC, market practice was that the non-dealer entity was the only party providing Collateral Assets.

UCC


UK

Means the United Kingdom of Great Britain and Northern Ireland.

UK-FCARs
Means the UK Financial Collateral Arrangements Regulations (No. 2) Regulations 2003\textsuperscript{13} as amended by the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010/2993 (\textbf{UK 2010 FCAR Amendment})\textsuperscript{14}.

\textbf{U.S.} United States of America

\textbf{Working Paper} Means the academic paper: Huertas, Michael, "Too big to reform or too important to miss? Why the EU needs more consistency on the rules on collateral and Custody of client assets and client money as part of CMU 2.0" (December 14, 2019).

\textsuperscript{13} Available here: http://www.legislation.gov.uk/uksi/2003/3226/made

\textsuperscript{14} Available here: http://www.legislation.gov.uk/uksi/2010/2993/made
Preface

The foundation of any capital market is its infrastructure, including its arrangements for the “Collateral Ecosystem”. Capital market infrastructure should work in an integrated fashion so parties, including issuers, investors and intermediaries can transact seamlessly on a level playing field instead of a patchwork.

That is not the case today in the EU. In particular, no uniform single EU-wide Collateral Ecosystem exists. Although various EU Directives/Regulations have improved individual aspects of the Collateral Ecosystem, such instruments have neither been uniformly applied across the EU nor integrated with one another. Many of the legislative measures have also been minimum as opposed to maximum harmonisation texts, thus leaving EU-MS national options and discretions, contributing to fragmentation. Core pillars of the Collateral Ecosystem, specifically the EU-FCD and EU-SFD are Directives, some of which pre-date the FSAP, have not been fully updated to the post-FSAP and now post-GFC/CMU wave of new standards. Consequently, as each EU-MS transposed Directives into national law, they did so in national terms in the context of national institutions. Divergences exist. Goldplating adds further divergence. They also exist in relation to Regulations, as applied in EU-MS even where they are of a maximum harmonisation nature. Even between the UK and Ireland, despite their closely linked markets and legal systems, divergences do exist.

These national divergences in those rules create, what this thesis terms “conceptual gaps” and “conceptual translation risks” (CTR) and thus costs as well as “Financial and non-Financial Risks”\(^\text{15}\) that reduce the standards and protections those rules introduce. This affects almost all financial market participants, particularly where they document, transact and/or hold assets (including via Custody) in different jurisdictions. That in turn increases risk, including those specific to Collateral Assets, as well as transaction costs and hampers growth. This thesis assesses those risks as they apply to rulemaking but also in relation risks that are specific to the Collateral Ecosystem – notably, what this thesis proposes as Coll-RR and Cust-RR.

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\(^{15}\)See Glossary. NB there is no agreed EU-wide nomenclature and/or taxonomy for specific risk types, and the author thus uses those that are suggested by the ECB and/or the respective ESAs unless indicated to the contrary, but ultimately each regulated firm will have (or ought to) their own risk taxonomy as it applies to its own risk appetite framework.
These risks also apply even where institutional-led, often operational-focused and thus non-legal driven changes have provided solutions that are jurisdiction-neutral and interoperable across multiple jurisdictions, free from national influences (i.e. Jurisdiction-Agnostic). Such solutions, while transformative, are not, on their own, a panacea to plugging the (potential) problems in the plumbing. While the Eurosystem's work on the operational system known as TARGET2 Securities i.e. T2S is very much a step in the right direction in terms of operational-led cross-border functionality, more is needed. Some hope that new technologies (such as DLT) and/or new entrants (e.g. FinTech) will supply what is missing. They cannot. Legislative and regulatory changes will also be required and this thesis and related research in the Working Paper and evidence in the Annexes assesses and proposes what some of those steps might look like.

Economically, the most effective measure would be the harmonisation across the EU of the laws and regulations affecting the Collateral Ecosystem, ideally along the lines of the most commonly used regime, i.e. that of the UK (CASS) and parts of the Irish (CAR) regime adapted on a "jurisdiction agnostic" basis. Politically, however, such an approach is likely to encounter severe challenges. The question is whether EU-27 policymakers, in light of the UK's changing relationship with the remaining bloc, will take the plunge and move the discussion on fixing the plumbing from "too rigid to reform" to "too important to ignore".

The research in this thesis has been conducted at a seminal stage in the development of EU, English and Irish financial law and the regulatory regimes as well as the UK’s changing relationship with the Republic of Ireland and EU. Since the global financial crisis that started in 2008 (GFC), the relevant legal, regulatory and operational/technological framework has been radically reshaped and altered much beyond principles, which were, prior to the crisis, largely based on mercantile and property law principles rooted in the 19th century.

Even if further regulations and technical standards may be required to implement and give further effect to a true Single Market for financial services and thus the Collateral Ecosystem in the EU (including the aspects proposed herein), the building blocks for this new “new normal” are now largely in place. They however are not free from risks
embedded in those reforms, often undertaken through a multitude of (well-intentioned) actions of policymakers who have tried to close some but may not have achieved in addressing all areas of fragmentation and connected risks, as evidenced by an abundance of divergences and jurisdiction-specific rules/Goldplating.

In summary, financial services firms, market participants, clients and counterparties are increasingly more global and likely to continue so. The Single Market thrives when fragmentation and national barriers as well as options and discretions are eradicated. Does it, in 2019 and beyond, still make sense to have 28+ national regimes on Client Assets, Client Money, Collateral Assets and Custody as well as in respect of security interests and set-off? Specifically, do these 28+ regimes, parts of which derive from common principles set at EU law, reinforce rather than reduce fragmentation given that the 28+ regimes retain existing or have developed new jurisdiction-specific rules, concepts including some of which result from those very conceptual gaps and CTR, which seek to compete instead of interoperate with each other.

Without a new approach, that level of fragmentation would not be closed anytime soon, not least ahead of the new revised impetus to complete Capital Markets Union (CMU) now transitioning from 1.0 to its revised 2.0 attempt of integration to be pressed ahead during the 2019-2024 EU legislative lifecycle.

The law is stated as at 14 December 2019 unless indicated to the contrary and the Glossary of Key Terms are included to help readers navigate an area that is not free of legal and market jargon. This thesis is written primarily from the perspective of English, Irish and EU law (including, as applied in the UK and Ireland) and relevant regulatory regimes. It does not address issues on consumer protection or taxation.

As the law (including the case law) concerning the subject matter remains developing, and the research and the principles advanced in this thesis notably the proposed approach to identifying, mitigating and managing what are termed herein as new risk concepts and metrics, summarised in the Addendum to Chapter 1 as “conceptual gaps”, “CTR”, “Collateral Related Risk (Coll-RR)” and “Custody Related Risk (Cust-RR)” ought to develop in line with the changes of the law, this thesis aims to provide guidance on these issues in a pragmatic matter, notably given the analysis in the Annexes and Working Paper that should be read in conjunction with this thesis.
In many cases, the legal position may not be free of doubt as to the exact legal treatment, absent established case law (notably on the case of DLT as well as crypto-assets), and the views or propositions expressed herein are those of personal judgement on how such issues are likely to be decided if they were to come before the courts and/or competent authorities.

Moreover, the views expressed by the author are not necessarily those of Dentons Europe LLP and professional bodies of which the author is a member. This thesis is intended to advance academic and practitioner debate on key legal, regulatory and non-financial risk issues in a non-quantitative analytical manner as they may affect the Collateral Ecosystem as well as areas of non-financial risk affecting financial markets, in particular where these may have largely been overlooked. This thesis is thus not intended to be a substitute for legal advice on a specific question or transaction. All errors and omissions are those of the author.

Michael Huertas

10 January 2020, Frankfurt am Main, Germany
Part I – why, what, where and how?

1. Introduction to key issues and problem analysis

1.1 The rationale for this thesis and related research\(^\text{16}\) was born out of practitioner experiences gained in-house, in private practice, as a lawyer qualified in multiple jurisdictions, as well as while working at the ECB\(^\text{17}\) across a wide spectrum of transactional and regulatory advisory work including on EU policymaking affecting capital markets and the Collateral Ecosystem.

1.2 Collateral Assets and the financial market infrastructure are the two key components that make up the ‘Collateral Ecosystem’. This Collateral Ecosystem is core to the functioning of financial markets that have grown exponentially in the past 30 years concurrently with greater legal and market-driven integration of European markets. The Collateral Ecosystem underpins a wealth of financial, payment and ‘real economy’ transactions. As such, the Collateral Ecosystem is often referred to as the “plumbing of financial markets”.

1.3 Financial market transactions, collateral and Custody arrangements take place across a multiple of types of direct and indirect relationships, across multiple pairings of counterparty types and across multiple jurisdictions. London and Dublin have, despite the GFC and Brexit, retained their role as leading global financial centres for ‘front-office’ trading (London) and middle and back-office functions (often in Dublin) of trade processing, settlement and post-trade services including Custody. Despite the interoperability of operational systems, market participants and FMIPs are required to comply with the laws and regulatory system of each jurisdiction, as they apply to them. This applies to trading but also post-trade issues, notably the Custody of Collateral Assets. Efficient, reliable, consistent application of laws relating to the trading, clearing, settlement and Custody is critical to investor protection, fair, efficient, safe and liquid markets. Conceptual gaps and CTR affecting the Collateral Ecosystem comes with a cost of compliance, administration and mobilisation efficiency. They also make it more difficult to gauge risk exposures to what remain, 10 years after the GFC, important

\(^{16}\) Please refer to various publications by M.D. Huertas in the Journal of International Banking Law & Regulation.

\(^{17}\) Views expressed herein reflect solely the views based on the academic research of the author and not that of his current or previous employers.
questions of “Who does what with whom, when and how and where are my assets?”, “Where is my collateral and how much of it can I get back and how quickly?” along with “How much risk does this exposure to this person create?”

1.4 This thesis, in three parts, aims to propose new thinking on risks that stem from conceptual gaps and CTR, as these arise due to divergences in rulemaking generally, and the Collateral Ecosystem specifically, as well as those stemming from Coll-RR and Cust-RR and a range of related metrics. These metrics are defined in the Addendum to Chapter 1. Each of these parts aim to highlight existing and new risks that exist in the Collateral Ecosystem post-GFC as they apply in the legal and regulatory systems of:

(a) the EU;

(b) the UK\(^{18}\); and

(c) Ireland,

given the shared legal/regulatory, linguistic and market-based heritage of the UK and Ireland, each, while they are EU-MS, as shaped by the EU-level rules that exist superordinate to the national level regimes. The “closeness” of English and Irish law as well as the regulatory regimes derives, from Ireland, for the period it was part of the UK, being the first extension of English common law outside of England and following Irish independence, judgments of British courts continuing to be of persuasive but non-binding nature in Irish courts. Moreover, the Irish financial services policymakers have emulated various British financial services regulatory frameworks and taken similar (but slightly different) supervisory expectations, as adopted to suit the jurisdiction-specifics of Ireland and those operating from and/or through the jurisdiction. Additionally, the fact that the Ireland is within the EBU and the Eurozone and that the UK has, following the outcome of the Brexit vote, begun to establish its path to its eventual exit from the EU provides another overlay of analysis that is relevant for EU, Eurozone and third-country jurisdictions and market participants in those jurisdictions.

\(^{18}\) Comprised, at the time of writing of England, Wales and Scotland as well as Northern Ireland as “home nations” and relevant jurisdictions.
Comparing these jurisdictions presents a useful case study. Specifically, as irrespective of the common principles, language and shared school of law that exist, there are various conceptual gaps and CTR that arise and present themselves between the EU level rules (in bullet point a) and the rules that are subsidiary to them that exist at the national level (in bullet points b & c) termed herein “Vertical CTR”. Divergences also exist between the rules that exist at the national levels (in bullet points b & c) termed herein “Horizontal CTR”.

The greater the level of CTR, the greater the cost of compliance as well as doing business in or through that given jurisdiction. CTR may equally increase risks in Coll-RR and Cust-RR exposures where market participants fail to take action of jurisdiction-specific differences. One such example are the differences between say the EU-FCD and that the UK-FCARs, which implement the EU-level laws, expanded conceptually through Goldplating, thereby also generating differences to the protections contained in the Irish-FCARs. Given London’s dominance as the EU’s financial centre, there are good grounds to argue that the EU, after losing London, ought to use the CMU project\(^\text{19}\) as (1) means to remove fragmentation more generally from the Collateral Ecosystem and (2) to possibly adopt the best of British and Irish rules in the respective FCARs, UK CASS and Irish CAR frameworks and adopt these, on a Jurisdiction-Agnostic manner for the benefit of the EU-27 or at the very least the EU-MS in the European Banking Union (EBU). This would not be the first time the EU has been inspired and borrowed concepts from EU-MS. Bosomworth’s suggestions, make sense and go to the heart of eliminating CTR, even

\[^{19}\] See Bosomworth, Andrew in “From Capital Markets Confederation to Capital Markets Union” in Dombret and Kenadjian where at page 60 Bosomworth (rightfully) concludes:

“In theory the CMU already exists. Article 63 of the Treaty of Functioning of the European Union (TFEU) already allows for the free movement of capital across intra-union borders. And 19 member states share a currency union. In practice however, we do not observe the extent of integration of capital markets as we do in other CMUs with deeper federal structures, such as the United States. Europe has instead what I call a capital markets confederation.

The question becomes are we content with the confederation structure or do we want to develop it further? And if we want to develop it further do we want to achieve the type of features we observe in the United States with deep, liquid markets and no intra-state cross border impediments to the movement of capital?

Assuming we want to achieve the latter then I see five prerequisites needed to realize it:

1. Harmonization of the regulatory treatment of the financial sector (banking, insurance, asset management, pension funds), including taxation and capital standards.
2. Harmonization of bankruptcy [i.e. insolvency] laws and wind-down and recovery procedures.
3. Evolution of common financial infrastructure such as clearing houses for security and payment settlements.
4. Evolution of common deposit insurance.
5. Introduction of common credit, and regulatory, risk-free asset.

A lot of progress towards realizing CMU can be achieved via steps one, two and three, which do not require TFEU changes.”
if he does not offer means, such as those suggested herein, to achieve that and where CMU could go even further.

1.7 This comparative case study is likely to grow in importance as the UK’s relationship with the EU and Ireland changes following it ceasing to be an EU-MS i.e. the process commonly referred to as Brexit). Some of these Brexit considerations, as relevant to the Collateral Ecosystem and market participants, are described below and a line-by-line analysis of EU, UK and Irish rules of cornerstone legislation, EU-SFD, EU-FCD, UK-FCARs, Irish-FCARs and CASS and CAR are set out, due to space reasons, in the Annexes. Annex 1 provides an original line-by-line analysis comparing EU, UK and Irish financial collateral arrangement rules. Annex 2 provides a similar original line-by-line comparison and map of divergences relation to Client Asset and Client Money rules.

1.8 At the time of writing, this “testing environment” forms the largest concentration of trading, settlement and Custody of financial instruments within the EU by Collateral Ecosystem stakeholders. The conclusions drawn from this testing environment are likely to have pan-EU wide relevance, despite Brexit sparking a new relationship and divergence of the UK from the EU’s Single Rulebook and the Single Market.

1.9 The new risk concepts proposed herein aim to empower policymakers but also market participants when assessing the EU’s current Collateral Ecosystem, its risks plus areas where reform is ripe and achievable, so as to strengthen the EU’s Single Market and the Single Rulebook upon which it is built. Due to regulatory reforms and economic pressures, the use of Collateral Assets will likely increase further as markets, which have grown exponentially over the past 30 years, continue to concentrate the clearing of transactions through CCPs and the processing through CSDs and require Mandatory as well as Two-Way Collateralisation. This raises the question as to why policymakers have not paid as much attention on fragmented rules and the resilience of collateral mobilisation channels and Segregation?

20 For a more in depth discussion of the EU’s Single Rulebook project please refer to M.D.Huertas “The phasing out of the UK’s Financial Services Handbook: a missed opportunity for the EU’s Single Rulebook and the Capital Markets Union project”. 
1.10 **Collateralisation, mobilisation channels and Segregation**

1.11 Risk in financial markets is managed through contractual means (representations, warranties, covenants and a range of other information disclosures that are given by the relevant parties) but also, partly, given the saying that “possession is nine tenths of the law”, by one party taking Collateral Assets to secure against the risks of the other party. Collateral Assets are thus provided by one party, as collateral provider, to the other (or another), as collateral taker, so that in the event of the collateral provider defaulting on its obligations the collateral taker can recover some of its loss – assuming there are sufficient Collateral Assets present and readily available to enforce against. Using Collateral Assets that are sufficiently valuable/desirable, whether in the form of cash, cash-equivalent or financial instruments has long been used to mitigate risks, provide credit support for the collateral provider and stand as security for the risks that the collateral taker has vis-à-vis the risk exposures it faces in its dealings with the collateral provider. These concepts of collateralisation also exist beyond financial markets, whether as a deposit, secured loan, a pledge over receivables or a letter of credit for goods etc. Their origins, as with the legal principles, including the laws of security interests pre-date modern financial markets, and operate, partly due to dematerialisation of markets, with a given amount of “legal fiction”\(^2\).

1.12 Market participants can at any given time be both a collateral provider and collateral taker to any multiple of counterparties. This applies to parties’ relationships with whom they trade but also with whom they maintain collateral relationships. These relationships can be in respect of and amount to any multitude, volume and quality of Collateral Assets, across various transaction chains and exposures. These relationships vary and like Collateral Assets’ valuation and quality (including parties’ perception of value/quality) will change over time. Consequently, collateral decisions and parties’ priorities both at the pre-contractual documentation stage and after execution of documentation are not static, they are subject to monitoring and often amendment to reflect the priorities, needs

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\(^2\)“legal fiction” as defined in Collins Dictionary of Law means “something assumed to be true for the sake of convenience whether true or false”. In contrast a ‘legal presumption’ for purposes of interpreting and applying non-contentious elements of applicable law is usually summarised as “a conclusion based upon a particular set of facts, combined with established laws, logic or reasoning. It is a rule of law which allowing a court to assume a fact is true until it is rebutted by the greater weight (preponderance) of the evidence against it.”
of and exposures between the relevant contractual parties. Equally, decisions are not isolated, rather they will have carry-on and spill-over effects to the wider market as Collateral Assets move, are custodied, supplemented, manufactured or removed.

1.13 Prior to the GFC, prime brokers took collateral and rarely provided collateral. Collateral that was provided was safeguarded and custodied by the collateral taker, to the extent it was not taken on an absolute outright and/or title transfer basis and thus, upon receipt, becoming the property of the collateral taker. Collateral and Custody was perceived as a boring (often backward) back-office function and cost centre. Tri-party, let alone CCP arrangements were rare, margin calls infrequent, reporting to counterparties and regulators fairly limited and largely a manual process. The risk paradigm of those times placed greater focus on the failure of the collateral provider as opposed to the dealer entity as collateral taker, custodian or FMIP.

1.14 The events that led to and which followed the insolvencies of the LBIE franchise in 2008 and MF Global in 2011 \(^{22}\) would shed a spotlight on a Collateral Ecosystem having to


Lehman Brothers Holdings Inc. was a global financial services firm that was one of the largest victims of but also a catalyst in the GFC. It filed for Chapter 11 insolvency protection on 15 September 2008 triggering insolvency proceedings in other jurisdictions notably in respect of its UK subsidiary Lehman Brothers International (Europe). MF Global was a major global financial derivatives and commodities brokerage firm that became insolvent in 2011.

LBIE had held money on behalf of many clients, including some affiliates of Lehman. The Client Money Rules of Financial Services Authority were in the Client Assets Sourcebook, chapter 7, issued under the FSMA 2000 section 138. FSMA 2000 section 139 permitted FSA rulemaking for ‘clients’ money being held on trust in accordance with the rules’, and accordingly CASS 7.7.2R said that client money was to be held on trust for the purpose of the Client Money Rules. If a firm failed, the Client Money Distribution Rules in CASS 7.9 applied. But under CASS 7.4, a firm could either (1) pay money into a segregated account or (2) put the money into the firm’s own house accounts and then segregate it into client accounts at the close of the preceding day’s business. Lehman had done the alternative approach in (2). On 15 September 2008, Lehman went into administration, a ‘primary pooling event’ under CASS 7, so the funds in each ‘client money account’ were to be treated as pooled and then distributed so that each client received a sum rateable to their ‘client money entitlement’. The administrators asked the High Court for directions under the Insolvency Act 1986 Schedule B1, about how to apply CASS 7 to the client money that Lehman held. There was a lot of unsegregated client money in the firm’s house accounts because of the operation of the alternative approach, and also significant non-compliance of Lehman with CASS 7 over a long time.

A series of perceived liquidity problems and large fines and penalties dogged MF Global starting in 2008, and led to its bankruptcy in 2011. In 2011, MF Global faced major pressures to its liquidity over several months. Some analysts and financial commentators indicate that MF Global probably experienced a number of trading days in 2011 during which the firm’s bets on sovereign debt would have required the use of customer funds to meet capital requirements, thereby maintaining operating funds and possibly
continue to operate in stressed conditions with excessive use of rehypothecation and exercise of other rights to use. Despite reforms that have aimed to make “banks safe to fail” and improve protection for buy-side participants, dealer counterparties will have the greater information and bargaining power versus buy-side and specifically non-financial counterparties. They thus set the terms of what Collateral Assets are provided and which are taken, when, how and where they are custodied.

1.15 At its heart, Collateral Assets minimise the risk of financial loss to a collateral taker if the collateral provider, or another counterparty, fails to meet their obligations. Upon declaration of an event of default and the expiry of any grace period, (if applicable) the non-defaulting party can exercise its rights and equally do so as collateral taker with respect to the collateral (as determined by the contract governing the collateral relationship.) In such circumstances a collateral taker will typically have the right (or to direct others – such as a Custodian) to:

(a) take possession of the Collateral Assets (to the extent the collateral taker does not already hold legal title);

(b) sell or otherwise dispose of the Collateral Assets and keep the proceeds from some sale and/or disposition; and

overall solvency. A large part of these pressures on MF Global were a result of the firm’s involvement in a significant number of repurchase agreements. Many of these repo agreements were conducted off their balance sheet. Failure of a number of investments by MF Global, and other, failure of repo positions contributed to the massive liquidity crisis at the firm. MF Global experienced a meltdown of its financial condition, caused by improper transfers of over $891 million from customer accounts to a MF broker-dealer account to cover losses created by trading losses.

On October 31, 2011, MF Global executives admitted that transfer of $700 million from customer accounts to the broker-dealer and a loan of $175 million in customer funds to MF Global’s U.K. subsidiary to cover (or mask) liquidity shortfalls at the company occurred on October 28, 2011. MF could not repay these monies with its own funds. Improper co-mingling, or mixing, of company and client funds took place for days before the illicit transfer and loans, and perhaps for many other days earlier in the year. According to the New York Times, "MF Global dipped again and again into customer funds to meet the demands", perhaps beginning as early as August 2011.

MF Global declared bankruptcy on October 31, 2011, and the company was liquidated beginning in November 2011. The trustee liquidating the company said that the losses incurred by customers of MF Global stood at $1.6 billion at April 2012. In January 2013, a judge approved a settlement that would return 93 percent of customers’ investments, with the prospect of additional compensation from the company’s general estate. In December 2014, MF Global Holdings settled a U.S. government lawsuit, agreeing to pay $1.2 billion in restitution and a $100 million fine for customer losses tied to the company’s 2011 collapse.
use the proceeds to satisfy the collateral provider’s obligation (e.g. interest, amortisation). In such circumstances, any:

(i) excess of proceeds over the amount of the obligation is returned to the collateral provider; and

(ii) deficiency becomes an unsecured claim of the collateral taker on the estate of the defaulting collateral provider.

However, this will not be the case, if the obligation is “non-recourse”. Moreover, while Collateral Assets are “held” in Custody in accordance with safekeeping arrangements, often by an affiliate of the collateral taker or, in particular since the GFC, by a third-party Custodian, the Collateral Assets are to be safeguarded. This means those Collateral Assets, like financial assets, are subject to, or ought to be subject to documented safekeeping arrangements that reflect and follow EU and EU-MS’ rules – including Segregation through the various holding/Custody levels.

1.16 Discrepancies, divergences and CTR in those rules can lead to new or exacerbated financial and non-financial risks. So too can instances where the relevant documentation between the counterparties get compliance with the rules wrong, or, as in the case of Lehman Brothers (more specifically Lehman Brothers International (Europe) (LBIE) client facing documentation that was used (including sophisticated financial counterparties) stating that Client Assets and Client Money were being safeguarded with the then applicable rules in the UK. However, in reality an estimated 98% of those assets were transferred by LBIE to its US operations in order to take advantage of more favourable rehypothecation rules permitting a greater right of use and thus cheaper funding access. This meant that many of those Collateral Assets were not protected as

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intended. This impacts not only the holding of Collateral Assets but also mobilisation channels.

1.17 **Types of mobilisation channels**

1.18 Collateral mobilisation channels using SFTs\(^{24}\) can be distinguished as follows:

(a) “*traditional SFT*” operating between institutional investors (as beneficial owners of the securities) who lend their securities directly or via agents, such as custodial banks, asset managers or specialist firms, to prime brokers and other principal borrowers which could be split between:

   (i) “*traditional repo*”;

   (ii) “*traditional SecLending*”; and

(b) “*central bank mobilisation*” placing cash on deposit or engaging with repo and SecLending with the relevant central bank to place eligible collateral in exchange for cash funding. The funding obtained may be (and often is) to acquire higher-yielding assets.

Market participants in the above SFTs would also (and still distinguish) between General Collateral or **GC trades** which are entered into where a general set of Collateral Assets are accepted and the nature of what is provided as a collateral asset is indifferent. The GC trade market is seen to be more liquid when compared to those SFTs that are categorised as “**Specials**” in which a specific asset is identified as either the subject or concurrently the collateral asset underlying the transaction. Since the GFC, pressures on sourcing Collateral Assets has meant that market participants can and do create GC baskets i.e. of portfolios which can be used in automated trading systems, pooling systems or matching systems.

1.19 Each of these SFT transaction types are built around legal and economic constructs that recognise a “**collateral leg**” also known as the “**cash-leg**” whereby cash or financial instruments are delivered as Collateral Assets in exchange (and as security) for a

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\(^{24}\) See Glossary.
“financial instrument leg”, with an obligation to unwind each of the legs of the transaction. The unwind occurs either at:

(a) maturity of the transaction; or

(b) prior to maturity due to the occurrence of an agreed event of pre-defined circumstances, including default triggers, which might arise at any time prior to or upon the scheduled maturity of these transactions and which the non-defaulting party opts to enact,

Consequently, financial instruments and/or cash are simultaneously the object of the collateralisation and the object of the contract.

1.20 Collateralisation arrangements of these SFTs, as explored in further detail below, are split between those that are bilateral, i.e. the collateral taker receives Collateral Assets and holds it in a Custody account with a Custodian. Alternatively, the collateral provider and taker agree to use a tri-party arrangement, which might include using a CCP, in which the Collateral Assets do not flow bilaterally between the parties, but rather the flows are to the tri-party provider and/or CCP who in turn holds the assets in Custody accounts with a Custodian. In both instances, the safekeeping of those assets takes place in a Custody account. The degree and approach to safeguarding as well as the application of Client Money and Client Asset rules and respective Segregation requirements may differ from jurisdiction to jurisdiction and type of collateral provider.

1.21 Historically, parties would look to these collateral mobilisation channels and SFTs to source financial instruments for investment purposes (i.e., for their own needs) or to meet their own trading and/or settlement requirements (sourcing to reuse as well as to meet/avoid settlement failures). Greater sophistication in financial markets but also greater pressure on financial instruments’ mobility has led to greater use and volume of transactions in these mobilisation channels.

1.22 While financial instruments are purchased by institutional investors for investment and income, as well as possible strategic reasons, an owner of a financial instrument can mobilise these, or require FMIPs to do so, in order to generate extra income from the fees paid to the investor in return for mobilisation of such financial instruments (mobilisation fees). This thus can increase the yield on the financial instruments or a portfolio thereof.
and/or can contribute to offsetting trading and holding costs. The flexibility that these channels permit allows market participants to benefit in both allowing financial instruments to “be worked to earn their keep” as well as to source financial instruments for periods of time without having to purchase them outright.

1.23 Holders of such financial instruments, in particular those that are “near cash” and/or HQLA, which may attract a premium from willing parties, have several reasons to permit these financial instruments, often by instructing FMIPs to enter these into automated lending programmes to be mobilised to generate income. In other instances the FMIP and/or dealer entity/Custodian, may, where permitted either by the nature of the collateral arrangement or by exercising rehypothecation and/or rights of re-use (see discussion below) itself take the assets and mobilise these for its own purposes. This may seem at odds with the notion that Collateral Assets ought to stand mobilised for the benefit of a collateral taker but these approaches, irrespective of LBIE and MF Global, remain fundamental to efficient and functioning liquid financial markets as explored in Chapter 2 given the (finite) inventory of Collateral Assets and firm-specific collateralisation needs. Intermediaries, who will act in multiple capacities, including as FMIPs, will play a vital role in the smooth working of any mobilisation channel but also in collateral manufacturing as well as CUT and other transformation transactions. This activity can also pose pitfalls.

1.24 As discussed at para. 2.55, not all Collateral Assets are viewed equally. The post-GFC reforms (notably in the form of CRD IV/CRR in terms of prudential capital changes and focus on HQLA and EMIR in terms of mandatory collateralisation of OTC derivatives and mandatory clearing, as well as the SFTR, means market participants generally need more “good”/desirable collateral. Such collateral also needs to ideally be able to mobilise through channels, whether as a TTCA or SFCA for purposes of the EU-FCD, as applied in relevant jurisdictions. Equally, regulatory requirements stipulate what is eligible collateral (cash and other “liquid” assets) to be used for initial margin and variation margin (including for SFTR and EMIR activity as well as in accordance with MiFID II/MiFIR more generally), and what a collateral provider may do with it:

(a) ‘initial margin’ (IM) refers to the minimum value in eligible Collateral Assets that a collateral taker requires the collateral provider deliver to it, or its designate, in order to engage in a financial market transaction or in relation to a portfolio of
transactions and covering the majority of non-market risk attributes relative to the collateral provider i.e., counterparty risk, credit risk, legal risk etc. as well as to cover losses that could arise in the period between the defaulting counterparty’s last VM payment and the point at which the surviving party can hedge or replace the transaction. IM is posted i.e. provided when the transaction is executed and is subsequently adjusted as necessary throughout the lifetime of the transaction. IM is required, mostly due to EMIR, to comply with the EMIR “Margin Rules”, setting out requirements for collateral agreements, collateral eligibility criteria, collateral concentration limits, calculation methodologies and Segregation requirements25 restricting use of TTCAs; and

(b) ‘variation margin’ (VM), often referred to as maintenance margin or mark-to-market margin, is the additional amount of margin over the IM amount to account for the current market value of the financial instrument or a portfolio of financial instruments. It refers to the minimum value in eligible Collateral Assets that a collateral taker requires the collateral provider deliver to it, or its designate, in order to cover the market risk(s) arising during the life of a financial market transaction that extend, or could conceivably extend, beyond the initial margin provided. In the EU, VM, for EMIR-relevant trades, is permitted to be provided using a TTCA and does not have a requirement to separate margin from collateral taker’s risks.

1.25 The GFC’s regulatory and economic changes have put a greater pressure on ‘smart collateralisation’ techniques focusing mostly on optimising:

(a) Two-Way Collateralisation;

(b) enterprise-wide collateralisation i.e. centralised liquidity for HQLA driven transactions and non-HQLA driven transactions; and

(c) structural optimisation using CUT and other upgrade transactions,

25 Notably initial margin must be:
• valued daily using prescribed calculation and valuation methods;
• collected on same-day basis without offsetting of initial-margin amounts;
• segregated from the proprietary assets of the collateral taker or Custodian;
• available in the collateral holding structure and equally in timely manner following default of provider;
• cash must be held in segregated account of third-party credit institution or recognised equivalent; and
• excluded from any rehypothecation, re-pledge or other reuse rights except for permitted reinvestments.
1.26 In light of policymakers asking more of the plumbing and given it fragmentation, this thesis argues that questioning the resilience of the plumbing and one's access to it remains very much relevant for all types of market participants regardless of whether they are:

(a) financial counterparties (FCs), typically acting in their role as sell-side liquidity providers – also referred to as intermediaries or in their role as manufacturers of Collateral Assets; or

(b) the various actors on the buy-side, which may include any array of non-financial counterparties (NFCs) and/or end-users, whether they act as long-term investors in financial instruments in assets or shorter-term traders therein; or

(c) even as financial market infrastructure providers (FMIPs), (FCs, NFCs and FMIPs collectively Collateral Ecosystem stakeholders).

1.27 In addition to the above, collateralisation’s reduction of risk primarily depends on the ability of the collateral taker to exercise its claim to the Collateral Asset be it in relation to the mobilisation of the Collateral Asset, the security interest (not harmonised across EU) and/or title transfer, as well as ability to net and set-off claims. The same is true in relation to the safeguarding and/or Custody of such Collateral Assets (not fully harmonised across EU) and the protections afforded by their Segregation (not fully harmonised across EU) in a consistent manner.26 These are questions of law – be it at EU-27- or national-level of the individual EU-MS and they come with benefits for those receiving protection from the law and costs for those providing protection. They are also dependent on each party’s roles and motivations.


“Account segregation is one mechanism by which regulators, legislators and authorities seek to achieve client asset protection. The meaning of “account segregation” differs across regulations and the use of the term within the industry – segregation can be both an internal book keeping concept, and an external account concept. The concept of account segregation is considered in more detail on page 7. In addition, segregation can be required to different levels – between securities account holder and securities account provider assets, between the assets of particular types of securities account holders, or between the assets of each individual securities account holder.”
1.28 This is a complex matter within jurisdictions and even more so across jurisdictions, especially where the underlying financial market transaction (e.g. a SFT) and the collateralisation arrangements, including the Collateral Assets provided and the Custody of the Collateral Assets, are governed under the laws of two or more jurisdictions. In such cases, there is a heightened risk that the Collateral Assets will not afford the collateral taker the protection it has assumed, including the level of Segregation.27

1.29 **Spotlight on Segregation**

1.30 Segregation occurs at various levels of the holding/Custody chain, and may involve a number of different jurisdictions28 as well as documented and non-documentated arrangements, consistency is crucial as to whether account structures run on an individual or an omnibus basis. EU-level measures are (currently) not consistent (i.e., MiFID II/MiFIR has slight differences to that of EMIR and national-level rules (UK’s CASS and Irish CAR) implementing EU-rules have additional differing requirements to each other but to the EU level. Figure 1, taken from AFME’s 2016 Paper, highlights this issue in that an investor may not be fully aware of when “individual” Segregation switches to

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27 AFME’s 2016 Paper, (worryingly) refuted the principle that increased levels of Segregation result in greater protection for a Collateral Asset provider upon the insolvency of the account provider i.e., Custodian/Depository. This argumentation, which rested on the premise that greater segregation is burdensome for costs and operational efforts and that holding/Custody chains are infallible, is flawed as LBIE and MF Global have demonstrated. AFME represents the interests of major dealer entities and thus its “Principles” presented in the paper should be read with that context. While some are welcome, specifically the suggestion of greater use of industry legal opinions for each market, which are updated annually, covering the holding/Custody chain through to the (I)CSD, the cost of such opinions are ultimately to be carried by the buy-side and others are (or ought to be) common sense for sophisticated market participants.

28 See Annex 2 to AFME’s 2016 Paper as well as Annexes to this thesis.
“omnibus” accounts and what the Cust-RR exposure is through the various holding/Custody chains.

![Figure 1 - Segregation types](image)

1.31 This can be further accentuated if the Collateral Assets are safeguarded or custodied (with a Custody provider or other qualified person) in a manner that is different to what the collateral provider assumes. These considerations, whether individually and/or taken together, can pose a danger not only to the collateral provider and/or taker, but potentially to the financial system at large given the interconnectedness of market participants via various transaction chains and individual relationships at different points along those chains, that themselves are not static. Consequently, market participants ought to be aware of the risk metrics this thesis introduces\textsuperscript{29} as CEPCR and Concentration Risk, Coll-RR and Cust-RR as well as Recoverability Rates to assist with answering the question “\textit{where is my collateral and how much of it can I get back?}” Even, after the failures of LBIE and MF Global that caused London to shake global markets, the post-GFC responses this question still remains a risk for all types of market participants and more so as the UK’s relationship with the EU changes.

\textsuperscript{29} See Glossary.
1.32 Markets assume, including in relation to Collateral Assets the plumbing (i.e. the mobilisation and holding) works. They pay little to no attention, certainly not in developed European markets with dominant FMIP providers, to risks outlined herein despite some very recent shocks throughout the GFC. Although they are assuming such risks, they are not paid (certainly not always in terms of mobilisation fees) for doing so nor are they always provisioning against such risks. This is particularly the case where certain collateralisation channels, incorrect perceptions of risk and/or deficiencies as well as poor collateralisation and Custody practice as well as overuse of rehypothecation can compound such problems and be a catalyst, especially when the collateral mobilisation channels stop and collateral velocity slows.\textsuperscript{30} This can affect individual but more likely will affect a multitude of transactions and relevant relationships in those chains.

1.33 Transaction chains

1.34 As each counterparty can have multiple relationships with counterparties as well as in terms of roles as collateral provider and taker and different exposures, each interaction thus creates a ‘transaction chain’ in which Collateral Assets move through mobilisation channels. This overview of a relevant entity’s agreed terms with a given counterparty (primary relationship) as well as what impact any terms of its own connected party (secondary relationship) or the connected party of that counterparty (tertiary relationship) as well as the respective relationships with ancillary service providers and FMIPs (ancillary relationship) means that for the primary relationship is crucial in identifying, mitigating and managing financial and non-financial risk(s) proactively. This merits having a 360 degree view on the appropriateness, consistency of content, cross-references and hierarchy of terms, the resilience of individual and interconnected terms, the degree of information asymmetry and what this means for financial and non-financial

\textsuperscript{30} The “velocity of collateral” is the ratio of the total pledged collateral received by the large banks divided by the primary collateral, the actual outstanding amount of securities in the primary collateral pool. Essentially, this ratio measures the reuse of collateral due to financial intermediation between banks and non-banks, also known as “collateral chains”. See original work by Singh, Manmohan, “Collateral and Financial Plumbing”; (Singh) as supplemented by: https://ftalphaville.ft.com/2018/07/10/1531202400000/Collateral-velocity-rebounds---recent-estimates-and-policy-implications/#comments.
risk management as well as the trigger and satisfaction of various monetary and non-monetary obligations throughout the trading and collateral relationship (this is termed herein as a **360 degree risk assessment**) as well as distort privity of contract as assets move through various holding/Custody chains and tiers of accounts.

1.35 In order to achieve a full 360-degree risk assessment parties ought to adopt a **look-through approach** to approximate/assess the degree of exposure that arises in each of the primary, secondary, tertiary and ancillary relationships. This look-through approach may allow a more appropriate modelling of the documentation and legal risks that one faces in the documentation exposure. It may also help to model the financial risks that may arise in the relationship. It may provide a more refined approach to quantifying (assumed) values for the types of risks discussed herein, each, as adjusted for any effects of CTR. In addition, this perhaps different approach to current risk management or legal documentation practice is one that needs constant refreshing as relationships and documented terms are not static but rather are fluid and evolve.

1.36 The following diagram in Figure 2 below sets out the existence of primary, secondary and tertiary relationships as well as the ancillary relationships in the Collateral Ecosystem. It considers a 360-degree risk assessment from the perspective of Party A and a look-through approach should be applied in respect of all known or anticipated chains and exposures where possible. It is important that the simplistic example below can be considerably more complex and interrelated, irrespective of the existence of any central nodes such as CCPs and execution venues that have been interposed since the GFC to pool the multitude of bilateral exposures into multilateral exposures.
1.37 As an example, A trading with B may exchange Collateral Asset N1 and N2 with one another in addition to A receiving “F” (financial assets). As soon as A uses F or the N2 assets it has received with C, as may be permitted at law or by contractual agreement, the transaction chain, originally between A and B, has been extended. As a result, B may not even have notice that the transaction chain has been extended. Consequently, C may also have no notice that the assets it may receive may mean that Counterparty A is under an obligation to return these to C. The amount of possible combinations and lengths of chains are exponential.

1.38 Where assets are fungible i.e., interchangeable and sufficiently liquid and/or available in the market i.e., can be acquired by the taker for delivery to the collateral provider, these risks may be less of an issue. Where however risks arise are when assets are less fungible,
replicable, liquid or, as was shown during the GFC, the plumbing stops flowing. Mapping these chains, or at the very least being cognisant of the Coll-RR and Cust-RR as they might arise or actually appear, or can by proxy be expected to appear in these chains, even in a centrally cleared and/or Blockchain enabled world, may allow those that map these risks to be able to better identify, mitigate and manage exposures and thus reduce potential or actual loss. It also helps answer the fundamental question of where Collateral Assets are and how quickly and how much can be recovered.

1.39 The exposures and risks created in any part of a transaction chain may differ and a financial market transaction’s risks and exposures may be different (or develop differently) to the collateral asset transactions. Those factors may evolve independently and any correlation between the elements may be fluid and different evolution speeds. Thus, collateral correlation risk can move quickly and independently of relevant transaction chains. What this means in practice, is that in a given financial market transaction, the Collateral Assets that are supposed to secure that financial market transaction may not fully secure the exposure and risks of the financial market transaction. In such instances additional collateral, credit support or security is typically required. As indicated above, the fact that Collateral Assets, like financial market instruments, even non-fungible assets move through various transaction chains, might further complicate matters. The longer the transaction chain the more Collateral Ecosystem stakeholders are involved. If the degree of correlation and any risk exposures are increased by either the financial market transaction and/or the collateral asset transaction and this has adverse consequences then this causes problems for the market participants and FMIPs involved.

1.40 Accurate capture and greater consistency is also paramount in being able to identify, mitigate and manage issues with respect to the concepts discussed further below on CTR, Coll-RR and Cust-RR and how that factors into VARINCA and VARIGCA. If parties can couple both an application of a 360 degree risk assessment with a look-through approach to drive identification, mitigation and management of the relevant financial, non-financial risks including the proposed items herein, as adjusted for CTR can yield a powerful fluid tool to create a ‘risk map’ of relevant exposures and obligations that accommodates the legal/regulatory items that traditional risk management may not capture fully or may have done predominantly on a fragmented, silo and/or reactive based context in terms of establishing exposure and establishing solutions.
Furthermore, in addition to the different risk perspectives proposed above, traditional risk approaches have since the GFC have only since 2012 and EMIR begun to fully consider the mitigation of adverse risk exposures that arise due to the interconnectivity between participants, as well as Concentration Risk(s) and the respective correlation amongst such market participants active in the Collateral Ecosystem (Collateral Ecosystem Participant Concentration Risk or CEPCR). Traditionally, the monitoring of such exposures on a proactive basis has been limited to counterparty credit risk monitoring. Whilst this may work fine in relation to monitoring bilateral, possibly individually documented exposures, it becomes a bit more complicated when one fails to account for the various roles in the relationship.

It also poses problems, when one considers that, out of, say, 100 transactions, 70 of which are collateralised on a bilateral basis, that these may in each instance have different ratings-based triggers (if at all) that are relevant for triggering events of default, transfer and replacement mechanics to replacement counterparties or providers of services, the cessation of specific roles (such as calculation or valuation agent) on the one hand as opposed to looking at overall exposures. With EU reforms introducing a new prudential regime for investment firms, notably those Collateral Ecosystem stakeholders, based on various firm-specific risk factors (referred to as “K-Factors”) including a “risk to market” factor, CEPCR might provide a useful additional metric.

Looking at CEPCR in the context of a simple example, suppose “Megabank” acts as a Custodian/Depository across a number of key transactions, collateral arrangements and relationship and each of these are documented by various agreements, with varying differences in terms as the relationship has evolved. Some may have mitigants (contractual and/or ratings based triggers) which may insufficient in relation to a host of operational functions or the (prompt) replacement of Megabank as should any of the triggers have been activated. CEPCR plays two important considerations here, namely firstly CEPCR in relation not having a greater diversification in providers of Custody/Depository services and secondly, in relation to not having more uniform terms/mitigants in documented exposures to Megabank to ensure that there is a greater

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ease in remedial action should any of the relevant triggers be breached. This would help participants regardless of how the EU-FCD is supposed to protect those “eligible financial collateral arrangements” from the impacts of Megabank’s failure, which LBIE and MF Global’s failures proved can still be subject to problems.

1.44 An overconcentration to any counterparty in the Collateral Ecosystem, in particular those that provide material services directly or on an outsourced/delegated arrangement, are likely to have an adverse impact and be only of a temporary minor disruptive effect if there is disruption in continuity of services and no activation of a replacement mechanic. Any failing could have more far-reaching consequences and exacerbate financial and systemic risks. Hence, any evaluation of service provider, counterparties, ought to build on a sound counterparty credit risk assessment and other due diligence that is conducted typically at on-boarding of the counterparty, but a periodic reassessment of those factors during the course of the relevant exposure. CEPCR permits benchmarking as to whether any risk concentration is likely to become untenable or a systemic risk in its own right and the continuity of one’s own business. In applying CEPCR correctly, one would add it to the on-boarding consideration and perhaps ask in relation to each role undertaken by Megabank:

(a) how likely is a disruption or failure of Megabank, its affiliates and connected persons, going to adversely affect or impair my own business continuity efforts?;

(b) how much exposure is too much before a disruption of failure of any of Megabank its affiliates and connected persons, would adversely affect or impair my own business continuity efforts;

(c) am I sufficiently protected against a failure or disruption between any of Megabank its affiliates and connected persons and any of their counterparties and service providers?;

(d) are there any other providers of a comparable service that I could readily use as an alternative or as a replacement to Megabank and would I be over-concentrated to such party, its affiliates and connected persons?; and

(e) can the use of Haircuts/Overcollateralisation protect from those risks?
1.45 In arriving at finding a Haircut and setting the minimum levels of the amount of Collateral Assets to be taken, the collateral taker needs to assess the risk exposure of the collateral provider. Assuming it falls within the collateral taker’s overall risk appetite to the exposure, as well as the specific transaction, one will measure the variability of the risk factor over a set time horizon. One would set confidence intervals and calculate the default probability of the obligor i.e., the collateral provider \( (PD) \) the loss given default \( (LGD) \) of the obligor (with or without collateral) and the exposure at default \( (EAD) \) for single collateral asset types as well as overall the value at risk \( (VaR) \) and calculate a credit VaR for a portfolio of Collateral Assets exposure.

1.46 Other Coll-RR and Cust-RR risks that are not adequately covered by Haircuts/Overcollateralisation and which are much more fundamental are those that stem from conceptual gaps and CTR that drive fragmentation of the EU’s Collateral Ecosystem. These new risk categories are complementary to the existing paradigm of risks that financial market participants and Collateral Ecosystem users are familiar with. These new categories are also relevant in the context of assessing the types, feasibility and efficiency of tools and principles employed relating to the identification, mitigation and management of the existing paradigm of risks that exist in financial markets.

1.47 **Differences remain and these matter – conceptual gaps and CTR**

1.48 The EU’s integration efforts have long, certainly, since the start of the first Single Market integration projects, notably the 1999 FSAP and since 2015, the CMU, acknowledged issues on fragmentation generally and specifically in relation to the Collateral Ecosystem. Despite efforts in overcoming them, divergences and thus barriers (including, after close to 30 years, the Giovannini Barriers) continue to exist. They, along with the EPTF Barriers, apply as a result differences in concepts, linguistics and incorrect and/or differing implementation, including “Goldplating” of concepts by individual EU-MS and/or grandfathering (preservation) of national concepts and/or other means of preserving or differentiating competitive advantages of the jurisdiction or national champions.
1.49 These issues apply across the whole of the EU in various different forms and strengths of barriers as well as some being rooted or dependent on national law/regulatory originated concepts. Rules in this area are fragmented along national lines, subject to a “strong-form path dependence”\textsuperscript{32}, irrespective of various jurisdictions having some conceptual similarities on overarching principles even where these are derived from EU legislative and/or national requirements.

1.50 Crucially, unlike some of the existing headings in traditional risk management in financial services, the closing of conceptual gaps (see below) and elimination of CTR\textsuperscript{33} (see below) can lead to an upside\textsuperscript{34} of efficiency and harmonisation. This is because addressing these issues improves comparability, convergence and ultimately standardisation of regulatory rules inasmuch as non-regulatory drafting such as contractual language. By contrast, if left to continue, conceptual gaps and CTR may exacerbate other risk exposures and cause an overall downside risk\textsuperscript{35} propagation.

1.51 **Language matters**

1.52 Language and law/rules co-exist autonomously but operate on structurally similar systems that rely on rules that are core to the construction itself, guide its evolution and guarantee its consistency.\textsuperscript{36} Both law (rulemaking instruments, contract and soft-law) and language are conditioned by the social dimension in which they are placed and where

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\textsuperscript{32} Strong-form path dependence reflects, in economic theory, how a set of decisions that is faced in a given situation is limited by the decisions chosen or circumstances experienced in the past (similar to the legal doctrine of precedence) irrespective of their relevance to the present situation. For a fuller discussion please see: Donald, David C., Regulatory Failures in the Design of Securities Settlement Infrastructure (August 15, 2010). Available at SSRN: https://ssrn.com/abstract=1669208 or http://dx.doi.org/10.2139/ssrn.1669208 where on page 3 discusses, in same light of theories of Liebowitz and Margolis, notions of “third-degree” path dependencies, which relate to situations where perceived switching gains are high but transition is (deemed) impractical, as it relates to improving financial market infrastructure providers involved in settlement processes.

\textsuperscript{33} See \textit{inter alia} usage of this term by Huertas in the following works: https://www.google.co.uk/search?q=%22conceptual+gap%22&sourceid=ie7&qf=com.microsoft:en-GB:IE-Address&qac=&oq=&safe=active&qfe=active&qs=a&rf=1&ei=Qe4ZWNJBH-TW8e84Z7YAQ&amp;gs_nf=sl#safe=active&q=%22conceptual+translation+risk%22

\textsuperscript{34} The market terminology of an ‘upside’ or ‘upside risk’ is used to denote that the impact of a risk has a positive and/or desired impact, as viewed from the perspective of the observer.

\textsuperscript{35} The market terminology of a ‘downside’ or ‘downside risk’ is used to denote that the impact of a risk has a negative and/or adverse impact, as viewed from the perspective of the observer.

\textsuperscript{36} See p96 in Francesconi, Ennio, Montemagni, Simonetta et al., which focuses more on natural language processing as applied to law as opposed to assessing the outcomes of linguistic differences in legal texts and effects on markets.
they dynamically define and fix their “object” in relation to a continually evolving social context i.e., law is reactive and judges interpret legal language in an operative sense. Law and rules are strictly dependent on linguistic expression and as communicated (written/oral) in a given context. Even in customary rules in markets (and also market terminology), there is an element of textualisation.

1.53 Language plays a role in accentuating divergences, including when everyone making and everyone following the rules uses the same language – as demonstrated below in respect of English, the (primary) drafting language of EU, UK and Irish financial services rulemaking, but also across languages – see Glossary – Linguistic CTR.

1.54 Legal and market terminology co-exist yet may have different meanings generally i.e. false cognates across jurisdictions but also for different stakeholders. This thesis distinguishes markedly between market and legal terminology. The market terminology use of “posting collateral”, which is used as an umbrella term that can explain any amount of transaction chains and security interests. The body of EU supervisors uses a jumble of such market terminology as well as the misuse of the word pledge, often left undefined and used in a market terminology as opposed to legal terminology context, and mixes the terminology up with a more Jurisdiction-Agnostic term of “mobilising collateral”. That term does seem to be a good balance between including a wide body of legal and regulatory concepts and merging it with the needs of users of market terminology. This is of course not welcome for market users and/or lawyers in the absence of a common term that is sufficiently Jurisdiction-Agnostic that still express with certainty the legal terminology while also reflecting the principles understood of users of market terminology.

1.55 Taking the example of a security interest, the word “pledge”, whilst it has a legal meaning (certainly in common law jurisdictions), EU policymakers, including drafters of its legislative instruments, have used the word “pledge” in a non-legalistic manner. Thus, various security interests, albeit with differing degrees of commonalities and/or conceptual gaps to the English or Irish law pledge37, such as the German law security interest, a Pfand are summarised, in EU legislative instrument as a “pledge”. Yet, the national-law grounded concepts of security interests have jurisdiction-specific concepts

37 See Addendum to Chapter 2 for a high-level comparison of English and Irish law security interests.
that may not be (fully) intelligible to market participants outside of a respective jurisdiction.

1.56 Put simply a German law security interest, regardless of how it is called, will not be fully equivalent to what English or Irish law understands a “pledge” to be within the context of its given legal system as the Pfand has different constituting features, including formalities under the German Civil Code (Bürgerliches Gesetzbuch). This is an example of CTR in the absence of, as discussed in Part III,:

(a) greater comparability of security interests and their jurisdiction specifics; and/or

(b) an EU-wide unitary security interest.

1.57 The same degree of CTR will exist between what English law considers to be a pledge, and the requirements as a result of English case law in (Gray v G-T-P) and what Irish law, not being bound by that case clarifying the concept of “control”, considers to constitute a pledge. Even if Irish and English law of security interests share certain common features, there are differences. This also applies irrespective, even where national laws are amended/influenced by EU-level rules, including in the form of the EU-FCD and EU-SFD as the laws of security interests remain (regrettably) national in nature with a strong-path dependence – The concepts are “similar but different” due to jurisdiction-specifics. See also discussion in Addendum to Chapter 2.

1.58 This ultimately could present an issue, as enforcement of said pledge could, depending on facts specific to the counterparties, financial instruments and Custody relationship, differ. The 2017 EPTF Report notes\(^\text{38}\), in relation to EPTF Barrier 8 (Uncertainty as to the legal soundness of risk mitigation techniques used by intermediaries and of CCPs’ default management procedures) that:

“Lack of clarity as to the “possession” or “control” test: Article 1(5) FCD states that the Directive applies to financial collateral, once “it has been provided”. However, FCD lacks rules on the “provision” of collateral. Recital 9 of the FCD merely provides that “the only perfection requirement which national law may impose in respect of financial collateral should be that the financial collateral is

\(^{38}\) On pages 75 and 76.
delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control [emphasis added] of the collateral taker [...].” Therefore, the FCD seems to rely on a “possession” or “control” test for the perfection of financial collateral arrangements. However, it does not specify what is involved in taking ‘possession’ of financial collateral (is it sufficient for the collateral to be in the collateral-taker’s account at the CSD? Is it sufficient to be “earmarked” in the collateral provider’s account?) or “control” (is it sufficient that the collateral-taker has a legal right to refuse a request from the collateral-taker to withdraw collateral?). The CJEU ruling in the case Private Equity Insurance Group v Swedbank[39] does not provide sufficient clarity as regards the “possession” or “control” test under the FCD.

Ambiguity in insolvency laws as to whether collateral provided after the opening of insolvency proceedings is covered by FCD protections: Article 8(2) FCD requires Member States to safeguard financial collateral that has been provided on the day of, but after the moment of the commencement of insolvency or reorganisation proceedings, is enforceable and binding on third parties if the collateral taker proves that he was not aware, nor should have been aware, of the commencement of such proceedings. However, it is not clear which steps and events are protected by Article 8(2) FCD: Is it sufficient that the collateral taker was unaware of the opening of insolvency proceedings at the time the collateral agreement is concluded (transaction)? Or must he be unaware of the opening of the proceedings at the moment of the delivery, transfer, holding, registering etc. of financial collateral so as to be in the “possession” or under the “control” of the collateral-taker?

Legal uncertainty as to the applicable law to book entry security collateral. The conflict of laws rule of Article 9(1) FCD points to the law of the place of the “relevant account”. A fundamental problem is that an account itself, strictly speaking, has no location; their location is to be determined with reference to

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[39] “Judgment of 10 November 2016, Private Equity Insurance Group v Swedbank, C-156/15, ECLI:EU:C:2016:851, paragraph 38-44. In the UK, courts had to rule in two cases whether financial collateral in the sense of the UK-FCARs, has been “provided” (Gray and others v G-T-P Group Limited: Re F2G Realisations Limited (in liquidation) [2010] EWCH 1772 (Ch) and Lehman Brothers International (Europe) (In Administration) [2012] EWHC 2997 (Ch)). 99 The CJEU reiterated the provision of Article 8(2) FCD in its Judgment of 10 November 2016, Private Equity Insurance Group v Swedbank, C-156/15, ECLI:EU:C:2016:851, paragraph 46.”
other factors. In any case, the connecting factor of Article 9(1) FCD is unclear and has not been interpreted uniformly across Member States. This can result in legal uncertainty in an important case, commonly encountered in post-trade collateral arrangements: where a financial intermediary, such as a clearing member or a custodian providing settlement services, receives securities from its client into an account provided by the intermediary. Depending on the jurisdiction, the question of the identification of the relevant account can lead to different possible answers: (i) the accounts of the collateral taker on the intermediary’s books; (ii) the account where the intermediary’s entitlement to the securities is recorded (such as the next intermediary in a custody chain or the CSD or another set of books) or (iii) the account of the collateral provider. The end investor needs to agree either in individual case or in generalised manner with the custodian as to the conditions under which the assets may be used as collateral.’’

1.59 Moreover, there is no single EU-approved resource that provides equivalence in terms of an English law governed pledge as a security interest with say a German-law Pfand. The same is true in indeed of the difficulty, even amongst shared neighbours, on the equivalence (or not in the case of the UK’s divergence following the Gray v G-T-P case) between and English and Irish law governed pledge generally but more specific for purposes of the pan-EU wide protections that are governed by the EU-FCD. That itself, as, a Directive creates conceptual gaps and CTR issues, which as assessed in Annex 2 has been implemented in individual EU jurisdictions with jurisdiction-specific rules, national options and discretions or differing views on interpretation, which has the possibility of raising/exacerbating Coll-RR or Cust-RR, even if the market does have some structural and documentation solutions.

1.60 CTR also exists and propagates other risks, where a concept, principle or outcome, is set at the EU primary legislative instrument level, and at any subsequent subsidiary legislative instrument, level is different, whether refined further or simply incorrectly reflected. Legislative ‘Goldplating’ or incorrect transposition across the EU by EU-MS are examples of CTR. So too are issues where for example EU legislative instruments, for say the asset management sector ‘X’, for the insurance sector ‘Y’ and for regulated lending and taking of security ‘Z’ all cover a common concept but do so in different ways.
These divergences are evidence of both conceptual gaps as well as CTR. In EU policymaker parlance, these issues, to the extent they are identified (which often they are not) are subject to “calibration” i.e., harmonisation/streamlining etc. as forms of convergence.

1.61 In the absence of any EU-wide laws facilitating a mandatory and/or voluntary regime for full harmonisation of the Collateral Ecosystem, and even in areas where such EU-wide laws, regulations or concepts do exist, conceptual gaps and CTR exist. These contribute to the risk that the collateral taker will not actually receive the protection that it assumes the relevant rules will provide as well as the risk that the Custody arrangements will not provide the safeguarding for the Collateral Assets in the manner stipulated or the level of Segregation. Absent action, market failures that make apparent this divergence between the perception and reality might cause financial markets to suffer a severe disruption. The 2008 failure of LBIE and the 2011 failure of MF Global UK Limited highlighted these issues and were accelerants to the GFC and the responses generally sought to make the banking sector safe to fail and centralise risk and collateralisation through CCPs and clearing houses.

1.62 Equally, absent a definitive and fully uniform EU-wide regime, including unitary EU-wide security interests, there are inconsistencies amongst EU jurisdictions on how national legal systems view of “ownership” of financial instruments. Notably, incompatibilities exist on negotiability and bona fide dealings on the one hand with the principle of absolute protection of holders of financial instruments. Despite common EU principles, domestic solutions differ on concepts and results. Some apply the ideas of “traditional” property/insolvency law doctrine while others apply *sui generis*. The degree of emphasis favouring the protection of the holder versus the negotiability of the instrument equally matter.

1.63 These divergences matter in all types of financial market transactions and Collateral Asset arrangements both where standards, but also where concepts, differ and/or are interpreted/viewed differently between jurisdiction A versus B etc. Where counterparties and/or the jurisdictions they operate in have a different understanding of concepts and standards this undermines trust, raises costs. All of this divergence ultimately reinforces fragmentation. The conceptual gaps as well as the CTR exists between the two regimes (Horizontal CTR) due to existing measures that are super-equivalent in scope, design or
interpretation (including retaining measures that existed prior to an EU law instrument – See Annex 2 for examples) or which are jurisdiction-specific, whether by design of the legislative draftsman (such as the CASS rules – See Annex 1 for examples) or as a result of court driven divergence such as a result of Cukurova or Gray v G-T-P in the UK changing various concepts of EU law and common principles as well as English law fundamentals in the law of collateral, Client Assets and Client Money.

1.64 This is the case even when using English law governed documents in Ireland in relation to Custody services and submitting to Irish courts, who would adjudicate on matters of English law, the regulatory regime that would apply to how those regulated activities of Custody are provided would be the Irish rules and would most likely also apply Irish-FCARs as opposed to UK-FCARs, even if the parties may have attempted to agree this differently. Recognising these differences, the risks and the costs are thus important to identify, mitigate and manage. Increasing convergence (e.g., of legal systems, regulatory and supervisory approaches and/or requirements or contractual boilerplate) and increasing standardisation may narrow the ability for conceptual gaps to emerge.

1.65 **Divergences exist even with established hierarchy of laws**

1.66 Divergences exist even with EU law being superordinate to national law. This is the case even if the EU’s approach in interpreting concepts and terms is that these, in an EU legislative instrument are to be given “an autonomous or uniform meaning” across the EU. Consequently, terms are to be interpreted by the courts in each EU-MS when used in relation to the application of a rule under the Rome I Regulation. That approach however does not mean that terms are mutually intelligible and interoperable as to concepts in other EU legislative instruments and those of national law nor that some persons holding the rulemaking pen at national level may apply Goldplating.

1.67 While the ECJ is the ultimate arbiter of a meaning of a term or concept used in a given EU legislative instrument, an avenue for greater consistency and interoperability might come about in further EU efforts on promoting harmonisation especially if it uses more “Jurisdiction-Agnostic” drafting. Such drafting would thus seek to complement, overlay

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but also supplement and/or replace existing domestic solutions that exist in private and commercial law underlying financial market transactions and the Collateral Ecosystem.

1.68 These differences highlighted above, while posing problems also raise the question, as explored in Part III whether the EU should, either by way of using a 29th Regime, similar to the U.S. UCC, and creating a unitary security interest (that works across languages/schools of law) thus build an EU UCC. A 29th Regime refers to creating a parallel regime (that stands either above and/or as an alternative) to those of national jurisdictions rather than looking to harmonise those. An example of this would be say the FCD and SFD and more recently the BRRD, the SSM and SRM as the two pillars of the EBU which create an alternative in the form of a uniform set of measures that stand superior to the 28 plus insolvency regimes of individual EU-MS. Such a regime would be welcome in the EU Collateral Ecosystem and could complement the private transnational regulatory regimes that exist in the form of master agreement documentation suites in say the form of the ISDA, GMSLA and GMRA, which historically make up the bulk of the relevant Collateral Asset transactions. A 29th Regime could be used concurrently to using EU legislative means of maximum harmonisation and Jurisdiction-Agnostic drafting to close conceptual gaps and reduce CTR. It also raises questions whether EU policymakers ought to work with industry associations to standardise certain reporting and other disclosure requirements, and provide agreed clauses, that are documentation-neutral and Jurisdiction-Agnostic, and greater use of Industry Legal Opinions to improve greater legal certainty on some of the issues raised herein. This is especially the case in a Collateral Ecosystem and financial markets, where Jurisdiction-Agnostic rulemaking instruments, whether as a legislative “29th Regime” or targeted technical operating process can sidestep legal fiction and match market infrastructure systems’ practice with pragmatic approaches. FinTech and RegTech may play a contributing role in making this happen, but will still require a human hand in closing-out conceptual gaps and keeping CTR in check. Rather, FinTech’s disruption, may need to create entirely new concepts that reflect the specifics of the digital age displacing current processes as very much distinct to the dematerialised and certificated based trading and mobilisation of collateral that rapidly advanced during what is termed the ‘machine age’. Those new concepts will need to, subject as proposed herein, fit in with the realisation of new risks. In many ways, it is easier for lawyers and policymakers to define those risks concurrently whilst FinTech forges new solutions so as to have a
possible legislative, regulatory and operating framework that does not lag behind and is thus permissive as opposed to restrictive.

1.69 The UK has been quick to expand the scope of EU protections to wider scope of persons and circumstances and the Irish rules have included rules, that the UK do not have, concerning Irish jurisdiction-specific matters, notably with respect to fund administration providers. This means the divergence, as discussed in Annexes II, demonstrate that the UK strength of divergence from that of the EU is stronger than it is to that of Ireland, and Irish divergence of its rules to that of the EU is less than its divergence from UK rules and II, demonstrate that the UK strength of divergence from that of the EU is stronger than it is to that of Ireland, and Irish divergence of its rules to that of the EU is less than its divergence from UK rules. While this expansion is welcome for market participants, indeed many of which consider this UK/Irish “jurisdiction-specific” Goldplating to be the gold-standard, the UK’s changing relationship with the EU-27 means the remaining bloc would be best pressed to amend and expand its own regime to borrow the best of the British and the Irish regimes.

1.70 In summary, the language of legislation and rulemaking therefore matters, especially to the Collateral Ecosystem as the “plumbing” of financial markets, where, even 10 years after the GFC and key failures in the Collateral Ecosystem (LBIE, MF Global etc.), the question of “where are my Collateral Assets and how much of it can I get back?” remains unanswered. So too are core questions that matter, certainly in markets that since the GFC have, as part of legislative and/or market-led infrastructure reforms, become more connected and where collateralisation is more prevalent. The GFC, whilst a trigger for change in thinking on risk and compliance, also put the brakes on financial integration, financialisation and cross-border convergence of the EU’s financial markets and the Collateral Ecosystem which is only beginning to develop, albeit slowly. Part of this is down to a lack of confidence, but more importantly, there still being much to do in terms of rules and infrastructure to integrate 28 European markets in financial services into a true Single Market.

1.71 The EU’s overarching aim in financial markets has been to build a Single Market for financial services (i.e. the internal market) built upon a “Single Rulebook”. The GFC has meant that the EU has moved to using more Regulations, i.e., directly applicable EU legislative instruments rather than EU Directives i.e., legislative instruments that requires
transposition i.e., implementation into national laws. Surely if EU law aims to unite and eliminate conceptual gaps, then Horizontal CTR let alone Vertical CTR should not exist. Unfortunately, this is wishful thinking, despite the best efforts of the EU and many stakeholders at national levels.

1.72 Part of this failing is due to errors made unwillingly/willingly at a national level and these not being corrected or these being incapable of being corrected. Moreover these failings exist (and thus risks for market participants) despite EU treaties and EU case law having established a general rule that EU-MS cannot legislate against or contrary to the aims of EU legislation. The Treaty on Functioning of the European Union designates the "internal market" and "consumer protection" as areas of "shared competence". This means that EU-MS can only act where the EU has chosen not to or has explicitly ceased to do so. The primacy of EU legislative and regulatory instruments in the event of conflict between the EU level instruments and the laws and regulatory instruments of EU-MS of the European Union is an established concept of the EU. This means that hierarchy is established as follows:

(a) EU level instruments, comprised of:

   (i) EU treaties and general principles of EU law;

   (ii) EU legislative acts (EU Regulations, Directives and Decisions as well as non-binding Recommendations or Opinions); and

   (iii) EU secondary legislation (delegated acts and implementing acts); and

(b) laws and regulatory instruments of EU-MS of the European Union.

As Bosomworth, points out EU counterparties increasingly trade across intra-union borders whereas national-domiciled policymakers, regardless of their views on EU integration, serve their jurisdiction-specific interests. The creation of the EBU, the achievements of CMU 1.0 and Brexit have however begun to strengthen an Europeanisation of financial services rulemaking and supervision. Further work is required, as discussed below.

1.73 Whilst much of the legal and regulatory regime applicable to authorized credit institutions and their regulated financial service activity is harmonized at the EU level including
through the use of EU law in the form of "Regulations", which take direct effect in the EU-MS, there are a number of areas where either:

(a) no harmonized EU law exists and thus national requirements may take precedence - unless in the case of certain instances national competent authorities (NCAs) or EU level authorities (such as the ECB-SSM) have exercised their own regulatory rulemaking or supervisory powers to introduce binding legal requirements (i.e. as EU law and/or national requirements) or have communicated their "supervisory expectations" (i.e. as "soft law") those measures take precedence over the national requirements;

(b) EU law exists but it has been supplemented or subject to Goldplating;

(c) EU law exists but it has, mostly in the case of EU law that is not a Regulation (i.e. with direct effect) but requires national implementation such as an EU Directive, yet to be implemented into national requirements; or

(d) EU law exists but it has been incorrectly implemented into national requirements or incorrectly interpreted by competent authorities and/or stakeholders thus leading to the various types of CTR,

collectively these four issues form conceptual gaps that require, with assistance from counsel, navigation from both a compliance and a business strategy perspective.

1.74 Some of the issues on hierarchy and relations to one another are explored in a standout study commissioned by the EP’s influential policymaking Committee on Economic and Monetary Affairs (ECON), prepared by Professors Langenbucher & Tröger of the Frankfurt based Sustainable Architecture for Finance in Europe at the Goethe University of Frankfurt, where this author teaches, entitled “EU Mapping 2017: Systematic overview on economic and financial legislation”42, which provides graphic overview on core legislation in the area of economic and financial services within ECON’s mandate as at May 2017. While that study does not discuss conceptual gaps and conceptual translation

(Langenbucher & Tröger)
risks, readers may find it useful to refer back to some of the materials in the study to help them understand correlations between legislative and regulatory building blocks and this thesis highlights any changes in the law as to updates to the building blocks assessed in Langenbucher & Tröger.

1.75 In summary, while conceptual gaps exist where there is an absence of a concept, a CTR can also arises when either rulemaking bodies or market participants incorrectly implement rules, principles and/or objectives of legislative and regulatory regimes or do so differently in a particular sector, asset class and/or jurisdiction. CTR also arises where any of the aforementioned actions or omissions are subject to judicial misinterpretation or inconsistent interpretation.

1.76 The absence of an EU-wide regime for the Collateral Ecosystem, even if EU policymakers do not borrow what market participants consider to be the gold standard still means there is no uniform answer to “who owns what” but more importantly “who can do what, how and when” with Collateral Assets, client assets and client money and specifically segregation and rights of re-use. Instead, a patchwork with ample conceptual gaps and CTR exists.

1.77 At the time of writing, despite the ECB-SSM and the wider European System of Financial Supervision (ESFS) along with NCAs in certain EU-MS along with relevant legislative policymakers revising the fitness and suitability of rulemaking on a periodic basis, there is no sole gatekeeper of to monitor and mitigate CTR. This means that the improvements that are done are often done piecemeal to individual legislative instruments. Usually these are in the form of a Corrigendum’s to correct mistakes, or amendments to make improvement or even conducting a wholesale amendment and restatement – i.e., a recast in EU terminology.

1.78 As there is no central office, despite proposals from commentators\(^\text{43}\) to task the EU Publications Office given its tasks\(^\text{44}\) to have a full clean read across what the EU terms a


Single Rulebook (which is not really that single to begin with) and to check for conceptual gaps, national barriers and effectively conduct quality control on a periodic basis. This could be a deliverable that CMU 2.0 could well achieve as this thesis proposes in Part III.

1.79 In addition to those issues comes, ultimately the key fact that much of that EU legislation was conceived, drafted and implemented more than twenty years ago in what were then the White Paper on Financial Services and the Financial Services Action Plan 1999 (FSAP) and thus well prior to the GFC and financial markets that were much less global, concentrated with key exposures to centralised or systemic market participants and certainly less electronified let alone less digitised.

1.80 **Brexit and opportunities for CMU**

1.81 Brexit heightens the importance of closing these conceptual gaps and mitigating CTR. Today, in the EU the issuance, trading, financing, clearing and settlement of capital market instruments such as securities and derivatives occurs largely, even predominantly in the UK under English law. Following Brexit, collateral arrangements under English law may no longer qualify as an “eligible financial collateral arrangement”. If so, arrangements documented under English law may expose counterparties to higher capital charges and/or more burdensome administrative requirements. For this reason, counterparties may wish to re-document their arrangements under the law of an EU-MS.

Given the similarity between English and Irish law, many market participants are likely to use Irish law as the basis for the revised documentation. However, “similar” is not “identical”. There are important differences between English and Irish law as they pertain to the Collateral Ecosystem. These affect the risks that counterparties bear, particularly if there is an event of default in the collateral arrangement.

1.82 EU policymakers face two choices. They can either leave participants to their own devices, and to continue to redocument arrangements (if they choose to do so) under existing EU-MS and EU law and thus operate in a patchwork of requirements. Or, policymakers can change law and regulation in a manner that harmonises and creates a level playing field by drafting, in a Jurisdiction-Agnostic manner, new as well as reforming existing laws/rules on:
• rights related to ownership in financial instruments (and Collateral Assets) as well as security interests or at least improve mutual understanding of security interests thereof – See Addendum to Chapter 2 for a comparison of UK and Irish law security interests;

• netting and set-off so that these may apply uniformly across the EU;

• consistent treatment of Collateral Assets for purposes of:
  
  o the EU-FCD and EU-SFD;

  o safekeeping of Client Money and Client Assets as well as Custody arrangements and levels of (consistent) Segregation through the holding/Custody chain,

and apply this to all collateral arrangements between market participants (i.e. non-consumers) across the EU-27 or at least across the Eurozone-19 by borrowing the best of British and Irish rules (referred to herein as a CASS Rollout), including where these rules have Goldplated EU rules or developed their own concepts and also build an EU UCC building equally off the EU reform proposals that stalled in 2011 referred to as the draft Securities Law Directive (SLD) that was reinvigorated briefly in 2013 (SLL) referred to herein as a Draft SLL Rollout and discussed in Part III.

1.83 From a public policy standpoint, adopting such a wholesale approach would be optimal, particularly if the EU-27 were to use English law as the basis for the new EU-27 standard. This would minimise transition costs associated with Brexit and preserve the protections that market participants have under English law and assume they will continue to have post-Brexit. It would also perhaps considerably limit the CTR impact on Coll-RR and Cust-RR (and possibly reduce those risks altogether) in a manner that, by looking to the EU’s favourite CMU benchmark, makes a transaction conducted between one party in Louisiana (which has a civil law character) with another in California at no greater risk than any of the other 50 states that have completely adopted both the UCC to govern commercial transactions as well as a range of other federal level securities and markets laws. The same is true in respect of inter-jurisdictional financial transactions across Canada.
Equally, seizing the opportunity to reform and also reform thinking on EU rulemaking in this area, would put an end to the cycle of:

(a) national-led development, including Goldplating;
(b) EU dovetailing (at times copying and capping); and
(c) national mirroring of other national-led Goldplating,

that has led to fragmentation with a multitude of “similar but different” states of law with respect to the Collateral Ecosystem, with some jurisdictions trying to best each other.

CMU offers EU policymakers an immediate opportunity to end such fragmentation, as the impending departure of the UK from the EU will force the EU-27 to set up an EU securities and capital markets regime on a basis other than English law. It allows policymakers to shape a canvass of consistency as opposed to a patchwork that has, as described in the following paragraphs, has been pieced together, often with certain needed reforms falling through the cracks due to national political interests at the expense of what would be prudent policymaking. That new capital markets regime should include provisions that provide issuers, investors and intermediaries the same or better protection than they currently enjoy under English law. That would foster both lower costs and greater resilience in financial markets, and therefore underpin growth in the EU’s ‘real economy’.

Launched originally in September 2015, the “Action Plan on Building a Capital Markets Union” was updated notably in June 2017 and was supposed to have been finished in

45 Available at: http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf. The CMU Plan was accompanied by the following two publications that should be read in conjunction with it:


2019. Brexit surely was one factor that delayed delivery of much of what was supposed to be finalised CMU legislative and regulatory rulemaking reforms. Other barriers included EU-level policymakers focussing considerably on consultation, often on known issues, rather than advancing (as much) action and putting in place legislative instruments. Despite these drawbacks, completing the CMU remains a work in progress and the original plan is ripe for its next step in delivering reform. Equally, the ECB, as central bank but also at the head of the SSM has also indicated its support for CMU as a catalyst to completing Single Market integration. That being said, the ECB has (rightfully and thankfully) been equally quick to point out certain “missed opportunities” that CMU 1.0 fell short on.

1.87 A new CMU 2.0, which, at the time of writing this thesis, despite some first broad strokes of policy proposals, is yet to formally launch, already has a lot of expectations from policymakers and market participants resting upon it. Regrettably, CMU 2.0 has yet to fully embrace the need, despite EU policymakers having spotted the problem over the past 30 years, to counteract fragmentation with reforms and harmonisation of rules on the Collateral Ecosystem. This begs the question of “why?”

1.88 Surprisingly to date the answer to that question has been more along the lines of the adage “if it ain’t broke don’t fix it” as well as “if it’s broke don’t shout about it”. Deferrals and

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47 See Speech Benoît Cœuré, Member of the Executive Board of the ECB, at the ECB Representative Office in Brussels, 3 December 2019 available in full at: https://www.ecb.europa.eu/press/key/date/2019/html/ecb.sp191203-043847dfc1.en.html and in particular the following remarks:

“Of course, it would be naïve to assume that a capital markets union can be achieved without investing political capital. Improving and harmonising national insolvency laws, for example, goes to the very heart of our legal systems. But it is capital well invested.

Risk sharing by private investors reduces the need for public risk sharing and for the protracted and acrimonious discussions that often ensue.

A capital markets union can’t function without European-level supervision of systemic intermediaries and infrastructures. There are large cross-border spillovers and, if things go wrong, the banks that are directly supervised by the ECB would be left bearing most of the financial risk. Recent reforms of the European supervisory authorities and of the European market and infrastructure regulation (EMIR) were missed opportunities.

The United Kingdom’s departure from the EU will have a lasting impact on the architecture of European financial markets. This reinforces the need to react and complete the capital markets union.”
“other priority issues” have taken priority in the legislative and rulemaking agenda of the EU. Reforms to the financial and supervisory architecture affecting capital markets, the business of banking, fund management and insurance have been transformative despite differing degrees of change.

1.89 However, these reforms focused on “front office” requirements first and very little on the “back office” aspects that relate to the Collateral Ecosystem as the “plumbing” of financial markets. If, as introduced above and in prior academic research48 on rehypothecation, itself a critical tool used to mobilise and re-use Collateral Assets, the laws, rules and concepts that serve as foundations to these new pillars of post-GFC policymaking are not harmonised beyond existing EU and national efforts then this hardwires risk into the financial system.

1.90 This remains the case despite EU principles, including those that existed prior to the GFC, having been interpreted, expanded and improved on by the British regulators in the form of the UK’s Client Asset Sourcebook (CASS) of the UK Financial Conduct Authority’s (FCA) Handbook. Ireland’s regulator, now the Central Bank of Ireland (CBI) mirrored those rules in the form of the Client Assets Rules (CAR) and supporting Irish legislative developments, which in turn were then subject to further EU reforms that dovetailed the national led efforts of the UK and Ireland.

1.91 The most important of these EU efforts affecting specifically the Collateral Ecosystem, beyond expanding the eligibility of Collateral Assets to credit claims in 2009/10, included changes to principles introduced originally in MiFID I, which EU-MS had incorporated into their own regimes prior to the GFC. The post-GFC response at the EU level affecting the Collateral Ecosystem sought to implement relevant parts of the G-20 Pittsburgh Commitments. This culminated inter alia, in the EU, in the introduction of EMIR in 2009, the AIFMD/R in 2011 as well as in 2014, the MiFID II/MiFIR Regime as well as the Securities Financing Transaction Regulations (SFTR) and the Central Securities

48 See M.D. Huertas in “Hedge Funds, Master Netting Arrangements and Rehypothecation: Limiting Systemic Risk Through Increased Transparency” This LL.M. dissertation was completed during a period in the midst of the GFC, following the failure of LBIE and well prior to the fallout of MF Global where rehypothecation began receiving regulatory and academic interest, including through research of M. Singh et al.
Depository Regulation (CSDR) that entered into force with phased application dates from 2014 to beyond 2019.

1.92 Taken together these EU reform measures placed the need for greater collateralisation of transactions, whether on a bilateral basis or via the increased use of CCP clearing or tri-party arrangements, at the forefront of what has become the new “new normal” of the current 2019 state of financial markets. Pre- and post-transaction transparency along with greater disclosure on rehypothecation rights and rights of re-use were introduced by the MiFID II/MiFIR Regime in 2014 but effectively followed changes the FCA introduced to CASS between 2009 and 2014.

1.93 These EU reforms, even where they built off national-led efforts did, in part, cause CASS and CAR to be “updated” via CDR 2017/565 on organisational requirements and CDD 2017/593 on safeguarding of financial instruments. Despite these updates to some parts of the national rules, wider fragmentation still exists as do gaps. Some of this is also due to CDD 2017/593, as a legislative instrument, being a Delegated Directive as opposed to a Delegated Regulation i.e., use of the latter would not require national transposition and the ability for national-led efforts to create further fragmentation.

1.94 Despite regulatory reforms, mostly forged out of the GFC and a certain degree of legislative and regulatory fatigue and institutional inertia since then, this has meant that these vital aspects of the Collateral Ecosystem have largely gone untouched, or where action has been advanced, it has not been by way of maximum harmonisation measures or otherwise eliminated fragmentation. Other measures simply “lost-out”, notably during 2010/2011, where political pressures favoured the creation of the EBU, which, while welcome, left a lot of useful legislation and rulemaking to be delayed, stalled or cancelled altogether. This piecemeal approach in patching-up a patchwork accentuates Collateral Ecosystem related risks as well as firm-specific but systemic risk in the Collateral Ecosystem and CMU 2.0 could change that. CMU 2.0 draws parallels to the U.S.’ experiences in building a continental-wide integrated capital markets infrastructure.

1.95 Lastly, properly documented and executed, collateral arrangements can reduce loss given default and therefore reduce credit and counterparty risk. However, improperly documented or poorly executed collateral provides no protection at all. In such circumstances, collateral will undermine rather than support financial stability. This is
further complicated when concepts used in the field diverge and/or differ or indeed when they have differences in their meaning but also their interpretation notably in the realm of legal interpretation, in particular in relation to security interests and (ownership) rights in respect of Collateral Assets.

1.96 For reasons discussed above and in the comparative law analysis in the Annexes to the, which are summarised in this thesis, the cross-border comparison as well as the assessment of the level interoperability of the Irish and British regimes on CASS and CAR are highlight that CTR can exist and have quite real effects even where those jurisdictions are very similar but different. Surprisingly, the individual divergences between UK and Irish rules as well as those national rules and the EU regime on the same subject matter have not been conducted in academia or in practitioner texts.

1.97 Given the degree of interdependence of the financial services markets between the UK and Ireland, this is an area where detailed study of principles and rules of two distinct, yet closely related, legislative and regulatory regimes merit investigation. The intended key outcome of this research is to assist market participants understand how best to comply with the regimes, aid domestic supervisory policymakers to calibrate rules where appropriate and assist EU policymakers in drafting a common set of rules beyond the comparably high-level principles in the CDR 2017/565 and CDD 2017/593.

1.98 This research is also likely to be relevant for a Collateral Ecosystem that continues to be subject to ‘disruption’, of varying degrees and depth by FinTech challengers. The intended key outcome of this part of the research, which builds upon earlier findings of the author in respect of identifying, mitigating and managing documentary CTR, is to highlight the importance of conceptual gaps as factors that exacerbate fragmentation. The new proposed risk concept of CTR, including its sub-components of Documentary CTR and Legislative/Regulatory CTR, aim to assist market participants, legislators and supervisory policymakers on measuring and eliminating existing conceptual gaps and fragmentation as well as improving harmonisation of EU markets by using ‘Jurisdiction-

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49 In the context of how EMIR i.e. Regulation no. 648/2012/EU is transposed into derivatives documentation maintained by ISDA see M.D. Huertas in the chapter “ISDA 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol (the ISDA PortRec Protocol) and other EMIR relevant ISDA Documentation Solutions” as part of the German language practitioner text “Handbuch EMIR – Europäische Regulierung der OTC-Derivate”. ISBN 978-3-503-16386-1 published 26. November 2015.
Agnostic’ drafting going forward. This is a priority that cannot continue to be ignored or delayed, especially if CMU, EBU and further Eurozone integration are to actually happen.

1.99 The above paragraphs have introduced some of the key issues affecting the Collateral Ecosystem, the risk of inertia and some of the proposed solutions to reduce CTR and thus reduce Coll-RR and Cust-RR that exists as a result of the evolution of the ecosystem, as discussed in the next Chapters in Part I as well as due to market participants.
Addendum to Chapter 1

Glossary of key new terms proposed

| 29th Regime                                                                 | A 29th Regime refers to an EU legislative principle that creates an optional parallel regime structure that (crucially) does not displace existing national law of the EU-MS. An example of such proposals in the past have been the European Contract Law. From a legislative drafting approach, a 29th Regime’s appeal is that as a potential body of EU law (federal if one wishes) can deliver principles and obligations to its users (i.e., legislative destinations) that co-exist rather than displace national EU-MS law(s) and thus avoids being tied-up in the intricacies of EU-MS’ jurisdictions and having to be implemented as it co-exists even if superordinate to national laws. In many ways such a 29th Regime could act as a leapfrog to overcome otherwise difficult use of instruments of legal fiction trying to bring together multiple jurisdictions and schools of legal thought in an area where, despite pan-EU financial market infrastructure providers, the cornerstones underpinning the legal and market environment remain deeply entrenched along national lines. Such a regime would be welcome in the EU collateral ecosystem and could complement the private transnational regulatory regimes that exist in the form of master agreement documentation suites in say the form of the ISDA, GMSLA and GMRA which historically make up the bulk of the relevant transactions that mobilise and/or serve to monetise collateral assets in the collateral ecosystem. |
| Collateral Ecosystem Participant Concentration Risk (CEPCR) | CEPCR, building on the concept of Concentration Risk (especially N-CR and S-CR), aims to apply the thinking to the Collateral Ecosystem, including a recognition of the various roles that market participants play and the degree of interconnectedness of exposures (incl. N-CR) expressed as follows:  
- Concentration Risk Across all Custodian/Depository roles (A);  
- As adjusted by:  
  - Concentration across all other key roles (B);  
  - as adjusted by ratings based triggers in A plus resilience of mitigants in A as adjusted by ratings based triggers in B as adjusted by resilience of mitigants in B and correlation to A; and  
- As globally adjusted to correlation to Concentration Risk amongst Affiliates and cross-default triggers (C).  
From a collateral exposure perspective, it also raises two key questions namely, whether an over-concentration can in fact adversely increase Coll-RR and Cust-RR and how that factors into VARINCA and VARIGCA calculations in light of limited Custodian/Depository providers meaning diversification is unlikely to be an affordable mitigant. |
| **Collateral Related Risk (Coll-RR)** | Means the:  
- financial risks; and  
- non-financial risks that are specific to the Collateral Assets, including, as adjusted for Concentration Risk notably Coll-ACR. |
| **Concentration Risk** | Which, a traditional (and thus established) risk metric, that describes the level of (risk) exposure of one party to a concentration on:  
- a single counterparty (i.e., name concentration risk – N-CR);  
- sector (sector concentration risk – Sec-CR); and/or  
- jurisdiction (jurisdiction concentration risk Jur-CR); and  
- for purposes herein, would be extended to cover Collateral Asset concentration risk (Coll-ACR). |
| **Conceptual Gap** | Means a situation where a concept in one system of law/regulation exists (Jurisdiction A) but it does not exist in another system (Jurisdiction B) or does not exist as fully due to divergences or other changes to a concept. |
| **Conceptual Translation Risk (CTR)** | A CTR exists where a concept in one system of law or regulation (again, Jurisdiction A) sets out a requirement that another system of law/regulation (Jurisdiction B) is required to follow but either does not follow as fully or that system amends, supplements or otherwise causes divergences from the requirements of Jurisdiction A. CTR can occur at a couple of levels and in different degrees of strength. It can be represented as:  
- **Vertical CTR** in the case of differences, gaps or divergences between rules as drafted at the EU-level and those that exist at the national level of individual EU-MS. This Vertical CTR comes about even in the event of an EU Regulation, which requires no implementing measures, being supplemented by (existing or new) national legislative measures that do not give correct or otherwise limit the effect of the EU level measures (including by way of Goldplating); and  
- **Horizontal CTR** which can exist to reflect the divergences between the laws and rules at the national level of individual EU-MS including the laws of EU legislative instruments as applied in those individual EU-MS. Horizontal CTR can come about due to the EU rules not having been transposed, i.e., implemented in a manner giving correct effect or otherwise limiting the effect of the EU measures, whether by expanding and/or limiting |
the scope of the concepts in the EU level legislative instrument(s) or because national law level instruments have not been amended or drafted to give such effect (including due to Goldplating).

Equally, both Horizontal and/or Vertical CTR can exist in relation to divergences between:

- the legislative/regulatory requirements, i.e., the requirements of CDD 2017/593 (see below) as set out at the EU level versus as transposed and how it operates in the Irish rules versus the UK rules, which go well beyond the EU and Irish rules and this divergence could be distinguished as Legislative/Regulatory CTR, and

- divergences that exist in documentation, including master agreement documentation frameworks that market participants use for financial market and collateral asset related transactions. By way of an example, divergences may exist, however minimal, between, contractual terms based on Master Agreement documentation suite A (pro forma of a GMRA for example) versus B (pro forma of a GMSLA for example) etc. or where such master agreement documentation suite may have different governing law versions (2002 ISDA Master Agreement governed under English law versus the Irish law governed version) this can be distinguished as Documentary CTR.

<table>
<thead>
<tr>
<th>Custody Related Risk (Cust-RR)</th>
<th>Means the following risk types and attributes:</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>• non-financial risks (both quantitative and qualitative) specific to:</td>
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<tr>
<td></td>
<td>○ the documentation; and</td>
</tr>
<tr>
<td></td>
<td>○ non-documentation,</td>
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<tr>
<td></td>
<td>arrangements in place with the Custody provider (including any sub-custodians) and/or as they relate to the mobilisation channels, operational risks and legal, specifically risk of loss of title to Collateral Assets; and/or</td>
</tr>
<tr>
<td></td>
<td>• the financial risks (in particular credit/counterparty risk) specific to the provider of Custody provider, as adjusted for CEPCR.</td>
</tr>
</tbody>
</table>

| Jurisdiction-Agnostic | Refers to rulemaking that is jurisdiction-neutral and interoperable across multiple jurisdictions, free from national influences. |

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50 This is a very present (albeit unreported) issue that has affected a range of major dealer entities, including global Custodian/Depository businesses due to Collateral Assets not being appropriately recorded in books, or a UK significant branch of a German BUSI that outsourced its Custody business to a London-based subsidiary of a U.S. headquartered Custody provider, failing to record Collateral Assets in line with German in addition UK CASS rules, thus meaning the title to the assets and the Segregation the BUSI had contractually agreed to provide to its clients, was not being complied with. Loss to title, while risky in solvent situations presents serious problems in the event of insolvency, notably as relevant rules remain local and contractually, the rules of the Custodian/Depository as opposed to the accountholder are likely to govern the relationship.
The following example, as supported by the extracts below demonstrate Linguistic CTR, i.e., CTR that results in a “similar but different” outcome stemming from a common root concept being, due to differing use of language, yielding divergence and thus different obligations.

Example:

In English, certainly in legal drafting as used by EU policymakers, “should” is taken to mean “must”. While “should”, when used as an auxiliary verb does not denote a requirement that is absolutely mandatory, as with the auxiliary verb “shall” the use of “should” does still denote an absolute obligation with some degree of optionality and/or a strict supervisory expectation.

Assessing this in the context of Linguistic CTR, one can look at Recital 12 CDD 2017/593 in the table below and that:

- In French, the word used is “devraient” from the third-person conditional of “devoir” which is taken to mean “must”, however, as used herein reads “devraient agir” and thus is taken to mean “should act with” and while implying a stronger sense of urgency than in the German text (see below) implies a conditionality; and

- In German, the word used is “sollte” from the third-person singular preterite of “sollen” which expresses a suggestion that something ought to be done but does not mean that it must be done as would be the case with the verb “müssen” which means “must”.

Note also that in the French text extract below, the second reference where in the English “should” and in the German “sollte” appears is not included. Rather, the obligation in the French text is instead to consider.

This in itself demonstrates CTR between the French to the English and German versions. The same type of confusion exists in relation to post-GFC legislative instruments continuing, even expanding, the use of recitals to legislation to introduce operative provisions/supervisory expectations rather than providing just interpretative measures, as text in recitals are often not subject to the same degree of interest during the legislative process.

<table>
<thead>
<tr>
<th>English text extract</th>
<th>French text extract</th>
<th>German text extract</th>
</tr>
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</table>
| “Where investment firms place client funds with a third party, the investment firm should exercise all due skill, care and diligence in the selection, appointment and periodic review of the third party and of the arrangements or holding and safekeeping client funds, and should consider the need for diversification and mitigation of risks, where appropriate, by placing client funds with more than one third party in order to safeguard clients’ rights and minimise the risk of loss and misuse…” | « Lorsqu’elles placent les fonds de clients auprès d’un tiers, les entreprises d’investissement devraient agir avec toute la compétence, tout le soin et toute la diligence requis pour la sélection et la désignation de ce tiers, ainsi que pour le réexamen périodique de cette décision et des dispositions régissant la détention et la conservation de ces fonds, et considérer la nécessité de diversifier et d’atténuer les risques, s’il y a lieu, en plaçant les fonds des clients | „Platzieren Wertpapierfirmen Kunden­gelder bei einem Dritten, sollte die Wertpapierfirma bei der Auswahl, Bestellung und regelmäßigen Überprüfung dieses Dritten sowie bei den für das Halten und die Verwahrung der Kundengelder getroffenen Vereinbarungen mit der gebotenen Professionalität und Sorgfalt verfahren und prüfen, ob Risiken gestreut und gemindert werden müssen, gegebenenfalls indem die Kundengelder bei mehr als einem Dritten platziert werden, um die Kundenrechte zu wahren"
While a discussion on conceptual gaps and CTR arising from language differences on security interests are beyond the scope of this thesis, which would merit a study in its own right, a common example of linguistic divergences leading to confusion that EU regulated firms stems from the use of “should” in English-language legislative drafting (and/or in internal policies). This confusion has affected a number of BUSIs and led them to ban the use of “should” or its equivalent in other languages, including where English is the operating language of the BUSI in relation to internal policy and procedure documents.

<table>
<thead>
<tr>
<th>Recoverability Rate</th>
<th>A Recoverability Rate, which aims to supplement Collateral Asset valuation techniques, may be calculated by taking:</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>• the value of Collateral Assets provided by collateral provider to collateral taker plus the amount of income earned thereupon prior to maturity of the transaction; as adjusted for</td>
</tr>
<tr>
<td></td>
<td>• the value of the Collateral Assets upon enforcement, less enforcement costs incurred to recover those Collateral Assets and/or (in the alternative) any provision of equivalent Collateral Assets, as adjusted for value, in this context, “value” ought to be fair value and a value at risk calculation may also be helpful for a market participant to assess its risk exposures.</td>
</tr>
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</table>

It is worth assuming that Recoverability Rates on Collateral Assets provided may be lower in value returned than the value returned on Collateral Assets taken and forming part of collateral inventory under control of a collateral taker. This is due to the assumption that it takes longer time for collateral provided to be returned than it does to enforce over collateral taken and under the control of the collateral provider who can enforce upon it.

Individual Recoverability Rates, could also be assessed as an overall exposure in the form of a **Net Collateral Asset Value at Risk**, which:

- aggregates a collateral provider’s exposure on its Collateral Assets in its collateral inventory (collateral provided less collateral taken which equals the INCA, assess the qualitative and quantitative Coll-RR and Cust-RR properties of the INCA and presents a net figure for the VARINCA; and
- the same can be extended to assessing the aggregate of Coll-RR and Cust-RR, as adjusted for assumed Recoverability Rates for collateral provided and collateral taken, to yield a VARIGCA.
For the purposes of the above the following terms are defined as follows:

- **INCA** means inventory of net Collateral Assets, which reflects the amount, type (incl. by relevant code such as ISIN or CUSIP) and location (by Legal Entity Identifier), on the date of determination by the collateral provider, of the Collateral Value of its net inventory (i.e. provided and taken i.e., under control and not reused) of Collateral Assets that would be realisable (assuming positions can be netted and set-off) upon closing out a transaction with one or multiple counterparties.

- **VARINCA** means the Value at Risk of the INCA and assesses the value at risk as a measure of the risk of loss of the Collateral Assets over given “normal market” conditions in a set (time-)period – thereby being able to assess the amount that the calculating entity (collateral provider) might stand to recover.

- **VARIGCA** means the Value at Risk of Inventory of Gross Collateral Assets which provides an estimated loss on Collateral Assets held by the calculating entity as collateral taker and the loss on Collateral Assets that have been provided by the calculating entity, as collateral provider, to other market participants (including those Collateral Assets that the calculating entity has received as collateral taker and rehypothecated or otherwise re-used as collateral provider) without factoring in a net position.
2. **Why are reforms needed now?**

2.1 The expression of “*never let a good crisis go to waste*” rings true for areas of the post-GFC regulatory reform to financial services. Whilst a lot of these reforms have been translated into market participants’ compliance objectives and relevant “change the business”, “run the business” and “business as usual” implementation workstreams, the Collateral Ecosystem has not (yet) had the full benefit of reforms as comprehensive as select parts of the financial markets environment (transaction types and asset classes) that rest upon the Collateral Ecosystem.

2.2 Despite all the global and EU regulatory driven change has shaped how post-GFC transactions are structured, executed, cleared and collateralised, the opportunity to improve the Collateral Ecosystem has overall not improved. The impending loss of London for the EU-27 and the move away from a Collateral Ecosystem that has over-relied, in parts, on UK’s Goldplating of EU rules, means that when those rules are gone, EU-27 policymakers and market participants would benefit from (1) more harmonised EU rules, which (2) may take the best of the UK’s and Irish concepts. There are good grounds for this given, as introduced above, and as explored below in the context of a repo, an abundance of jurisdiction-specifics fuels fragmentation and costs.

2.3 Prior to delving into the detail, it should be noted that most non-cash Collateral Assets are dematerialised when held and/or mobilised. When they become subject to security interests, they are held in FMIPs such as clearing systems, in the UK and Ireland, this would primarily be Euroclear (which includes CREST\(^51\) and for Irish securities these having been migrated to Belgian headquartered Euroclear Bank ahead of Brexit\(^52\)). A full discussion on the operational mechanics of the Euroclear Rulebook and CREST is beyond the scope of this thesis, as is a full discussion on the differences between English and Irish law concepts of taking security interests over financial instruments in the common system of Euroclear. In summary, that process equates to taking security in respect to rights to or

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\(^{51}\) See: https://www.euroclear.com/dam/PDFs/SETtlement/EUI/MA2740-CREST-settlement.pdf

\(^{52}\) See relevant information at the time of writing: https://www.euroclear.com/about/en/regulatory-landscape/Brexit/Irish-corporate-securities-migration-update.html
proprietary interest in specific dematerialised financial instruments and/or depending on account structure (and use of nominees) in the interest in the pool of fungible financial instruments. All of this depends on the nature of the clearing system and the relevant parties including their roles and motivations.53

2.4 It should be noted that the law governing those security interests are set in the respective rulebooks. Consequently, these may not be English and/or Irish law governed. Moreover,

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53 Holding financial instruments in immobilised form, however, does raise complex legal issues for anyone taking security over those financial instruments. The nature of the owner's interest in the relevant financial instruments depends on the structure of the clearing system in which those financial instruments are held and the nature of the agreement between the parties. The different ways in which financial instruments may be held in a clearing system include the following:

- **Beneficial ownership of financial instruments remains with the depositor:** if the owner deposits financial instruments with the system and requests that they be held in a separate account and only be dealt with in accordance with the owner's specific instructions, then beneficial ownership of those financial instruments remains with the depositor, even though the clearing system has possession of the financial instruments. If the clearing system then becomes insolvent, the financial instruments will not be distributed to the system's creditors and the depositor will be entitled to recover them. As the beneficial ownership remains with the depositor, the depositor can grant a legal or equitable charge over those financial instruments. The CREST system is organised on this basis for customers that hold accounts in it.

- **Securities are held jointly in a pool by co-owners and each owner has an interest in the pool:** in some cases, a clearing system may agree with the depositor not to acquire title to the financial instruments deposited. If, however, the financial instruments are mixed together and become indistinguishable from each other (fungible), the individual depositor loses its proprietary rights over the specific financial instruments. Under English law, where goods belonging to different owners are fungible, all the owners become co-owners (tenants in common) of the entire pool of goods. If the clearing system were to go into liquidation, the co-owners could insist that the pool of financial instruments be shared between them pro rata. They would not rank as unsecured creditors, because they still hold a proprietary interest in the financial instruments, albeit jointly. A depositor can grant a legal or equitable charge over its interest in the pool of financial instruments. The Euroclear system operates on this basis. Owners of financial instruments (or shares) who do not have an account with CREST, and who deposit their financial instruments in an agent's account (usually a bank or stockbroker) hold their shares and financial instruments in CREST on this basis.

- **Securities are held in a communal account and a depositor has a contractual right to receive back an equivalent number of the same financial instruments:** the final possibility is a situation where a depositor deposits financial instruments in a communal account and there is no agreement that the depositor will retain title to those financial instruments. The clearing system acquires title to the financial instruments when they are deposited, and the depositor acquires a contractual right against the clearing system to receive back an equivalent number of the same financial instruments that it deposited. This makes it impossible for the depositor to give security over its interest in the financial instruments because it no longer has a proprietary interest in them. The depositor can, however, give security over the contractual right that it has against the clearing system for return of an equivalent number of the same financial instruments that it deposited. In this case, the solvency and financial reliability of the clearing system would be important to the person taking security.

In practice, the systems that operate on this basis (such as Clearstream) are not governed by English law. When taking security over assets in these systems, lenders would use documents governed by the law of the jurisdiction in which the assets are held.
differences exist between how certain security interests relating to Collateral Assets operate in English when compared to Irish law – See Explanatory Notes to this Chapter. This matters where, as is often the case, the trading relationship, collateral and security interest arrangements are English law but the Custodian/Depository operates (and/or the arrangements are documented) under Irish law and the FMIP under different laws altogether.

2.5 **Assessing the need for reform by looking at who does what with whom, when and how**

2.6 As a result, in modern financial transactions (even the simplest forms of types of transactions and assets – and thus SFTs (in particular repo) for the purposes of the Collateral Ecosystem), assessing the legal and non-legal risks of who does what with whom, when and how is important in any given range or permutations of transaction exposures. This also applies to collateralisation and Custody relationships (including as they relate to Collateral Assets). Ideally, especially if EU-27 policymakers are pressuring to move away from the dominance of one system or access to that of the UK, having an understanding, of comparative law, as well as the harmonised concepts, where they do exist across legal systems, is likely to be paramount. This is the case as:

(a) a single institution engaging in financial market transactions may have collateralised those transactions with multiple counterparties from multiple jurisdictions, each of which may have differing strengths of (diametrically) different attitudes to security, collateral and Custody as well as differing national rules on and/or differing interpretations of EU rules on Collateral Assets and Custody; and

(b) throughout a single transaction/collateralisation lifecycle of a given transaction various governing law of documentation/account or applicable laws to asset/counterparty/financial market infrastructure provider can have mutual application at any given stage.

2.7 Market participants, even in the simplest of bilateral relationship exposures will have multiple roles. This applies to FCs certainly but also to NFCs as one can, in a bilateral relationship, be both collateral provider and taker. This is of course normal, but the point
to note is that these differing roles come on top of the differing priorities and motivation of market participants generally as well as within the specific roles and also depending on the transaction type and Collateral Assets provided or received. All of these considerations can also differ between depending on the position in a relevant transaction chain. Equally, for some roles these are:

(a) ‘static’ over the lifetime of a transaction (including through the transaction chain) and are roles that are either innate due to the nature of the counterparty i.e. a dealer entity or which have been appointed, such as a security trustee;

(b) ‘semi-static’ over the lifetime of a transaction and which change upon the determination of a trigger event including a default – this could include the role of calculation agent or valuation agent etc.; or

(c) ‘fluid’ over the lifetime of a transaction and which are driven by the evolution of the risk associated with the actual transactions – this includes the roles of collateral provider and collateral taker.

2.8 The evolution of these roles can change both in the context of individual components of the transaction(s) as well as across exposures and relationships. Market participants may act as collateral provider and/or collateral taker to one another and as the transaction develops, those roles may change. Importantly, a change in one role may not always correspond to the roles in the financial market transaction.

2.9 The allocation of roles as well as the degree of stasis also changes across transaction types and asset classes. For derivative transactions executed OTC (irrespective of whether cleared or non-cleared) or for margin lending, some key roles typically remain static, as has historically been the case. Only since the worst of the GFC have some dealer entities, and only in relation to transactions with those smaller FC or sufficiently larger NFCs counterparties, with sufficient bargaining power, relented to accept contractual arrangements whereby their roles as say a calculation agent or the valuation agent are ‘ported’ i.e. transferred to a replacement entity in the event of pre-defined circumstances or where the appointed party is incapacitated. In exchange traded transactions there is even less optionality and fluidity in some of the key roles.
2.10 So why do these roles matter? For one, they determine the amount and types of Collateral Assets to be provided and safeguarded and will often drive what happens with the Collateral Assets once they are received and whether these are applied for permitted onward mobilisation. Such permitted onward mobilisation may occur with or without the consent or knowledge of the original collateral provider and move assets received by the original collateral taker across and down further transaction chains to which the original collateral provider is not party.

2.11 In turn, this collateral taker may be a party, in particular if it is a FC and specifically a dealer entity, to any multitude of transactions, each with their own collateralisation requirements. This means that, from its perspective, the incoming assets from the original collateral provider, can be mobilised, assuming it has the contractual right or receives absolute title to those assets for use in subsequent transactions and/or collateral arrangements. From the perspective of the original collateral provider there is thus a limited ability to look past its direct counterparty and ‘look through’ the subsequent transaction chains. A look through down the various transaction chains would be helpful for not only tracking Collateral Assets but also in taking the veil off propagators driving idiosyncratic and/or systemic risk. Arguably, as collateralisation arrangements and risks become more pronounced, the need for a “look through”, possibly through greater use of DLT or certainly instrument-identifiers to make that possible, ought to be beneficial to manage Coll-RR and Cust-RR without compromising rehypothecation and re-use that are necessary for collateral fluidity and thus wider liquidity.

2.12 It is also important to note that aside from the importance of roles on the core questions of “who is doing what and where are my assets?” across one or multiple transaction chains may be shaped by specific risk appetite(s) in terms of exposure but also rights, including rights of use and rehypothecation granted and/or capable of being exercised over and in respect of (collateral/financial) assets in that specific transaction chain as well as subsequent chains. This risk appetite can be distinguished from a general risk appetite and is dependent on each relevant counterparty.

2.13 Depending on the role and exposure at any given time, counterparties may also attribute different sensitivity and importance to the Collateral Assets employed in the transaction they secure. These differences may be driven by the aims of the transactions and this may influence the attitudes as to collateralisation and the way assets are exchanged, received
and secured. For some transaction types, the counterparty’s (actual or perceived) risk profile and perception of its systems, may all play a factor in how a counterparty reaches its decisions. Like with the mutability of roles, perceptions and priorities on one relationship may differ in another and may also differ along chains of relationships.

2.14 These differing perceptions and priorities are relevant when (but not limited to):

(a) Collateral Assets are provided and parties determine the degree of Haircut or the percentage of Overcollateralisation that is required for the collateral relationship;

(b) Collateral Assets are received prompting issues on how they are to be held including custodied and what degree of Segregation is to be applied;

(c) Collateral Assets are received and whether they can be ‘monetised’ through contractual re-use or rehypothecated for re-use by the collateral taker; and

(d) an obligation to return the Collateral Assets arises, and an assessment of which Collateral Assets are to be delivered including whether the originally received Collateral Assets can be returned, whether equivalent collateral would be ‘cheapest to deliver’ and/or ‘best to deliver’ or whether instead the redelivery obligation should be dispensed with as discharge of obligations.

2.15 Generally the legal ability to rehypothecate or exercise a right of re-use depends on:

(a) whether the laws of the jurisdiction permit it;

(b) whether the contractual relationship permits it and since the GFC, whether this activity is allowed when dealing with a type of counterparty – generally there are limits or outright restrictions on this activity when dealing with certain counterparties, in particular those that are categorised as MiFID Retail Clients; and

(c) whether the parties have the operational capability to facilitate.

54 The market terminology use of “monetisation” refers to the process of employing assets, including collateral assets that are provided for specific purposes, for use in commercial transactions that would yield a return.
The legal and regulatory regimes, as well as the operational capabilities of market participants engaging in activity in the UK and Ireland recognise, (and increasingly since the GFC) regulate and require reporting on this type of activity.

2.16 Importantly, differences exist between contractual rights of re-use and rehypothecation. These include that a contractual right of re-use is that the collateral asset can be re-used by the collateral taker once that right is acted upon.

2.17 Rehypothecation for re-use is typically considered, albeit in market terminology absent a firm legal terminology, to mean the collateral asset can only be re-used for use by the collateral taker for its own “onward” collateral needs i.e., as collateral provider. The risks however are the same. Rehypothecation and re-use in relation to financial assets and/or Collateral Assets are often used by market participants, policymakers and supervisors interchangeably given that economically the process of appropriation and use of the assets are the same. Both terms however have specific and different meanings.

2.18 Rehypothecation is not defined in EU legislation, nor by the UK and Irish regulatory authorities but taken to mean the ‘process by which a party, usually the collateral taker, appropriates or otherwise uses financial collateral received as security for its own economic purposes including its own management of collateral obligations or delivery obligations. The term re-use often predicated by being ‘contractual re-use’ or ‘rights of re-use’ is equally not defined by EU legislation, nor by the UK and Irish regulatory authorities but taken to mean contractually agreed circumstances where the recipient may re-use the assets as if they were their own. Whilst the semantics between the rehypothecation and re-use matter, absent harmonised definitions, the post-GFC legislative/regulatory response has focused on disclosure of rehypothecation and contractual re-use rights prior to entering into transactional documentation, disclosure prior or at the point such rights are exercised and equally at periodic times following the exercise of such rights.

2.19 So why do parties enter into these arrangements to begin with? Rehypothecation lowers the rehypothecating party’s, usually a prime broker’s, costs of financing and some rehypothecating parties pass this cost saving collateral provider in terms of lower borrowing costs, therefore undercutting traditional lending channels. Rehypothecation
and re-use mechanics are also vital to ensuring collateral (to the extent it is a finite good) can be fluid and equally when mobilised move efficiently and thus contribute to liquidity

2.20 Collateral Assets that have been rehypothecated or had a right of re-use exercised in respect of them may, when used in subsequent transaction/collateral relationship chains come into the possession of countless third-parties/creditors. Each may have superior or competing claims the further the relationship is removed from the original collateral provider, who only will retain a contractual claim vis-à-vis the immediate counterparty that was the collateral taker and which, on insolvency or failure of the rehypothecating party would place the rehypotehcated/re-used assets in the estate of the failed/insolvent rehypothecating party and the collateral provider’s claims would likely be limited to the mutual debts due and exclude any overcollateralised amounts. Contrast this with the preferable situation, absent any other early mitigants, where the Collateral Assets are custodied in individually segregated accounts with a (tri-party) Custodian and the Collateral Assets as well as the collateralisation relationship is excluded from insolvency or regulatory recovery and resolution powers by the transacting parties having agreed the application of the EU-FCD and/or UK-FCARs and Irish-FCARs.

2.21 Aside from regulatory concerns around credit leverage as well as recognition that it exposes Collateral Assets otherwise securing transactions to specific risks, primarily to Rehypothecation Risk, a term that is proposed herein and (hopefully) assists prudent risk management and which can be summarised that the collateral provider will become exposed, whether through the initial or subsequent transaction chains, the collateral provider would suffer an unacceptable loss of the specific Collateral Assets that have been provided or an inability by the rehypothecating party to provide suitably sufficient equivalent Collateral Assets to the collateral provider.

2.22 Why do supervisors and regulatory policymakers care about rehypothecation and rights or re-use? Aside from the risks of excessive, unpermitted or detrimental use of these methods undermining the actual security arrangements that the Collateral Assets are supposed to be used for or the loss that could occur, there is a general perception that rehypothecation and/or rights of re-use, when employed, cause leverage. This concern on credit leverage creation comes in addition to gripes that these tools are shadow bank tactics, that effectively encourage a process in which dealer entities, usually regulated credit institutions as opposed to ‘shadow banks’ (regardless of there being no legal
definition just a loose agreement amongst global supervisors) are in the business of “robbing Peter, in order to pay Paul”.

2.23 The laws in the EU, the UK and Ireland, despite the LBIE insolvency, as they currently stand at the time hereof do not limit the amount that a collateral asset can be re-used or rehypothecated in multiple transaction chains. These rights may be easier to exercise under a TTCA as ownership of the Collateral Assets (including rights to and interests therein) actually changes. By contrast a SFCA requires if reuse/rehypothecation are explicitly permitted i.e., granted under the documented instrument of the mobilisation channel or other mutual agreement between collateral provider and collateral taker.

2.24 The fact that the Financial Times’ Alphaville Blog very publically on 15 January 2008 warned about the dangers of excessive rehypothecation, when traditional risk models focused on client as opposed prime-broker dealer failure and LBIE’s failure seven months later, on 15 September 2008, triggered the self-reinforcing cataclysmic market meltdown that has become known as the GFC catapulted concerns on resilience of collateral to the forefront of regulators and market participants. This also caused certain scrambles to unwind transactions, including where collateral had been rehypothecated and the very still pertinent question upon an adverse trigger occurring of “where is my collateral and how quickly can I get it?” Frustration for many turned to outrage when it became clear that in LBIE (as well as with countless other GFC failures of prime brokers and counterparties that had rehypothecated, many excessively, illegally and/or unknowingly without implicit or explicit consent of their clients or clients not having conducted sufficient due diligence. EU rules also began to focus on the risks and disclosure requirements in respect of:

(a) multiple chains of rehypothecation and ensuring that a party exercising rights is doing so prudently;

(b) trapped/lost assets; and

(c) bona fide purchaser in exercising rights over an asset that may have been rehypothecated i.e., Barry comes to buy the assets that were robbed from Peter to pay Paul – does Peter have a claim against Barry? Are the assets traceable – and
this is where a DLT-empowered “look-through” solution could add value. DLT solutions are however not free from risk as discussed in Parts II and III.

2.25 Applying the above to SFTs, parties have multiple roles, differing motivations and the elements of the transactions and post-trade processes are subject to multiple laws. As a simple example, one might consider a scenario in which:

(a) a repurchase transaction’s (repo) contractual relationship (including netting and set-off) and trading terms are governed by English law (say a GMRA plus prime brokerage and custody terms), entered into between:

(i) the German subsidiary of UK credit institution (Megabank AG); trading with a

(ii) French domiciled Alternative Investment Fund Manager (AIFM) managing a Luxembourg domiciled Alternative Investment Fund (AIF),

with settlement by (and on the assumption that the location (fictional or otherwise) is ascribed to the location of the relevant account in the place of the relevant person):

55 For a fuller discussion on issues arising from the use of financial collateral assets in securities financing transactions (repos and securities lending) and prime brokerage, including treatment of client assets and corresponding use under English law governed market standard documentation please refer to Chapter 18 of (Yeowart, 2016) (Yeowart and Parsons), which however does not consider the GMSLA Pledge Structure Documentation suite comprised of the GMSLA (Security Interest over Collateral – 2018 Version); the Security Agreement for GMSLA (Security Interest over Collateral – 2018 version); and any Tri-Party Custody Documentation. See also perspective from an economic and financial stability analysis, which however do not consider the legal and regulatory considerations discussed in the Working Paper, from the contribution from (Schaffner, December 2019) available via: https://www.bis.org/publ/qtrpdf/r_qt1912k.pdf

56 It is important to note that unlike ISDA, as gatekeeper of one of the leading documentation suites of OTC derivatives trading, ICMA for GMRA and ISLA for the GMSLA, have, at the time of writing, yet to produce a documentation suite that is subject to laws other than those of England & Wales. While parties might, at their own decision, may seek to take Brexit-driven precautions and move their dispute resolution venue to that in the EU-27, so as to avail of the continued mutual recognition of enforcement of judgments etc. provided for in the EU and its “judicial area”, the supervisory scrutiny aspect of not relying on English law governed documentation, as set-out by the ECB-SSM and the European Supervisory Authorities, in each of their “Supervisory Principles on Relocations” see selected works available here: https://www.dentons.com/en/issues-and-opportunities/eurozone-hub/eurozone-hub-thought-leadership-selection
(A) a Belgian based (international) central securities depository (an I(CSD) for example Euroclear SA/NV; and

(B) custody provided for example with the Irish operations of a UK based AIFM depository.

2.26 No single law governs all aspects of a cross-border financial markets transaction and corresponding collateral asset arrangement. The law that governs a particular aspect will depend upon the legal/regulatory question that arises and how that question is formulated. The answer is determined to a range of circumstances, as they exist to the relevant counterparties, assets and jurisdictions involved in a particular transaction exposure chain and any connecting factors.

2.27 As a result, in a fairly standard and simple transactional exposure of a repo:

(a) English law applies to transactional documentation and the counterparties obligations (including netting and set-off) and their enforceability;

(b) French law applies to one counterparty’s capacity (as well as to its potential insolvency) and is thus a consideration for Megabank AG, who in turn is itself subject to German law considerations which are equally of relevance to the

57 For a further discussion on some of the issues relating to CSDs, notably in relation to use of securities held in the UK and Ireland’s CREST System, operated by Euroclear UK and Ireland please refer to Chapter 16 Part H in Yeowart and Parsons.

58 It is important to note that, certainly in English law, and the landmark case of Cukurova Finance International Ltd. and Cukurova Holdings AS v Alfa Telecom Turkey Ltd [2009] UKPC 19, a mortgage created under English law over shares in a company incorporated in the British Virgin Islands was recognised as constituting a security financial collateral arrangement under the UK-FCARs, i.e., implementing the EU-FCD in the UK, and thus reinforces the attraction of that approach under English law that there is no rule that requires the governing law of a security agreement to be the same as the law that governs the proprietary aspects of the security created. However, complications arise in the EU-27 plus UK in that the proprietary aspects of a security over:

- Cash and credit claims will be governed by the law governing the debt claim constituting the cash or credit claim collateral (Art. 14(2) Rome I Regulation);
- Directly held financial instruments in the form of definitive securities in bearer form will be governed by their lex situs, determined by the reference to the location of the physical certificates;
- Directly held registered securities will be governed by the lex situ determined by reference to the location of the register; and
- Intermediated financial instruments are governed by the law of the jurisdiction where the account to which those securities are credited and maintained in accordance with the “Place of the Relevant Intermediary Approach” (PRIMA) set out in the EU-FCD.
AIFM’s evaluation of its counterparty exposure as well as on behalf of the Luxembourg governed AIF it manages;

(c) The UK’s interpretation of the EU-FCD and EU-SFD (as defined below) apply to Megabank AG and AIFM as counterparties to the repo over which a title transfer collateral arrangement is agreed to extend to. The UK’s interpretation of key aspects of the EU-FCD and EU-SFD go beyond EU common principles including with respect to rights of use and the legal consequences of its exercise including issues of priority;

(d) Belgian law is of relevance as it applies to the clearing settlement system;

(e) Irish law as it applies to the custody operations and safekeeping arrangements for the AIF are of relevance;

(f) English and German law apply to the custody arrangements offered by Megabank AG; and, lastly

(g) both parties would have to consider whether there are any risks that are adverse in relation to the financial instruments that have been repo’d either for other financial instruments or cash.

2.28 Importantly, the transaction chain relationships assessed above will also be based on a range of contractual documented relationships, many of which will not just apply to the specific repo but are applicable to, and thus interpreted also as applying to, future transactions. These contractual relationships may also be subject to differing (possibly inconsistent) documentation hierarchies, assuming these in turn have been agreed, between various market participants. As an example, a GMRA governing the repo may be agreed between the parties to be overridden by the terms of a prime brokerage agreement between the parties.

2.29 In addition to the above, one has to consider relevant conflicts of laws. This is an area that EU law however does regulate in a fully harmonised fashion as supplemented by
various proposals, including as late of 2018/2019\textsuperscript{59} as part of CMU 1.0, that relate to the a proposal for an EU Regulation on the law applicable to the third-party effects of assignment of claims (\textit{Assignment of Claims Disputes Regulation})\textsuperscript{60} which aims to “top-up” the fact that he EU’s Rome 1 Regulation\textsuperscript{61} does not cover the question of third-party effects of assignment of claims. Even though the Assignment of Claims Disputes Regulation goes in the right direction, the legislative process is yet to be finalised. Conflicts of laws is also an area where relevant courts are sufficiently versed and thus a full discussion is beyond the scope of this thesis. Absent a clear hierarchy of who has priority of claims in holding tiers, conflicts of laws may emerge unless conflicts of law rules are clear and/or harmonised as to who has the requisite interest in the financial instruments\textsuperscript{62} and this could impact Recoverability Rates as multiple parties across holding tiers may have competing claims to the same assets or interests in those same assets.

\textbf{2.30} Despite the EU legislative and regulatory framework providing workable conflicts of laws solutions, the enforcement of security interests, including the exercise of any contractual and/or statutory rights of netting and set-off\textsuperscript{63} can be complicated in enforcing the priority of which law applies when and to what - even if the commercial effect is often the same. Some of this down to participants not being familiar with the intricacies of other, what they consider “foreign”, jurisdictions and some of it is down to the absence of an EU-wide common approach on such matters.\textsuperscript{64}

\begin{thebibliography}{9}
\bibitem{} For a full(er) overview see also: \url{https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-markets/post-trade-services/securities-and-claims-ownership_en}
\bibitem{} Notably at 6-10 of Goode 4th ed.
\bibitem{} As a mitigant, parties typically agree any combination of security package and interests with respect to collateralisation incl. non-monetary credit support, indemnification, guarantees and/or ratings trigger language, which may be particularly more relevant where either contractual or statutory set-off (particular with respect to a counterparty in insolvency (or analogous proceedings) to protect and compensate the other party’s position if set-off cannot be applied.
\bibitem{} Even if some concepts of harmonising common minimum standards of civil procedure, might show that there is appetite do the same in relation to enforcement issues in financial market and collateral asset transactions, as discussed in the “Common Minimum Standards of Civil Procedures: European Added Value Assessment” published 28 November 2019 available here: \url{http://www.europarl.europa.eu/thinktank/de/document.html?reference=EPRS_STU(2019)642804}\
\end{thebibliography}
2.31 All of these considerations can apply in a relationship with immediate exposure between counterparties (primary relationship) such as between Megabank and the AIFM or in any multitude of exposures along a transaction chain, i.e., where Megabank’s use of collateral assets it receives in the above mentioned repo are on-used with other parties. The longer the length of intermediaries or transmission channels extend the more complex and potentially risky the exposure becomes as the movement of dematerialised financial instruments and cash in settlements and payment systems requires the debiting and crediting of accounts.

2.32 It is important to recall that dematerialised financial instruments means instead of providing the holder of the financial instrument with a (paper) certificate evidencing his holding, the holder and its rights are represented by an entry in a register maintained by the issuer or on the issuer’s behalf. The register is the reason these types of financial instruments are called “book entry securities”.

2.33 The majority of the legal and regulatory systems in which modern financial markets in the EU and North America operate are born out of transfer mechanics of financial instruments that were paper, bearer or certificate based, whether registered or unregistered. This also extends to when, how and where possession of such financial instruments takes place i.e. the lex situs as opposed to lex contractus has a role as do issues on attitudes to security interests i.e., possessory security interests versus non-possessory security interests. These attitudes and attributes have impacts on how transfer, perfection and other formalities (incl. re fungibility), holdings, substitution rights (and what that means for existing security interests) and enforcement of financial instruments as well as collateral takes place. This extends to the actual asset but equally to the accessory to the assets i.e., corporate actions but equally in relation to voting rights and most developed jurisdictions consider these to be covered by the original security, even if not so provided. A number of industry standard trading documentation will typically have specific terms in manufacturing corporate actions back to the collateral provider as well as details of how voting rights are to be directed. In building CMU and in particular the collateral transfer mechanics that underpin a dynamic and integrated CMU, merits thinking that disrupts traditional thinking on these points.

2.34 For (I)CSD and the various market participants’ and levels of accounts, this means multiple credits/debits across accounts and up/down through the levels, where
participants, in particular intermediaries, can be account holder and account provider depending on which perspective of a relevant counterparty the market participants’ role in the lifecycle is being viewed. (I)CSDs have a “double role” in that they provide issuers with services and those that hold financial instruments of the issuers. The fragmentation however occurs in relation to the services offered. In the UK for example an (I)CSD may typically hold part of the issuer’s register of securities holders (shareholder register). The difference is how the held/immobilised securities are treated/entrusted by/to the (I)CSD. Under a trust model, such as that of CREST in the UK used in respect of equity securities, an issuer entrusts issued securities to CREST, which does not own the securities, but which issues entitlements in respect of the securities (CREST Entitlements) which are credited/debited to accounts of CREST (i.e. CSD) participants. As the (I)CSD is not an account holder, but rather a depository that holds/keeps the securities, it is important to note that fragmentation exists across EU-MS as to how the financial instruments are held/immobilised by the (I)CSD. A discussion on those points is beyond the scope of this thesis. Consequently, this is something where any future harmonising legislative initiative as part of the Draft SLL Rollout or other deliverable of any CMU 2.0, might be able to deliver tangible harmonisation through key principles that (I)CSDs’ need to adopt in relation to the securities holding, rather than focussing on harmonising national insolvency laws and laws on security interests.

2.35 The discussion on (I)CSDs reinforces the argument for harmonising rules on consistent Segregation, as well as general Client Asset and Client Money protections, afforded by intermediaries to their counterparties through the various level between (I)CSD and the end investor. Intermediaries should offer the same level of segregation and client asset/client money protection when applying it through the ‘vertical exposure level’ of various holding levels as well as across transaction chains or borders i.e. through the ‘horizontal exposure level’.

2.36 Differences due to fragmentation of legal and regulatory systems including incorrect translation of concepts through either the vertical and/or horizontal exposure levels can cause propagation of risk and losses for clients as the protections are not applied in the

same way throughout. In summary, modern, integrated and dynamic markets ought not to be susceptible to such risks or exposed to such fault lines that could be prevented by consistency being catered for contractually but more importantly by common legislative and regulatory requirements being applied in the same uniform manner.

2.37 In view of the above, and comments from Bosomworth and other commentators, if CMU 2.0 is to make the Single Market more single then a greater degree of determination is required to displace national barriers and frame common EU-27 wide Jurisdiction-Agnostic principles. Public sector-led efforts by the EC and other EU-level supervisory authorities, using CMU 2.0 as a catalyst, could close and/or correct these gaps and bring this collateral ecosystem, as a key foundation of financial markets to a more single, integrated and holistic legal, regulatory and market infrastructure. Until then, the laws and regulations specific to individual EU jurisdictions, despite the areas that EU law does harmonise, will have the primary say over “who owns what” but more importantly “who can do what, how and when” with collateral, client assets and client money as well as specifically Segregation and rights of re-use.

2.38 These issues, amongst introduced above and discussed in the following sections, are important to financial market participants when structuring, transacting, booking, executing as well as Custodying both financial instrument trade and equally the collateral asset transactions that support those trades. As explored below the items above impact also Coll-RRand Cust-RR and do so across multiple levels of transaction chains in particular with a view to the EU losing the London market.

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66 Including the ECB’s Collateral Management Harmonisation Task Force (the ECB HTF), which explored some ideas of the topic, albeit in the context of the pan-EU system TARGET2 and TARGET2-Securities, in its 29 November 2017 dated “Report on Collateral Management Harmonisation”, which does not look at the legal/regulatory but rather instead focuses on the operational barriers and places, on page 7, much of the regulatory and legal reform hopes on CMU in stating: “Other barriers to post-trade arrangements of financial markets in Europe also play a role, such as legal/regulatory barriers, but they are expected to be mainly covered by other initiatives, in particular in the context of the Commission’s Capital Markets Union effort.” See: https://www.ecb.europa.eu/paym/initiatives/shared/docs/eaae-arni-seco-2017-12-07-item-1.3-collateral-management-harmonisation-report.pdf
2.39 Losing London

2.40 The transaction chains and the trading relationships that drive the Collateral Ecosystem have mostly been dominated in Europe by London-based entities (including those headquartered in the EU-27) using English law governed documentation with a range of counterparties and equally in relation to transactions between non-UK domiciled counterparties. While the changing relationship of the UK with the EU is unlikely to cause an immediate reduction in the prominence of the choice of English law governed documentation, it will over time and has caused certainly ISDA to prepare both an Irish and French law governed set of master agreement documentation. ICMA and ISLA have yet to follow suit.

2.41 With ESMA, along with its other ESA and the ECB in its central bank but equally SSM role having each communicated to the NCAs as well as market participants, their supervisory principles on relocations (SPoRs)\(^{67}\) and what this might mean for the use of English law governed agreements, action by market participants, is only sluggishly gaining traction. Affected firms and their counterparties are not as enthusiastic about moving away from English law and thus all the protections that might be offered by the UK’s rules despite being told in an unequivocally clear manner that they must do so. Absent corrective actions taken by either policymakers or market participants, the risks highlighted herein are likely to increase. As a further step, EU policymakers, even if they do, as proposed, borrow from British and Irish rules, are likely to, over time, aim to reduce EU-27 market participants having reliance on exposures (contractual, counterparty or otherwise) to the UK when undertaking trading activity with a nexus to the EU, as doing so would also serve to increase an already fragmented EU-27’s Collateral Ecosystem. These issues also drive some of the more recent political inertia blocking reforms in this area but also building up risk.

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\(^{67}\) For an overview of coverage on the SPoRs please refer to: https://www.dentons.com/en/issues-and-opportunities/eurozone-hub/eurozone-hub-thought-leadership-selection
2.42 **Too rigid to reform? Why size matters**

2.43 Put simply, the very concept of fragmentation is incompatible with the very nature of the European Union, notably the Economic and Monetary Union (the Eurozone) and it is costly. However, it is important to recall that European capital markets and respective collateral markets developed historically across national lines. Much of the EU’s legislative initiatives, whilst laying strong foundations, as well as in certain areas, strong pillars for cross-border business to flourish, integration or harmonisation has not entirely followed through or has not as pervasively as one might have hoped. Put simply, the legislative and regulatory actions to date have come a very long way yet they have failed to fully debunk the heterogeneous nature of European markets in the same transformative manner that shaped North American capital markets and against which the EU, notably in terms of CMU, benchmarks itself against. With much of intra-European borders opened up, is it tenable that some key impediments relating to collateral, legal systems and governmental policy are still anchored on a 19th century closed-country model?

2.44 While the EU’s Single Market and the Single Rulebook underpinning it remain a work in progress that started in the 1980s, the Collateral Ecosystem has been much an afterthought. So too are the intricacies of roles and relationships that shape, define and fluctuate to create that ecosystem, which for many has seemed to “too rigid to reform”. Part of this is due to regulatory inertia, but also by forbearance, Goldplating and/or grandfathering of national concepts and/or other means of preserving or differentiating competitive advantages of the jurisdiction or national champions. Part of it is also due to the sheer size of the Collateral Ecosystem, reliance on certain mobilisation channels and thus the risk that moves through them and their systemic importance generally but also various participants possibly being catalysts or risk propagators, and size matters as discussed in paragraphs 2.45 to 2.60.

2.45 This is particularly the case when looking at the size of mobilisation channels of Collateral Assets, predominantly using SFT transactions, in particular the two primary avenues: repo and securities lending that assist in Collateral Assets moving either subject to a transfer of full title (title transfer) or a transfer by way of a security interest. The reliance on these channels, there documented and non-documentation related arrangements, given the size of financial markets and the increased cross-border nature of transactions coupled with the shift away, certainly from an EU perspective, from the
London market and English law friendly dispute resolution venues, makes these issues sizable. Moreover, “repo rates” i.e., the implied rate at which the financial instrument is leant are overnight funding rates that drive a range of commercial decisions with certain markets having favourable rates including whether repo trades are General Collateral or special i.e., for specific instruments and the impact of failure to deliver penalties. And size, as explored in the next paragraphs on collateral asset mobilisation channels matters, particularly as obtaining available inventory of Collateral Assets, specifically those that are HQLA or otherwise “eligible” collateral assets.

2.46 Collateral eligibility will typically be described and documented between the market counterparties. It may also be set by FMIPs and/or central banks such as the ECB. With certain collateral being more in demand than others, this poses problems if it is a finite good as some commentators (including Singh) describe. However, market participants engage in and combine collateral asset generation activity (CAGA) to:

(a) access existing and new collateral mobilisation channels including post-GFC developments of so-called ‘collateral highways’ and access to liquidity pools and/or ‘collateral hubs’;

(b) manufacture Collateral Assets;

(c) source collateral from central banks – who in turn accept a greater range of eligible Collateral Assets including non-marketable assets such as credit claims;

(d) engage in CUT and other collateral transformation transactions;

(e) rehypothecate and engage in re-use of permitted assets,

and thus depending on the individual circumstances of a market participant (whether as collateral provider or collateral taker) the actions above are used to manage one’s own gross exposure to Collateral Assets and one’s Inventory of Net Collateral Assets (INCA).

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As the preface\(^{70}\) in *Singh* summarises the industry debate (which is continuing since the GFC)\(^{71}\):

“…is the quantum of eligible collateral in the system actually sufficient to meet the regulatory requirements, and is it even possible to quantify that amount? Industry calculations diverge widely. Public authorities have generally produced significantly lower calculations. A further area of debate is the extent to which collateral is “reused” in the system. This has given rise to misunderstanding in the market due to the loose use of terminology that should distinguish more clearly between collateral that has changed legal ownership under title transfer and that which has not.”

2.47 The size of markets and activity further reinforce the need for eliminating borders as more participants transact in Collateral Assets across borders but also given the very hidden known risks that during the GFC and since various “collateral squeezes” since 2015 have caused these vital mobilisation channels and SFT trades to stop working. This is problematic as participants are increasingly, as a result of EMIR, SFTR, CSDR and the MiFID II/MiFIR Regime are required to move to mandatory as well as Two-Way Collateralisation during global macro-economic pressures (low interest rates, Brexit, trade-tensions, emerging economy corrections etc.) and sector-specific pressures (asset-price corrections, volatility either from a glut or a run on safe-assets). These pressures have caused erratic behaviour in SFT markets, while overall and cross-border volumes continue to grow thus increasing the importance of Coll-RR.

2.48 More fundamentally, market participants have increasingly shifted to using non-cash Collateral Assets and are expanding the use of collateral upgrade transactions (CUTs). CUTs. Involve Party 1 entering into a SFT with Party 2 to transform/exchange lower quality collateral (i.e., lower-rated/less-liquid bond or an equity) into higher quality collateral (with a preference for HQLA, such as highly-rated government bonds) for use by Party 1 with Party 3, putting a pressure on individual Coll-RR exposures but equally

\(^{70}\) Written at the time by Patrick Pearson a leading EU policymaker at the EU level and then Acting Director of what was then the Financial Markets team at the EC.

\(^{71}\) See *Singh* page xi.
on transaction chains, especially as a change in asset quality (risk) and/or an unwind of Party 1+2’s transaction can impact Party 1+3’s transaction.

2.49 The International Capital Market Association’s (ICMA) European Repo Market Survey\textsuperscript{72} for the period ending 5 June 2019 demonstrates how large the repo market is and how important it is for collateral mobilisation. ICMA’s study surveys market participants (primarily financial groups)\textsuperscript{73} and calculated a “total repo business” figure, which for the latest period stood at a record EUR 7.8 trillion representing a 5.6% year-on-year increase. Of that activity, 48.1% were repo transactions and 51.9% were reverse repo transactions, demonstrating overall market preference of respondents to the survey for a net in-sourcing of financial instruments for their (or their clients’) inventories. ICMA concludes this trend may be explained by central bank-led monetary policy activity and relevant asset purchase programmes – which reduces the stock of available collateral and floods the market with cash. ICMA also states that this shift is due to supervisory policymakers having, since the GFC, reinforced mandatory collateralisation of SFT and derivative transactions – so that market participants in-source financial instruments, with a preference for HQLA and other “risk-free” assets such as high-rated government bonds, while investing cash given the overall negative interest rate environment.

2.50 The International Securities Lending Association’s (ISLA) 11\textsuperscript{th} Securities Lending Market Report\textsuperscript{74}, dated 30 June 2019, reported that global on-loan balances of euro 2.2 trillion. Institutional investors, as holders of financial investors may offer their holdings to borrowers via lending programmes arranged by intermediaries. This allows investors to monetise their holdings without divesting of them. In keeping with ICMA’s reported rising trend of in-sourcing financial instruments, ISLA’s survey of respondents reported a rise of euro 16.6 trillion to euro 19.6 trillion for the period of 31 December 2018 to 30 June in available instruments in lending programmes. Of that reported inventory, 43% of global on-loan securities balances related to government bond lending. ISLA concluded


\textsuperscript{73} In the case of the 5 June 2019 ICMA Survey this included results from 55 offices of 51 financial groups (less than the preceding survey in December 2018) that completed a questionnaire about their business in terms of currency, type of counterparty, contract and repo rate, the remaining term to maturity, the method of settlement and the origin of collateral. In addition, institutions were asked about securities lending and borrowing conducted on their repo desks.

\textsuperscript{74} See: https://www.isla.co.uk/assets/smart-pdfs/isla-securities-lending-market-report/index.html#p=1
that these changes stem from pressures relating to sourcing (stockpiling) of HQLA\(^{75}\) for participants’ own collateralisation purposes coupled with the commencement in 2020 of the post-GFC rules on uncleared margin requirements for derivatives transactions. Equally, ISLA reported a rise in non-cash non-cash collateral standing at euro 1.4 trillion of which equity securities collateral made up 43% of the reported total.

2.51 Meanwhile, ESMA estimated in its (at the time of comparison to the aforementioned reports) most recent and first statistical report on EU derivatives markets, published 18 October 2018\(^{76}\), that, summarising data reported to it pursuant to EMIR, at the end of 2017, trade repositories reported a total of 74 million open OTC and ETD transactions (this does not include SFTs) amounting to a gross notional amount outstanding of around euro 660 trillion.

2.52 All of these exposures are required to be collateralised with “acceptable” Collateral Assets. What is deemed acceptable has changed during and since the GFC. The same also applies to over-collateralisation, which puts more pressure on a short supply of Collateral Assets that are deemed eligible. As Yeowart & Parsons states\(^{77}\), that at the time thereof (explanations in square brackets):

“Our global supply of high-quality collateral [HQLA on a global level as opposed to all Collateral Assets in Europe (which would be less)] is estimated at around euro 41 trillion, out of which euro 31 trillion is available for use.”

\(^{75}\) See also discussion on page 19 of 11th Securities Lending Market Report and drivers of evolution of trading behaviour in respect of “preferential treatment with HQLA” (emphasis added in bold and clarifications in square brackets):

“The reasons behind this trend are now well understood, with banks often preferring to keep HQLA regulatory driven non-cash trades open over the reporting date, preferring to scale back equity positions. There is also a preference to return cash collateralised loans to avoid having to engage in reinvestment markets, at a point when liquidity and investment opportunities could be limited. Typically, borrowers want to maintain regulatory driven HQLA trades over the year-end, as part of an active balance sheet management strategy where the LCR [Liquidity Coverage Ratio] is the primary binding constraint. These trades are in turn often collateralised with other securities which are themselves balance sheet efficient if pledged as collateral as part of a term HQLA trade structure. As we have already noted, there was something of an anomaly in fixed income markets just prior to the half year that saw increased levels of borrowing of government bonds. As Fig 3 highlights, the market perhaps off the back of a sudden change of sentiment or trading opportunity, seemed equally prepared to use both types of collateral over the turn in this particular case.”


\(^{77}\) See Preface of Yeowart & Parsons.
Collateral eligible to meet the market infrastructure requirements of EMIR is estimated at euro 28 trillion. Collateral eligible to meet the requirements of CCPs is estimated at between euro 3 trillion and euro 14 trillion for CCP-cleared repos and euro 5 trillion and euro 28 trillion of initial margin for CCPs.⁷⁸

Even if these figures are likely to have grown since 2014, they still rely on Collateral Assets’ fluidity/velocity and thus mobilisation channels that are free from undue influences of Coll-RR and Cust-RR. It is thus worrisome, in particular given that the GFC put mandatory and two-way collateralisation as one of the key reforms, that policymakers have not focused on creating a more resilient and level playing field in this key foundation of financial markets.

2.53 In contrast to the figures above, LBIE filed for insolvency proceedings on 15 September 2008 with a 93% drop in its share price, USD 1 billion in available cash, USD 639 billion in assets and USD 619 billion in debt at what has become a watershed moment that would lead to the depths of the GFC, with USD trillions in market value, credit crunches and collateral squeezes and growth eradicated and a nearly 10 year fight by many market participants to recover collateral from counterparties or “trapped” in LBIE’s insolvency estate. That watershed moment also became the catalyst for post-GFC reforms, including cementing CCPs at the centre of the Collateral Ecosystem and policymakers and market participants cognisant that no prime broker or other financial institution is immune to failure let alone “too big to fail”.

2.54 As financial markets have become more complex and global, increasingly since the 1980s, the need for collateral, of sufficient quality, quantity and liquidity, i.e. readily realisable value has increased. Market participants may place a premium on HQLA and other types of Collateral Assets may be perceived to be more abundant, valuable or liquid, as follows. This perception is counterparty-specific but may be summarised as follows in that some collateral is more desirable than others:

Footnote 3 to this quote cross-refers to the ECB’s July 2014 publication “Collateral Eligibility” on pages 4 and 12 which state that “…the figure for collateral available for use is stated to take into account the fact that not all collateral is accessible to market participants as a certain portion is blocked on accounts with central securities depositaries or custodians held in non-actively managed portfolios.”
<table>
<thead>
<tr>
<th>Collateral Asset type</th>
<th>Cash</th>
<th>Cash-equivalent collateral, typically includes:</th>
<th>Highly-rated marketable assets(^{79})</th>
<th>Marketable assets</th>
<th>Non-marketable assets(^{80})</th>
<th>Non-acceptable Collateral Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Perceived degree of quality</strong></td>
<td></td>
<td>High – usually higher for G7 currencies or those that trade as FX majors</td>
<td>High</td>
<td>Medium to high</td>
<td>Depends</td>
<td>Low</td>
</tr>
<tr>
<td>degree of perceived quality</td>
<td></td>
<td></td>
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<td>pre-GFC was primarily driven by credit ratings, market liquidity and asset liquidity</td>
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<tr>
<td>-degree of perceived quality post-GFC adds considerations of regulatory charges associated with the collateral asset type</td>
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</tr>
<tr>
<td><strong>Perceived availability of quantity</strong></td>
<td></td>
<td>High – but also high in demand for other use</td>
<td>High – but may be difficult to transfer as readily as other more readily negotiable instruments</td>
<td>Low as in high demand</td>
<td>High but in demand</td>
<td>High to extensive</td>
</tr>
<tr>
<td>-degree of perceived quantity is driven by what is available on collateral providers balance sheet or what can be readily sourced</td>
<td></td>
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<tr>
<td>- degree of perceived quantity post-GFC adds considerations on what collateral asset is cheapest to deliver, can be readily manufactured and/or which has a higher re-use value. Collateral Assets have thus an innate “tradeable” factor</td>
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<tr>
<td><strong>Perceived liquidity in ordinary markets</strong></td>
<td></td>
<td>High – but may become constrained depending on market pressures</td>
<td>High – but may become constrained depending on market pressures</td>
<td>High – but may become constrained depending on market pressures</td>
<td>Low to medium</td>
<td>None to low</td>
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<td>degree of perceived liquidity is driven by typically the degree of market liquidity (ability to realise value) and ease of asset being subject to realisable value when marked-to-market</td>
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Figure 3 – Collateral Asset types and their perception

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\(^{79}\) The term “marketable assets” is used to describe mainly debt securities that are admitted to trading and are highly rated.

\(^{80}\) The term “non-marketable assets” is used to describe mainly a range of non-traded assets that can be used as collateral, including credit claims, fixed term deposits.
2.55 The figures in paragraphs 2.49 to 2.53 above demonstrate the sizable issues, even when limited to the European, rather than global operations of EU domiciled market participants. When the repo or sec-lending market slows or comes to a halt, as during the GFC and at times thereafter, then liquidity in assets and their fluidity suffers thus affecting HQLA and wider Collateral Assets, even when Haircutted/Overcollateralised.

2.56 This thesis distinguishes between **Financial Market Transactions**, which may be secured by Collateral Assets and which may evolve separately to the **Collateral Asset Transactions** themselves or due to the relevant assets performing differently. Market participants refer to that difference itself as ‘**collateral correlation risk**’81. A ‘no to low’ value of correlation means the Collateral Asset (and its value) is unaffected by the change in the transaction and the relevant specifics it secures. In contrast, adverse collateral correlation can contribute to ‘**wrong-way risk**’82 i.e., which is the risk arising from exposure to a counterparty or issuer when the collateral provided by that counterparty or issued by that issuer is highly correlated with its credit risk. In other words, there is an interest in the Collateral Asset Transaction being able to perform sufficiently, resiliently and independently of the financial market transaction and the relevant counterparties.

2.57 As evidenced dramatically in the GFC wrong-way risk can lead to general liquidity risks. As a result, and in order to be sure that the Collateral Assets’ value and the proceeds of sale/disposition are likely to be sufficient to satisfy the obligations, a (prudent) collateral taker ought to, in addition to monitoring the collateral provider’s financial health as well as exposures across various transaction chains (as discussed below) ensure that the value of the Collateral Assets provided exceeds or are sufficient to satisfy the obligations at the point of default and thus:

(a) Value the Collateral Assets and assess their CAF (see below) frequently;

(b) Impose a Haircut and/or Overcollateralise taking into account:

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The decline in fair market value of the Collateral Assets that may occur in the interval between the default of the collateral provider and the sale of the Collateral Assets;

(ii) The “market illiquidity discount that the collateral taker may incur, if the position to be sold is disproportionately large relative to normal market volumes;

(iii) Any negative correlation (i.e. “wrong-way” risk) between the value of the Collateral Assets and the value of the obligation.

2.58 To realise the economic and risk reducing benefits, collateral arrangements must be properly documented and executed. Briefly put, documentation used by collateral takers and providers but also by and with other Collateral Ecosystem stakeholders should (and most of the master agreement documentation provided by ISDA, ICMA and ISLA in their unamended form do):

(a) Determine what constitutes an event of default, what opportunities, if any, the collateral provider may have to remedy such a default during a grace period, and what procedures the collateral taker must employ in order to exercise its right to use the collateral to satisfy the obligor’s obligation;

(b) Demonstrate (or require confirmation) that the collateral provider mobilising Collateral Assets:

(i) Has title to those Collateral Assets;

(ii) Is entitled to mobilise those Collateral Assets free from encumbrances to the collateral taker in question;

(c) Demonstrate that the collateral taker accepting the Collateral Assets:

(i) Has the authority to accept such Collateral Assets from the collateral provider in question;

(ii) Has the ability to take title and sell the Collateral Assets, in the event an event of default arises;
(d) Demonstrate that the collateral mobilisation method (either by title transfer or security interest arrangement) is valid, including without limitations imposed by any hardening periods (if relevant), does not represent a fraudulent conveyance and is intended to avail of the protections offered by the EU’s Financial Collateral Directive (see below);

(e) Such documentation should take into account that:

(i) Some or all of the assets may be held in Custody by a third party or any chain of intermediaries;

(ii) The party to whom the collateral provider originally mobilised the Collateral Assets may have taken them by way of title transfer of absolute title or have otherwise re-hypothecated these Collateral Assets for use with a third party – thereby moving the Collateral Assets from the original transaction chain (and thus exposures) to additional chains and differing exposures which may not be readily identifiable to the original collateral provider;

(iii) The Collateral Assets may be in dematerialised form in a CSD and/or may have any chain of intermediaries; and

(iv) The Collateral Assets and/or counterparties to the collateral arrangements may be in two or more jurisdictions.

Market participants may seek, as collateral taker and as collateral provider to agree and then document the granting of security interests over the Collateral Assets as well as any rights to or interests in the Collateral Assets, or the entitlements thereto held in the CSD or the range of intermediaries in any multitude of documented relationships highlighted in the considerations set out in point (e). Regardless of any exercise of rehypothecation or any right of use highlighted in point (e)(ii), Collateral Assets can (and do) move through mobilisation and other channels to various parties thereby distorting existing but creating new relationships along any multitude of transaction chains (see below). The longer the chain, the more difficult it becomes to answer that question with absolute certainty of “where is my collateral and how quickly and how much of it can I get back?”
2.59 Collateral Asset Fluidity (CAF) also generally refers to optimising the management and application of Collateral Assets. This typically includes:

(a) balancing the collateral provided with the collateral received and managing the inventory that one receives favouring higher-grade collateral (including those with high collateral asset liquidity – see Para. 4.47) or those assets that are subject to corporate actions, possibly stockpiling these against future needs/risks and generally extends cheapest to deliver collateral to its counterparties;

(b) ensuring that:

(i) collateral transformation, including CUTs, are applied in a manner that identifies and mitigates risks relating to the original as well as transformed exposures;

(ii) available “collateral inventory” is not static, i.e., all inventory of Collateral Assets generate a return;

(iii) collateralisation levels provided are marked-to-market with sufficient frequency and that do not allocate over-collateralisation and that such excess (if permitted to subsist) is not susceptible to any additional unmitigated risk; and

(iv) account arrangements specific to where the collateral is provided as well as received, what client asset or client money protections are available, what the applicable Cust-RR are and how robust the transmission/mobilisation channels are.

For most sophisticated market participants, the above may already form the basis of an appropriate “collateral optimisation system”, which may be applied throughout the lifecycle of a transaction, however these may not be joined up across business units and jurisdictions, irrespective of whether they are automated or centrally tracked.

2.60 Viewed through the economic lens there is consensus that fluidity drives liquidity, which drives efficiency of markets and permits the access to a universe of Collateral Assets to meet market participants’ collateralisation needs. However, when derivatives markets
adds jitters and cross-defaults occur across asset classes, parties re-assess and close exposures to their respective counterparties, including CCPs and FMIPs. This leads to self-reinforcing downward-spiralling pressures on asset prices and an absence of desirable collateral. This causes firm- and system-wide risks leading to the “music stopping and everyone scrambling for a chair”. In the absence of a true focus on reforming the Collateral Ecosystem, there is no certainty there would be enough chairs the next time the music stops and that it its own right merits new thinking.
Addendum to Chapter 2

Annex 1 does not provide a legal analysis of the differences between taking and enforcing security interests pursuant to English law versus Irish law. While there is available literature on the individual specifics including on matters of insolvency law, there is very limited literature on a comparative law based approach.

The following table aims to summarise aspects as a matter of convenience for the reader in relation to the discussion herein in relation to security interests in respect of or over a portfolio of cash and/or financial instruments in the EU-FCD as transposed into the laws and regulatory regime of both the UK and Ireland:

<table>
<thead>
<tr>
<th></th>
<th>England &amp; Wales</th>
<th>Ireland</th>
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<tbody>
<tr>
<td>English and Irish law follow the approach of <em>lex loci</em> of the assets so that choice of law of the security interest will depend on where the asset is situated.</td>
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<tr>
<td>It should be noted that confusion may often arise in that the types of relevant security interests available in both jurisdictions (a) mortgage, (b) charge, (c) pledge, and (d) lien are often muddled or bundled by policymakers inasmuch as market participants to use the term “pledge” synonymously with the word “charge” and “charge” to cover all of the four types rather than using the terms in accordance with their legal terminology. An understanding of these items is necessary for discussion in relation to financial collateral arrangements laws.</td>
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<td>To recap:</td>
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**Mortgage** refers to the transfer of title to an asset by way of security for particular obligations, on the express or implied condition that it will be re-transferred when the secured obligations are discharged. A mortgage can be a legal mortgage or an equitable mortgage. A legal mortgage can only be taken over existing property. Therefore, if a security document purports to create a mortgage over future dividends or interest in respect of the mortgaged shares or debt securities, that interest will be equitable rather than legal. Mortgages are easy to enforce and the mortgagee (unless documented otherwise) will be entitled to receive all communications but also all dividends, distributions and other rights accruing in respect of those financial instruments.

A **legal mortgage** is created by the mortgagor transferring legal title to an asset to the mortgagee. The mortgagor will be prevented from dealing with that asset while it is subject to the mortgage unless the mortgagee agrees otherwise. It is possible to document and effect a legal mortgage over financial instruments (other than cash) in bearer and registered form. A party can create a legal mortgage over dematerialised shares or immobilised debt securities held in CREST by instructing the CREST system to transfer the relevant shares or debt securities to the CREST account of the mortgagee or, if the mortgagee does not have a CREST account, to the account of the mortgagee's nominee. The terms on which the mortgagee holds the shares or debt securities need to be agreed and documented separately. The CREST system is structured so that the mortgagor maintains a proprietary right to the shares or debt securities, so the mortgagee will be in exactly the same position that the mortgagor was in as owner of the shares or debt securities.

Although not expressly stated, the English Court of Appeal decision in *Enviroco Ltd v Farstad Supply A/S* [2009] EWCA Civ 1399 appears to apply equally with respect to legal mortgages over uncertificated shares. Mortgagors and mortgagees need to consider the
An equitable mortgage (will) arise where one of the following applies:

- The formalities to create a legal mortgage have not been completed.
- The interest being mortgaged is itself an equitable interest.
- The parties have just entered into an agreement to create a legal mortgage over an asset at some time in the future.

It is possible to document and effect a legal mortgage over financial instruments (other than cash) in bearer and registered form. The CREST system has a facility that allows holders of shares and debt securities in its system to give an equitable mortgage (or charge) over those assets. CrestCo's Guidance on this facility is beyond the scope of this paper.

Charge refers to an agreement in which an asset is appropriate for such period until the satisfaction of a liability or an obligation. A charge, in contrast to a mortgage does not transfer legal or equitable interest in the asset from the chargor in favour of the chargee. Instead, a charge creates an encumbrance in favour of the chargee. It is possible to document and effect a legal mortgage over financial instruments (other than cash) in bearer and registered form. Charges may be fixed or floating depending on the control exercised by the chargeholder over the charged assets. If the chargeholder does not have sufficient control over the asset, the charge will be floating and not fixed. English case law, which Ireland has not followed, has set out certain criteria as to what must be fulfilled for “sufficient control”.

Pledge refers to the actual or constructive delivery of possession of an asset by way of security. A pledge may confer a power of sale. Since a key feature of a pledge is that the creditor takes possession of the asset, a pledge can only be taken over assets which are transferable by delivery of possession. Bearer shares and debt securities can be transferred by delivery of the document of title representing those shares or debt securities, so it is possible to take a pledge over bearer shares and debt securities. However, possession of registered shares and debt securities cannot be transferred simply by delivery of the certificate representing those shares or debt securities, so it is not possible to take a pledge over registered shares and debt securities but it might be possible over an account.

Lien refers to the right to retain possession of an asset until discharge of an obligation owed by the owner of that asset. Liens can be created by contract but they may also arise by operation of law. In practice, a lender seeking to take security over shares or debt securities is very unlikely to do so by way of a lien. It is far more likely to do so by way of mortgage, charge or pledge.

<table>
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<tr>
<th>Main forms of security interests in respect of dematerialised financial instruments</th>
<th>Main forms of security interests include a legal mortgage or an equitable mortgage. An equitable mortgage is often more desirable as legal title is not transferred. Normally with an equitable mortgage, a share certificate and undated stock transfer form is provided to the beneficiary of the security interest.</th>
<th>Main forms of security interests include a legal mortgage or an equitable mortgage or pledge of bearer shares. Ancillary documentation should generally be sought in connection with any security over shares. This may include share transfer forms and the original share certificates.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Main forms of security interest in respect of bank accounts, receivables and contractual rights</td>
<td>Main forms of security interests are either a fixed charge or a floating charge. To be eligible as a fixed charge the security interest must establish control over the asset concerned whether present or future as long as the assets is identifiable and strict controls are in place as otherwise the</td>
<td>Main forms of security interests are either a fixed charge or a floating charge. Where a fixed charge or assignment has been created by a company, a section 1001 notice in relation to book debts should also be filed with the Revenue Commissioners, under section 1001(3) of the Taxes Consolidation Act 1997.</td>
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Security interest would be recharacterised as a floating charge.

| Simplified priority of claims in insolvency (or event with analogous effect) of domestic company. | 1. Holders of mortgages and fixed charges;  
2. The costs of the insolvency procedure (which require creditor or court approval before being paid) followed by preferential creditors (some employee claims a “Prescribed Part” payable to unsecured creditors (this is a maximum of £600,000 of the net floating charge realisations calculated on a sliding scale which must be set aside for the unsecured creditors);  
3. Floating chargeholders; and  
4. Unsecured creditors for the balance of their claims. | 1. Any claim under section 19(2) of the Social Welfare (Consolidation) Act 2005, that is any sum deducted by an employer from the remuneration of an employee in respect of an employment contribution due by the employer and unpaid by the employer does not form part of the assets of a limited company in a winding-up. A sum equal to that deducted must be paid into the Social Insurance Fund ahead of all preferential debts (super preferential claim);  
2. Remuneration, costs and expenses of an examiner that had been sanctioned by the court under section 554 of the Companies Act 2014;  
3. Secured creditors holding mortgages or fixed security rank in order of their registration;  
4. Expenses certified by an examiner under section 529 of the Companies Act 2014;  
5. Costs and expenses of winding up (including liquidator’s legal costs);  
6. Liquidator’s remuneration;  
7. Preferential creditors (such as rates and taxes, wages and salaries);  
8. Floating charges (which have not crystallised prior to the date of the winding up of the Company) rank in order of their registration;  
9. Unsecured creditors; and  
10. Deferred or subordinated creditors |

In the case of an Examinership, the main form of proceedings in Ireland, all claims in one category in respect of each ranking, receive full payment before any remaining proceeds are distributed to creditors in the following category. When proceeds are insufficient to meet claims of one category in full, payments for that category are prorated. It is possible for the secured creditors to agree among themselves the order of application of the proceeds of the enforcement of their security so far as their secured claims are concerned.

| Recognition of a concept of a security trustee and/or agent? | Yes | Yes |
3. **Old problems in need of new thinking and how we got to the current system**

3.1 The question of “**where is my collateral and how quickly and how much of it can I get back?**” rush to the forefront of strategic priorities of market participants when things go wrong. This question that is still relevant more than 10 years after the financial markets and the Collateral Ecosystem suffered seismic shocks during the GFC despite since undergoing reform.

3.2 In getting to this new thinking, policymakers need to be clear that the law and regulation are not free from imperfection. Some imperfections have identifiable causes that can be cured and some derive from how the current Collateral Ecosystem was created by market participants and others from the reforms themselves. This applies even to those reforms that stem from targeted but often-uncoordinated rulemaking and unintended measures prior to or after the GFC.

3.3 Regrettably, significant fault lines in the legal, regulatory and market aspects remain. These affect existing and new players. Some of these pre-date GFC reforms, and/or have been overlooked irrespective of whether they are “hardwired” into the pre-GFC or because of GFC-reforms. In respect of the latter, this may extend to include issues introduced by mandatory clearing\(^83\) arrangements and new risk transmission channels that follow directly or via a clearing member\(^84\) to a CCP, an area that itself is prone to its own new risk channels and the “64 trillion euro question” of what happens when a CCP fails. This is only now, at the time of writing, benefitting from earnest action to finalise the EU’s CCP Recovery and Resolution Proposal\(^85\). In any event these fault lines are (or ought to be) known to policymakers, so too are the risks of inaction.

3.4 Correspondingly, the issues are (at the very least ought to be) known. Some, such as the Giovannini Barriers, go back to the start of the Single Market. Others have come about due to the divergence between UK, Irish and EU rules on Client Assets and Client Money,

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\(^83\) The process of establishing positions, including the calculation of net obligations, and ensuring that financial instruments, cash, or both, are available to secure the exposures arising from those positions.

\(^84\) An undertaking that participates in a CCP and that is responsible for discharging the financial obligations arising from that participation.

whether as a result of the EU-FCD, EU-SFD, CDD 2017/595 and others come from the absence of harmonised laws on security interests and ownership of financial instruments, including issues on Segregation. If EU policymakers are to progress CMU, then they need to truly map these issues, including prevalence of CTR and its impact on Coll-RR and Cust-RR and assess how to swap GFC-style “firefighting” for what the Collateral Ecosystem ought to look like if it were built from the bottom up free from national jurisdictional-specifics.

3.5 This is an issue, especially the premise that “if collateral makes the financial world go round” policymakers need to ensure those channels, often termed “the plumbing of financial markets” can continue to allow collateral to flow. This is particularly the case when looking at those channels having seized up in the GFC and showing signs of similar behaviour during 2019. Moreover, this is despite the EU having implemented post-GFC “firefighting” reforms in the form of SFTR, CSDR, EMIR, AIFMD/R and the MIFID II/MiFIR Regime introduced in Chapter 9.

3.6 Turning back to previous proposals and identified issues, also requires taking stock of both the historical, often piecemeal, evolution of the economic and legislative environment leading to the current patchwork and the degree of legal fiction applicable to how parties interact and their relevant roles. This allows for a legislative and non-legislative priority list of what needs fixing, reinforcing or building and which silos need integrating or breaking as well as which “collateral highways” need widening to work for the collateral market, its users and actors, its transmission channels and storage arrangements. Once that exercise is established by regulators, FMIPs and the clients that interface into them, the EU can focus on the establishment and/or reinforcing of such routes, including true collateral highways can be rolled out, to stretch across all vital points of the Collateral Ecosystem, thereby helping to close unwarranted and unhelpful fragmentation.

86 A collateral highway is a generic market term (although it is also used by Euroclear in its commercial service offering) used to describe collateral mobilisation channels that seeks to offer straight-through processing between various elements and be able to exchange collateral in different places, as opposed to a single collateral hub, amongst participants and thus deconstruct technical and legal barriers to connect collateral givers and collateral takers (regardless of their or the asset jurisdiction(s)) in an automated/straight-through processing manner. For a (visual) presentation of Euroclear’s Collateral Highway please refer to: Autheman, M.-A., 2013. “Collateral and new offers for an optimised management: an industrial revolution.” Financial Stability Review, Banque de France, issue 17, pages 187-195, April. (Autheman 2013)
3.7 These post-GFC legislative reforms have also caused more market participants to become collateral providers and takers across a larger scope of transaction types.\footnote{See: Autheman 2013} They have also impacted new financial market infrastructure nodes such as central counterparties or the reinforced role of (I)CSDs. This change in the collateral landscape, and the need for harmonisation, also applies to banking business, the EBU and those credit institutions that are key intermediaries, liquidity and financing providers as well as safekeepers in the collateral market as well as those that are faced with collateral scarcity or imbalance from a regulatory perspective. It also applies more generally to central banks role as collateral takers and their interaction with market participants, financial market infrastructure providers and the effects on stimulus and collateral availability.\footnote{See also the contribution of Autehman, Marc-Antoine “Collateral and new offers for an optimised management: an industrial revolution” in the 2013 Banque de France’s Financial Stability Review No. 17 available at: https://www.banque-france.fr/fileadmin/user_upload/banque_de_france/publications/Revue_de_la_stabilite_financiere/2013/rsf-avril-2013/19-AUTHEMAN_Marc-Antoine.pdf (Autheman 2013)}

3.8 While much of the GFC reforms have addressed mobilisation channels of collateral more as an afterthought, the private-sector, in particular FMIPs have taken action, some individually and some in consortia and some even coordinated with the ECB. A lot of this has involved building new infrastructure, such as T2S but also improving operational standards – greater use of straight-through processing in collateral processes and more rapid mobilisation and settlement.

3.9 Regrettably, much of the EU’s rulemaking may not take full notice of some of the operational issues and interconnectedness that institutional systems and their respective private – but transnational rulebooks cater for. This also includes those led by the ECB. Failure to take account of those interconnections can, in itself, also increase fragmentation. In addition to legislative and regulatory rulemaking, some “voluntary”/“soft law” instruments will be needed.
3.10 **Debunking myths on the Draft SLD/Draft SLL**

3.11 The EU has used voluntary tools or best-practice operational standards to advance institutional as well as infrastructure reform. These are formally non-binding but (often) backed by supervisory expectations and/or a “comply or explain” requirement that (may) make these read like rules. The EU has also proposed using a “29th Regime” as a complementary measure to legislative instruments. Taking this approach can assist in some areas, some of which policymakers may consider “too big to (currently) reform”. The ECB’s work on T2S is a good example of institutional reform with a quasi-legal rulebook applicable to FMIPs and much of the Collateral Ecosystem. Similar efforts by (I)CSD service providers, such as Euroclear are also good examples of private-sector led reform, as are comparable used as “Model Codes” in the U.S. the UCC. The EU’s efforts on the SLD and the SLL are other examples and Part III proposes a Draft SLL Rollout that builds off what became a stalled workstream in 2011 and ultimately 2014 that never advanced beyond draft legislative principles to a possible EU Legislation on Legal Certainty of Securities Holdings and Dispositions a.k.a the Securities Law Directive (Draft SLD).

3.12 The principles to the Draft SLD were first flagged in a consultation paper 2010\(^{89}\) and which built off the recommendations of the first and second “Giovannini Reports” i.e. a workstream that dates back to before 2001 that identified the Giovannini Barriers and gave rise to the EU-FCD. The Draft SLD was revised in 2012 and 2013 and public and private proposals were made inter alia amending the original concepts of the Draft SLD into a more wholesome Securities Law Legislation (Draft SLL). While that legislative project stalled and at the time of its creation was not all encompassing it may not be futile if adapted and built upon including revisions to principles to reflect existing and forthcoming EU legislative and regulatory developments and market developments.

3.13 In many ways the EP’s Directorate General Economic and Monetary Affairs’ 2011 Report on cross-border issues of securities law: European efforts to support securities markets with a coherent legal framework (2011 EP Report)\(^{90}\) – should be read with the

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caveat that the report is now outdated and terminology used therein not compliant with a number of EU legislative instruments that have followed. It is important to take note that the EC/EP interchangeably refers in various coverage on harmonisation of securities law as to what the exact scope is. One school of thought voiced in the EP 2011 Report, and which is a sensible summary, is that:

“Securities law is a broad term used to describe all relevant laws in a given jurisdiction that govern the various legal aspects of securities. Depending on the context, these laws are typically property law, commercial law, the law governing security interests like pledges and charges, insolvency law, corporate law, and, in some countries, dedicated laws governing the Custody/safekeeping of securities. Regulatory rules can also belong to ‘securities law’, depending on the context.”

3.14 In this context one should note that “securities” ought to be considered to be extended conceptually to include all MiFID Financial Instruments and equally cash as it is intended to also apply to collateral transactions and if it is to interlink with settlement system legislation such as the CSDR, it should be noted that Art. 1(2) of CSDR is clear that it applies to the settlement of all financial instruments. It should be noted that Footnote 12 of the EP 2011 Report raises a valid point (albeit somewhat crudely/simplistic) that remains ever present even with MiFID II/MiFIR namely that:

“…each jurisdiction has its proper legal understanding of ‘security’. Where EU law is concerned, for example, the MiFID, defines the term, it does not harmonise the national definitions of what a security is but merely defines which type of financial asset falls within the scope of the directive or regulation. Even Derivatives might be exceptionally treated as securities under national law, though they are usually outside the securities definition.”

3.15 This misalignment of terminology at policymaker level causes a risk, unless mitigated in any revised setting of scope for an updated Draft SLD as part of CMU in increased CTR and stagnation. The same applies to the EC/EP’s disregard for differences in terminology amongst security interests subject to national laws i.e., using the term pledge without definition or the fact that a pledge under Irish law and English law differ (as they need to be viewed through the ‘respective national lens’ i.e. in the context of the national laws
creating/governing security interests) and the fact that the EU typically (incorrectly) refers to say a German law created and governed *Pfandrecht* as a pledge, without clarification that there is no equality to say an English or Irish law governed pledge.

3.16 Accordingly, the key findings from the 2011 EP Report still hold true:

(a) “The legal landscape of securities holding and disposition as well as of assisting investors in the exercise of their rights attached to their securities is fragmented. The international nature of securities transactions leads to situations where the law of more than one country can influence the legal situation of securities holding. This is a consequence of the fragmentation of the law and widely acknowledged conflict of-laws principles.”

(b) “The result of the public consultation on the prospected Securities Law Directive is positive on the need for action in this field.” Yet little has taken place (both within the private and public domain) since the Draft SLD was consulted on. In fact, the EC and the SLL Working Group published two non-public working papers overhauling the Draft SLD as well as public minutes. The legislative project i.e. Draft SLD/Draft SLL presently is little more than a collection of principles that are not finalised i.e. a “phantom directive/regulation”) has stalled since discussion and would need to first have the principles updated to meet current requirements and driven forward for political agreement. It is worrying that without revision and commitment this phantom legislation would fail to achieve its and policymakers’ intended goals yet some of its aims are core to some of the reforms the CMU project itself aspires to deliver. As noted on page 5 of Paech 11/2012:

“The term ‘Securities Law Directive – SLD’ became a household name even before the instrument was officially proposed. Over the past three years, however, there has been a growing tendency within the European institutions to embark—as far as its financial services are concerned—on legislative projects in the form of regulations, i.e., directly applicable law, rather than directives. Hence—and given that the Commission still seems to be looking at the fundamentals of the future securities law—it is now probably safer to refer to ‘securities legislation’ so as to leave the
The ultimate form of the future instrument open, whether it turn out to be a directive or a regulation.”

(c) “The existence of the legal uncertainty in this area is uncontested. However, Member States have an interest to defend their current domestic concept underlying securities holding and dispositions; therefore, the solutions envisaged deviate.” Without the EU being committed to delivering short-term actions, including a 29th Regime that may be more politically palatable as opposed to a legislative instrument, the Draft SLD/Draft SLL will not advance and closing the conceptual gap in this area, in a similar manner as the U.S. UCC achieved will mean fragmentation will continue.

3.17 One way that could actually serve to increase comparability, harmonisation and standardisation of security interests across national laws, would be to use neutral wording, in the case of a the non-legal use of the word pledge to instead use non-legal wording to establish a common definition Jurisdiction-Agnostic Definition such as:

“a possessor security interest in respect of an asset through the creation or delivery of the (actual or constructive) possession of an asset until the secured obligation is discharged.”

3.18 Voluntary regimes should complement mandatory rules

3.19 While such operational and “voluntary” regime-based approaches are good measures they cannot deliver results on their own without legislative/regulatory rulemaking, as the ECB HTF Report suggests given that:

(a) the commitments are voluntary undertakings of major financial infrastructure providers and do not permeate through the whole market nor is compliance with those commitments measured with de facto certainty; and

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(b) the focus, to move securities settlement, for T2S users, and cash settlement, for TARGET2 users, to standardisation of messaging based on the global ISO 20022\textsuperscript{92} standard\textsuperscript{93}, greater interoperability and straight-through processing as well as meeting those Collateral Management Harmonisation Activities\textsuperscript{8} that are identified as either “Priority 1” and “Priority 2” business processes does not close all gaps.

3.20 This realisation by EU policymakers ought to be crucial as the EU moves to CMU 2.0 as, while these operational workstreams are certainly welcome, they do not close the conceptual gaps and CTR that already exist within and as a result of the legal and regulatory environment in the EU. Equally, some of the harmonisation proposals are taking place in thematic areas which have not (currently) been fully covered by legal and/or regulatory requirements (see Endnote to the Thesis). EU policymakers may want to use a 29\textsuperscript{th} or voluntary regime as flanking as opposed to primary measures to receive those policy goals.

3.21 In addition to new thinking on rulemaking, policymakers ought to push market participants to focus, instead of trying to leapfrog the current Collateral Ecosystem using untested (legal, operational, regulatory and FinTech-specific risks) DLT systems, on developing common operational risk taxonomy (often confused – willingly – with the wider term “non-financial risk)\textsuperscript{94}, including with respect to Coll-RR and Cust-RR and, equally, use technology as an enabler to identify such risks as opposed to pushing untested systems as a panacea.

3.22 Other areas where a combined legislative rulemaking and supervisory expectation setting at the EU-level has usefully used legislative and non-legislative means has been the EU’s EBU, notably the ECB at the SSM’s helm. Launched in 2014, the EBU marks a (welcome) “Europeanisation” of financial services policymaking, rulemaking and supervision. Use of maximum harmonisation tools, including through ECB legislative

\textsuperscript{92} For further information, please see: \url{https://www.iso20022.org/}.

\textsuperscript{93} The secretariat responsible for ISO 20022, i.e., its administration is currently headquartered in the UK.

\textsuperscript{94} See efforts of the Swiss Based: Operational Riskdata eXchange Association (ORX) available: \url{https://managingrisktogether.orx.org/search?text=collateral&run-search=true} which has (worryingly) nothing on collateral – despite the majority of pre- and post-GFC operational risk failures and regulatory fines of highest impact (proprietary data sourced from Corlytics) being
instruments and non-binding guidelines that read like rules, have impacted across a range of areas, some of which are beyond the traditional understanding of the ECB-SSM’s mandate of lead prudential regulatory authority. Collateral quality and resilience of mobilisation channels in the EBU has however, despite the ECB’s central banking and monetary policy role as one of the largest collateral takers and liquidity providers, has been limited to its “Jurisdiction-Agnostic” rulebook “the General Documentation”. However, more fundamentally the ECB, acting at the head of the EBU’s SSM, has demonstrated that it can reduce fragmentation and do so in targeted, efficient and rapid means. Its own actions to eliminate national options and discretions by using a combination of its own rulemaking powers and non-binding Guidelines, which reads like rules and set supervisory expectations that addresses are required to follow on a comply and explain approach for BUSIs within its SSM- supervisory mandate, but addressed to SSM-NCAs, and thus the BUSIs within its supervisory mandate, was novel. It took the market by surprise but laid the path for the EC’s own action to reduce national options and discretions across a range of key areas in the banking sector’s prudential regulatory capital rules through the CRR II/CRD V reforms.

These successes demonstrate that this streamlining can be done, without much detriment and pushback from national stakeholders and lead to a much more unified market. Moreover, the ECB-SSM’s approach on reducing non-performing loans and exposures, through adopting a comply or explain approach to its “Guidelines”, while officially non-binding, makes these read like rules that BUSIs are required to follow – even where there is confusion on the use of the word “should”. This goes to demonstrate that similar approaches are possible to tackle fragmentation in the Collateral Ecosystem in particular given its sizeable importance.

Consequently, if, this time could be different, and if the supervisory and regulatory tone is (hopefully) changing due to the Europeanisation of financial services rulemaking and supervisory action this could encourage greater EU-institutional (such as ECB) led as opposed to legislative action. The ECB-SSM has itself become more confident in its role in the EBU, and market participants seeing benefits from a more Single Rulebook in the EBU-19 EU-MS as opposed to 19+ interpretations, is translating into approaches of other authorities with differing but sometimes overlapping mandates. The ECB has equally delivered on some of the key operational changes that led to TARGET2 and T2S breaking down some of the Giovannini Barriers (but not all EPTF Barriers) and thus achieving some of points 1, 2 and 3 that Bosomworth points to.

Another argument that market participants have put forward for the 2019-2024 legislative cycle is the rising force of digitalisation and FinTech. This however may be more of a misnomer as there are risks that lurk in rushing to technical solutions that may not have been fully tested let alone may not be compatible with the legacy technology and laws underpinning the Collateral Ecosystem. Part of that relates also to assessing how much use there actually is in DLT-enabled Collateral Asset use cases.

Since 2017, roughly the time when DLT (including virtual currencies) moved out of the shadows of financial markets and regulatory policymakers to take centre-stage, the concept of tokenisation, i.e., bringing assets on to DLT transaction platforms to assist in collateral transparency, liquidity and fluidity gathered pace. In relation to DLT, this thesis concludes that regardless of some solutions having tangible use-cases, notably those that are able to assist in tokenizing assets and thus creating mobilisation avenues of difficult to transfer assets, creates liquidity. This is welcome and the Daimler DLT-Schuldschein transaction is feted as a pathfinder. However, problems with DLT-represented assets not being recognised as “eligible” for protections in the EU-FCD, EU-SFD nor capable of netting and set-off or becoming subject to a security interest nor Custody, let alone not being treated uniformly across the EU, even where ESA-led EU-wide guidance exists, as a financial instrument is a barrier and drives fragmentation. Moreover, it raises the concept of FinTech-specific risks, in addition to heavy reliance on “legal fiction”. Despite

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See: https://www.lbbw.de/articlepage/experience-banking/pilot-project-blockchain-daimler-lbbw_661e61yw9_e.html
this, DLT’s lure has led to multiple competing projects (some of which have failed) aiming to facilitate DLT adoption in the Collateral Ecosystem.

3.28 All of this DLT-driven change ought to be viewed against the larger picture in that the EU’s fragmented Collateral Ecosystem is, at the time of writing, still (only) getting comfortable with the shift from dematerialisation of financial services in the early 1980’s to digitised financial services and electronified trading from 2007 to DLT-empowered trading from (roughly) 2017. DLT-solutions, will also struggle unless policymakers and market participants get serious about eradicating conceptual gaps, CTR and fragmentation in respect of the EU’s Collateral Ecosystem.

3.29 Chapters 1-3, having set the scene of the problems, introduced certain proposed solutions and risk metrics, as explored in detail in Part III and also demonstrates that even in the simplest of repo transactions, many competing issues arise that impact Coll-RR and Cust-RR, which is accentuated by CTR affecting market participants and the market more widely. Chapter 4 discusses the evolution of the market before turning to the questions of the current legal framework and then in Part II looking at grounds for standardisation and FinTech Related Risks before turning to Part III assessing other changes that might serve to make the Collateral Ecosystem more harmonised.
4. The evolution of the “modern” Collateral Ecosystem prior to the GFC

4.1 The following subsections provide an overview of the main roles in Irish and UK financial markets that are relevant to the post-trade processes liked to the Collateral Ecosystem and that support the “modern” i.e., post-dematerialisation-based financial markets. The discussion below also assesses how these roles contribute to known/unknown risks as well as those relevant. The following subsections also draw on reference texts putting the evolution of the legal and market specificities of the Collateral Ecosystem into further context. Surprisingly, for such a vital, often jumbled and certainly complex part of the financial market and the risks specific to these roles, there are only a handful of texts, notably Marek and Yeowart & Parsons\(^99\) (Relevant Texts) that dissect the complexity of relationships and the different roles played (concurrently) by market participants.

\(^{99}\) See Bibliography notably:

- Busch, Danny and Ferrari, Guido (eds) “Regulation of the EU Financial Markets: MiFID II and MiFIR” (Oxford University Press 2017).
- Turing, Dermot “Clearing and Settlement in Europe” (Bloomsbury Professional 2012).
4.2 To the author’s knowledge (at the time of publication), the qualification and quantification of risks arising in the Collateral Ecosystem due to CTR has not been addressed by market participants in their operational systems and risk controls, nor by commentators (economists, risk professionals or lawyers)) or regulators.

4.3 Moreover, academic and professional discussion, including in the Relevant Texts, whether before the GFC or to present does not specifically assess the nature of risks related to Collateral and Custody relationships/exposures or the impact on collateral takers or providers and what this may mean for Collateral Assets’ recovery/Recoverability Rates. These are items that are considered in greater depth in the following Chapters herein, but they build upon an understanding of the complex, multifaceted nature of the Collateral Ecosystem and market participants’ roles as markets have evolved.

4.4 A number of these roles have evolved over time, or were established in certain jurisdictions, with certain legal concepts introduced to facilitate the role such as EMIR’s introduction increasing CCP’s systemic role. Other roles have had to respond to regulatory and/or market-led changes, including reinventing themselves. Dealer entities and settlement relevant intermediaries (SRI) have had to deal with the technological transformation from open-outcry to dematerialised and now slowly digitised straight-through processing all the while having to react to regulatory reform such as MiFID II/MiFIR, SFTR, EMIR, CSDR etc. SRI is a generic term, often shortened (confusingly) to just “intermediary” and is intended to capture other commercial organisations, such as credit institutions, equally when acting in an agency role and as (global) Custodians, which in turn interact with FMIPs.

4.5 All of this change means equally dealing with new but also addressing hardwired risks. Yet, even after the most recent spark of crisis, the GFC, many market participants currently take the operation of the modern Collateral Ecosystem and financial markets for granted. To a lesser degree, such change has also sought to generally upgrade the collateral and transaction transmission channels of financial markets, by de-risking them and reinforcing the role FMIPs, including custodians/depositaries play in the Collateral Ecosystem. It has not, as discussed in Chapters 1-3, put the Collateral Ecosystem at the forefront of improvements. This is the case despite such reforms requiring the ecosystem to do more. It has not also necessarily promoted greater transparency in terms of clarity and oversight of risk exposures in the ecosystem which are necessary to deal with systemic and idiosyncratic risks, nor has anything been done by regulatory policymakers to increase robustness and resilience of documented relationships to those risks given pressures pushing deregulation.

4.6 Despite some successes in application of re-regulation, the regulatory agenda is taking place against a (currently still) fragmented EU Collateral Ecosystem, with disparate financial market integration and sophistication. It is also taking place during a period of national and intra-national tension with respect to the future and political commitment to further EU/Eurozone integration and reform. As a result, more profound and far-reaching work is necessary to avoid regulatory drift i.e., straying into areas outside a specific mandate of a rulemaking/supervisory body. Unless opposed, such a drift could undermine the necessary implementation and essential further reforms to improve comparability, standardisation, convergence and harmonisation across the EU Collateral Ecosystem and its financial markets generally.

4.7 Hindrances caused by, as set out in Part III, political unwillingness, domestic bias/protectionism as opposed to technical inability need to be overcome. This is a fact that has plagued historical integration of contemporary EU financial markets and collateral since the birth of the European project and the (so-called) Single Market. That too is a constant as the following sections explain and also part of the lingering problems,
including as some of what is describer overleaf remains at the forefront of those presently shaping regulatory policy in the EU\textsuperscript{100}.

4.8 \textbf{Piecemeal evolution of the patchwork}

4.9 Peter Norman’s enjoyable, easily accessible practitioner text “\textit{Plumbers and Visionaries: Securities Settlement and Europe’s Financial Market}”\textsuperscript{101}, written with a fair degree of wit, provides further background reading on market practice and its evolution\textsuperscript{102}, including the people\textsuperscript{103} that shaped it generally. Norman also provides the context necessary to understand the often colourful historical market infrastructure that has evolved piecemeal since the creation of ‘modern’ finance and Eurodollars\textsuperscript{104}, the birth of Euroclear and how that cemented a market infrastructure that has continued to evolve rapidly from paper-based to dematerialisation. The advent of increased digitisation generally or computerisation of market and collateral transactions specifically, in turn lead (and continues to lead) to increased innovation of financial services, transaction types and market infrastructure that sought (and continues to seek) to overcome operational and legal barriers. Which notably led to greater efficiencies for FMIs, their users and their clients. This change in turn contributes to not only greater liquidity generation in respect of financial instruments and cash transactions, but also allows greater efficiency of

\begin{tabular}{ll}
\textsuperscript{100} & While a discussion of the role of conscious and unconscious bias as well as groupthink and the "old white male effect" on risk perception is beyond the scope of this thesis, it ought to be recalled that much of those policymakers that led the EU in, through and out of the GFC, began their careers in financial markets during the birth of what is considered to be “modern financial markets” in the UK and Europe. \\
\textsuperscript{101} & Norman, Peter, “\textit{Plumbers and Visionaries: Securities Settlement and Europe’s Financial Market}”, 2007, John Wiley & Sons (referred to herein as \textit{Norman}) \\
\textsuperscript{102} & See Appendix B to \textit{Norman} for Key Dates for the Securities Settlement Industry in Europe from 1963 until 2008. \\
\textsuperscript{103} & See Appendix C to \textit{Norman} for a Who’s Who in the History of European Securities Settlement until 2007. \\
\textsuperscript{104} & Not to be confused with Eurobond. Eurodollar bonds refer to bonds or other forms of ‘vanilla’ debt securities issued in USD issued by a foreign undertaken outside the U.S. and possibly the issuer’s jurisdiction of incorporation. A Eurobond in market terms refers to a bond or other ‘vanilla’ debt securities issued in the currency of another jurisdiction of market in which it is issued. Eurodollar bonds and Eurobonds can be issued as corporate, sovereign or supranational bonds. The term, Eurobond as used in political terms since the GFC refers to the proposal for EU Member States of the euro area to issue sovereign debt in a joint issuance. The proposal received support from the Commission in a 2011 Green Paper on Stability Bonds as a method to alleviate persisting funding issues in the European sovereign debt crisis that spanned the period from 2010-2012. The official term Stability Bonds was quickly muddled by the market (and a number of lawyers) as “Eurobond”. Irrespective of the issues on terminology, no such Stability Bond has been issued to date.
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allocation and management of Collateral Asset inventory by market participants seeking to invest, or those seeking to monetise holdings in their inventory. In each of this situations, achieving critical mass and capitalising on economies of scale becomes more realisable.

4.10 The emergence of accepted methods of SFTs in the early 1990’s, strengthened by the publication of Master Agreements and standardised legal opinions, assisted in standardising repo documentation across previously fragmented markets and eliminated the need for extensive legal scrutiny of elements related to counterparty, contractual terms and jurisdiction. The advent of SFT, being collateralised was perceived as minimising counterparty risks. As discussed herein such further standardisation across a number of other markets, including collateral would assist in eliminating wastage of costs and thus increase efficiencies. As Norman notes on page 99: standardisation of market practice, systems and documentation allowed greater liquidity as well as fluidity. Cash from repo trading was reinvested and financial instruments reloaned.

4.11 The European experience in dematerialisation, digitisation and creation of rules, were self-reinforcing contributors to greater depth of liquidity and volumes transacted. They were however by and large predominantly market-led. Put simply, these developments were flanked (albeit with degrees of delay) with respective regulatory policymakers incorporating market practices/mitigants as formal rules. This process of transformation into rules, is a good example of operational changes spreading through to the wider market across asset classes and forming the basis of a regulatory framework as opposed to a regulatory/legal framework evolving from existing legal concepts, as may be the case in relation to certain concepts of ownership of financial instruments and types of security interests.

4.12 These market driven concepts, including the regulatory frameworks, are now very much established and fundamental building blocks of contemporary market infrastructure. As explored by Norman and as highlighted herein, different regulators have however taken common concepts in post-trade processes and implemented them, in part differently. Such implementation has and continues to occur with differing depths and widths of conceptual gaps, thus potentially causing fragmentation and CTR. Norman eloquently draws all of this historical evolution of market developments, regulatory influences and their evolution into a concise explanation of how the two dominant backbones of EU financial
and collateral markets and leading FMIP, Euroclear and Clearstream, came about and how their corporate cultural evolution and relevant individuals have shaped development of the Collateral Ecosystem or reacted to external pressures. Norman concludes with an optimistic description of future financial reform programmes of the EU. This conclusion, while written prior to the outburst of the GFC, remains very current in distinguishing items that had failed previously and the personal or political stories of why they did so.

4.13 Whilst *Norman* may be pre-GFC literature, the thinking expressed therein including the lessons of how certain parts of the Collateral Ecosystem, market practice and market participants came to be as well as the stories of what was never built, completed or harmonised, remain for very much current and relevant for contemporary market participants. It also forms essential contextual background for any participant wishing to have an understanding of why components of Coll-RR and/or Cust-RR, including national divergences and any possible mitigants are the way they are.

4.14 In addition to an overview of security interests under English and Irish law highlighted herein, readers may also wish to consult leading practitioner text *Goode 4th ed.* in relation to security interests and financial instruments. Whilst *Goode 4th ed.* is concerned with issues in English law security interests in the domestic perspective, it provides good background as to some of the core issues explored in the topics herein, both domestically and on a cross-border perspective.

4.15 The leading legal practitioner text, “*Clearing and Settlement in Europe*” provides the necessary legal and regulatory introduction to much of clearing and settlement practice with a UK focus. In many ways this inspirational and timely publication prompted the need for a more refined focus on collateral, its risks and risks to FMIP as expressed in the thinking herein, in particular in light of changes to markets since 2012. The propositions made in this publication aim to draw new light on considerations voiced by *Turing 2012*.

4.16 Taking a step back from the aforementioned literature, understanding “*who does what and when for whom and more importantly why?*”, is one of the key questions relevant

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106 Turing, Dermot “*Clearing and Settlement in Europe*”, 2012, Bloomsbury Professional (referred to herein as *Turing 2012*)
for assessing collateral relationships as well as risk exposures in increasingly standardised but equally sophisticated and interconnected markets. It is also an ancillary question that helps answer the fundamental issue that collateral providers and takers have when things go wrong namely: “where is my collateral and how much of it can I get back and how quickly?”

4.17 These two questions remain relevant in light of increased restructuring and consolidation of market participants and FMIPs more specifically. In the same spirit the who does, what question above is fundamental in assessing “how much risk does this exposure to this person create?” In other words, each exposure will have different degrees of mitigation of characteristics of Coll-RR and Cust-RR. It is also an important question for the more wider-reaching need in modern EU collateral and financial markets to have greater comparability, standardisation, convergence and ultimately harmonisation in a manner that overcomes or side-steps the continuing or residual fragmentation that exists as a result of evolution to date. To some extent, market participants following dominant FMIPs and adopting such an approach in their documentation, operational arrangements and post-trade processes would go hand in hand with the continuing, and recently reinvigorated regulatory end-goal of EU policymakers, which is and remains, especially due to CMU, a simple and shared objective, namely “…to make cross-border activity as easy, efficient and cheap for client’s as domestic activity already is in most European markets.”

4.18 Yet, whilst a number of the legal and operational barriers that became apparent in financial markets’ evolution since the 1960’s have been overcome, fragmentation remains either residual or continuing i.e. worsening at the technical/operational as well as the legal/regulatory level. Regulatory intent and objectives have at times met with confusion as well as national and multinational obstinate reaction from EU-MS and market participants operating therein. Consequently, a number of the differences in the EU legislative and regulatory framework removing said barriers and affecting the Collateral Ecosystem both pre- and post-GFC have either been lacking, stalled, non-existent or where they have advanced, they have failed to be completed or have had mixed success.

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107 whether as a result of economic pressures or out of regulatory necessity.
108 Quote from Pierre Francotte, Professor, as then CEO of Euroclear, in a Euroclear thought leadership publication “Taking Stock”, June 2005 and quoted by Norman on page 233.
The Giovannini Barriers are still stubbornly present. As Turing 2012 observes\textsuperscript{109} in respect of the legislative and regulatory initiatives and the effect of the GFC:

“And so the cacophony of national rules and practices identified by Prof. Giovannini is still, obstinately in place.

The financial crisis of 2008 has brought the spotlight to bear on central counterparties and clearing, and that crisis has also catalysed a revival of the European legislative effort. Some 20 years after the first comprehensive EU directives relating to financial services, harmonised legislation is coming into force on the essential post-trade services which underpin systemic and economic stability.”

4.19 Much of the legal principles that continue to regulate clearing, settlement and Custody were shaped in the 1960’s. The barriers that emerged as a result of increased cross-border trading in Europe and the transatlantic trade also manifested themselves in frequent settlement failures\textsuperscript{110}. Those failures, exacerbated by operational and legal barriers often developed into full-blown crises, notably the “paper crisis” of the late 1960’s. However such events, once resolved lead to not only advances in risk management theory, but to operational change. One crucial change, which is now a well-anchored mitigant and cornerstone of post-trade process, but that emerged out of this settlement crisis, is Delivery versus Payment (DvP\textsuperscript{111}). DvP is common practice or pre-requisite across a number of transactions as is the greater use of netting and set-off.

4.20 DvP and the greater fungibility of financial instruments, as well as the resulting operational solutions of dematerialisation or immobilisation of financial instruments contributed to the increased digitisation of financial markets and post-trade processes. The implementation of real time gross settlement (RTGS\textsuperscript{112}) and, in other markets, continuous net settlement (CNS\textsuperscript{113}) or continuous linked settlement (CLS\textsuperscript{114}) each
contributed to greater intraday settlement finality, which in turn led to the need for the EU-SFD and EU-FCD. Greater legal and operational certainty provided the springboard to generating the depth of liquidity that many market participants take for granted across jurisdictions, asset classes and transaction types. The same also applies to market but also policymakers’ misperception that set-off is a readily available tool and that it operates free from jurisdiction-specifics across the EU.

4.21 The concept of fungibility refers to the financial instrument or cash’s interchangeability with other assets or cash of the same type. Alternatively, as Goode 4th ed. sets out at 2-05, 6-09 and 6-10 in the context of identifiability of the subject matter in relation to attachment and perfection of security interests under English law, sets out that fungibles are two or more units that, in terms of the delivery or transfer obligation are legally interchangeable. Interchangeability is a necessity to ensure greater collateral fluidity and was a pre-requisite to establishing dematerialised markets. As Goode 4th ed. explains, the principle of fungibility in English law, long pre-dates laws on financial instruments but finds its root in English law security interests attaching over commodity produce and need to specify identification of a certain type, i.e., certain amount, quality and quantity of potatoes, or an ISIN or other identifier or contents of a specified account. At 6-09 and 6-10, the issue of identification and fungibility with respect to financial instruments explains that with dematerialisation and unnumbering of shares, i.e., making them more indistinguishable between each other in the same ISIN the more fungible they are.

4.22 Spotlight on set-off

4.23 Set-off follows on after the process of netting and is a key means of risk and/or loss reduction (operational i.e., Herstatt Risk and counterparty as well as credit risk) in financial contracts (including Collateral Asset arrangements) between domestic but more importantly cross-border domiciled counterparties. While set-off mechanics are present in the majority of financial contracts used in the EU, the respective laws of set-off were not developed with financial markets in mind but instead have their origins in commercial
mercantilist principles refined mostly during the 19th century and shaped by each EU-MS and thus with resulting divergences.

4.24 Absent an EU-wide definitive definition (and in view of jurisdiction-specifics), the market terminology used in the leading text by Johnston, Werlen and Link115 describes “set-off” “…as a right to reduce or fully discharge a monetary obligation owed by a debtor to a creditor against a claim owed to the debtor by the (same) creditor such that only the balance remains”. Set-off may be used as a self-help remedy or as a defence to a counterclaim.

4.25 Generally, set-off, unless amended in a permitted manner by contract, may only be applied in respect of claims between counterparties that evidence:

(a) **Mutuality of claims** – owed between same two parties, acting in the same capacity;

(b) **Matured claims** – mutual claims must have same maturity;

(c) **Same type of claim** – i.e., an obligation to pay money (presumption is same currency) may generally not be set-off against obligations to deliver goods/services;

(d) **Amount of claim must be determined** – i.e. set-off is not possible until claim is determined (including after netting) regardless of the point in time that set-off is to be exercised; and

(e) **Exclusion of certain obligations** – tax obligations, personal injury compensation claims etc. may be excluded.

4.26 Yet, what may be agreed contractually can only be exercised in accordance with the national laws that apply to the relevant counterparties. This applies to a simple set of contractual relationships between market participants using an ISDA or a GMRA (i.e. transaction-specific documentation) for one or more transactions governed under such

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115 See 1.04.
master agreements. It also applies however to any other general (trading) terms and conditions that govern the relationship between the parties.

4.27 Consequently, even if set-off is set out in a manner in a transaction-specific document (presumably, English law governed), parties need to consider the effect of the “other” terms, which may be subject to other governing laws than those of England. While generally best practice in documenting trading relationships, not all counterparties may have agreed a documentation hierarchy\footnote{116}, i.e., which documentation and which terms take precedence over each other. Agreeing a hierarchy assists in determining which mechanics apply when and under what law. In most instances, trading relationships are documented over time, with various differing documentation across asset-classes and transaction types and such hierarchy may not exist. Therefore, multiple laws of set-off may exist as a result of the documentation but also where the claims and counterparties are based. This merits counterparties carefully assessing the impact this has on Coll-RR exposure(s) to solvent and possibly insolvent parties across a multitude of transaction chains and relationship levels.

4.28 The rules of set-off against solvent parties generally follow applicable choice-of-law rules and in most EU-MS share common principles. Contractual set-off is generally, recognised, permitted and enforceable. Set-off by operation of law (statute and/or common law precedent) between solvent parties may also apply as a self-help remedy or defence to a counterclaim.

4.29 Set-off against insolvent parties, is comparably more complicated. Firstly, it is not dependent on the existence of a pre-insolvency right (or contract) and secondly, it is subject to the operation of insolvency laws of the jurisdiction of the insolvent counterparty. These insolvency laws have a number of jurisdiction-specific considerations. This applies even where most EU-MS insolvency laws include the application of automatic stays and look-back/clawback periods as well as respective national, and where applicable EU, insolvency law influenced requirements that affect obligations, whether unmatured and/or contingent or otherwise where different (i.e., non-mutual) obligations may be set-off.

\footnote{116}{See Para. 8.}
In more practical terms, set-off between insolvent parties may also, particularly where Collateral Assets are outside the counterparties relevant jurisdiction(s) may require the opening of ancillary/secondary proceeding(s) in the jurisdiction of where that asset is located. This may add a further jurisdiction to the mix.

Unsurprisingly, English and Irish law, despite common origins, evidence certain jurisdiction-specific divergences that affect the law of set-off between solvent and insolvent parties. For set-off against solvent parties English case law has established principles that, while persuasive in Ireland, are not binding. Moreover, statutory-led divergences exist such as Irish law not having a concept of third party rights in contracts. For set-off against insolvent parties other differences exist as a result of UK and Irish insolvency law themselves having developed differently, with Irish law having undergone a number of amendments in 2012. These differences exist, notwithstanding both EU-MS and their insolvency laws being subject to and complying with EU-level provisions of insolvency law, even if the EU does not have a uniform EU-wide “Insolvency Code” – an issue that has long been highlighted in the Giovannini Barriers and again as a (much) longer-term CMU priority and a full discussion on these issues would merit a thesis in its own right.

Notwithstanding the above, Art. 8 of the EU-FCD, as transposed in the UK- and Irish-FCARs\(^{117}\), provides a common EU-level measure that disappplies certain insolvency law provisions to “eligible financial collateral arrangements”. This removes relevant Collateral Assets, provided they are subject to a TTCA or SFCA, from application of insolvency law and thus protects the collateralisation arrangement and permits set-off to be applied. As evidenced by the LBIE and MF Global insolvencies, where Collateral Assets are rehypothecated and/or subject to a right of use, they may cease to benefit from being subject to a TTCA or SFCA and thus may lose the Art. 8 EU-FCD protections, and would, in the event of insolvency of the party exercising such right, become subject to the insolvency estate. This raises a number of questions of law but equally skews the

\(^{117}\) See also Ireland’s Netting of Financial Contracts Act 1995, which while the Irish-FCARs “update” the Act, as discussed in Annex 1, Act states that notwithstanding any provision of Irish law relating to bankruptcy, insolvency or receivership the provisions relating to netting, the set-off of money provided by way of security, the enforcement of a guarantee and the enforcement and realisation of collateral (thus Collateral Assets) and the set-off of proceeds therefrom, as contained within a (master) netting agreement or guarantee, provided it is legally enforceable against the counterparty and/or other person providing security. The issue is that this exclusion/protection only applies to those items that qualify as “financial contracts” (see Section 1 of the Act) and these do not equate to all types of what the MiFID II/MiFIR Regime terms “financial instruments”. The Act misses for example derivatives on futures or options along with contracts for differences as well as (derivatives on) emissions allowances.
Recoverability Rate calculations that aim to help solve the question of “where is my collateral and how much of it can I get back and when?”.

4.33 As evidenced in Annex 1, the divergences between EU-FCD (and EU-SFD) to that of the Irish-FCARs, but more importantly the UK-FCARs present a risk in their own right, even where the UK-FCAR’s Goldplating of what arrangements it covers, who is protected and what can be done with Collateral Assets goes beyond what EU-law originally designed and where the UK’s expanded rules are seen by many market participants as the gold standard and thus, as proposed, the EU ought to amend its own rules to bring them up to this standard.

4.34 The Draft SLL was supposed to harmonise some of the issues above and create a more homogenous EU-wide law on set-off. A Draft SLL Rollout, whether as a 29th Regime or binding Regulation ought to do that. This matters, in particular where divergences are greater between other EU-MS’ laws of set-off for solvent and insolvent parties than those of England and Ireland. Absent that action, these divergences are strongly “path dependent” and matter in the absence of an all-encompassing EU-wide law of set-off118, compared for example to the U.S.’ UCC applying across the constituent jurisdictions, means that counterparties’ exercise and enforceability of set-off against solvent and insolvent parties, includes obtaining comfort from legal counsel.

4.35 Some of this comfort is provided by “industry legal opinions” (ILO), notably the ISDA Opinions (see Bibliography). These provide counterparties with explanations on the legal treatment (of say and English law governed ISDA in Ireland for netting and collateral purposes) concerning the use of relevant pro formas of master agreement documentation covered by the relevant industry opinion.

4.36 Comfort does not however exclude the existence of conceptual gaps nor minimise CTR nor does such comfort typically extend to non-master agreement documentation i.e., ILOs would not extend to consider Megabank’s General Terms and Conditions (or other specific terms) that Bancogrande has agreed to and which therein state that these are super-ordinate and thus take precedence over ISDA documented relationships. This

118 Other than the impact of BRRD (II), as transposed into the UK and Ireland as well as relevant conflicts of law EU legislative instruments –notably Rome 1 Regulation – which sets out common EU-wide rules (excl. Denmark) that determine the applicable law., that are beyond the scope of discussion in this thesis.
means that even where an ILO provides comfort for an ISDA-documented trade and exercise of contractual set-off pursuant to that ISDA, it will not cover the right of set-off under the super-ordinate terms. The ILO will also not cover any terms on set-off, where it exists, in respect of relevant Custodian/Depositories – and thus Custody Related Risk.

4.37 The following Figure 4, which expands on work in Johnston, Werlen and Link\(^\text{119}\), presents an overview of some core differences between English and Irish law of set-off:

<table>
<thead>
<tr>
<th></th>
<th>England</th>
<th>Ireland</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>General Principles</strong></td>
<td>Where a person is able to set-off a claim owing to it against a claim of another, even where that other is insolvent, the claim is in substance “secured” (although this does not create a security interest) to the extent of the set-off and the claiming party need not prove for its claim nor wait for the representative of the other (including the insolvent estate) against it. Further, contractual set-off falls outside the provisions of the Companies Act 2006, as amended ss. 859A to 859Q requiring registration of charges created by companies registered or having a registered establishment in England &amp; Wales.</td>
<td>The need for specific agreement to apply set-off outside bankruptcy is required.(^\text{120}) With the introduction of the Companies Act 2014 (ss 599 and 600) and from 1 June 2015, security over cash or monies in an account with a financial institution does not require registration with the Companies Registration Office.</td>
</tr>
<tr>
<td><strong>Is non-insolvency set-off provided for by statute?</strong></td>
<td>No (other than in court proceedings), but contractual set-off is enforceable.</td>
<td>Yes, and mandatory where judgment is made for plaintiff in a claim and a defendant in a counterclaim.</td>
</tr>
<tr>
<td><strong>Banker’s Right of set-off</strong></td>
<td>Yes, English law recognises money held by an entity as a “bank” may exercise a right to combine accounts and set-off mutual claims owing between the bank and the customer in respect of debit and credit balances held with the bank (but not necessarily different branches). (^\text{121}) Libyan Arab Foreign Bank v Bankers Trust Company [1987] 2 FTLR 509, which also discusses the treatment of branches as separate to that of head-office, also discusses that such rights may also be afforded to the customer.</td>
<td>Yes but subject to specific agreement. Courts, will in principle, generally give effect to banker’s right of set-off save for special protections that may exist under Consumer Protection Codes and/or the European Communities (Unfair Terms in Consumer Contracts) Regulations 1995 and 200, the Consumer Credit Act 1995.</td>
</tr>
<tr>
<td><strong>Is set-off mandatory</strong></td>
<td>Yes, in accordance with Insolvency Rules (England &amp; Wales) 2016(^\text{122}) and, where applicable UK Banking Act 2009.</td>
<td>No, but set-off is freely permitted between mutual parties</td>
</tr>
</tbody>
</table>

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\(^{120}\) The Governor and Company of the Bank of Ireland v Martin and Martin [1937 IR 189 as well as Murphy J in Re Euro Travel Ltd, Dempsey v Bank of Ireland unreported 28 May 1984 p 9.

\(^{121}\) For a fuller discussion see Johnston, William, Werlen at page 179 to (incl.) 188.
Figure 4 – Comparative analysis of set-off in England and Ireland

4.38 As a result of the above, even jurisdictions with a common heritage do have some fundamental instances of CTR. This merits care when documenting but also exercising set-off with solvent and insolvent parties.

4.39 As described herein, that response, which continues to evolve, is in itself fragmented and not all encompassing in both breadth and depth. The tapestry of trade and post-trade rules and the stability it is supposed to provide makes more of a disjointed and erratic Jackson Pollock than any structured, balanced and harmonious landscape that has had a uniform brushstroke applied. Moreover, while DvP exists, this applies equally to fundamental risk mitigants such as the law of set-off across the EU, which despite the GFC and its impact on Collateral Assets and liquidity, which is explored in the next Chapter, remain fragmented along jurisdiction-specific lines.

4.40 1987 and the GFC - lessons learned for Collateral Ecosystem resilience?

4.41 The GFC’s fallout started in select corners of financial markets. It then spilled-over and transformed into self-reinforcing pressures that were difficult to contain. As these propagated they subsequently caused a general malaise. In some areas, the GFC’s impact killed markets and asset classes altogether, in others it transformed them. Stressed market conditions highlighted the need for more Collateral Assets and resilience of mobilisation
channels across all markets and the “real economy” — echoes of the 1987 crash were surpassed and that raises questions about whether lessons had been learned since then.

4.42 As Norman notes on page 79, the October 1987 market crash was a wake-up call for top policymakers and senior bankers on risks arising from post-trade arrangements for the first time. As the Bank of England’s 1993 Report from the “Task Force on Securities Settlement” set out “The events of 1987 moved settlement issues out of the back office and into the boardroom.” Whilst this crash took place after the passing of the Financial Services Act 1986 in the UK, which set out the then regulatory framework for financial transactions, plus a number of informal codes relating to collateral, it would be quite some time before the first steps at European harmonisation would begin. They have only been addressed, at a high-level in CDD 2017/593 as part of the MiFID II/MiFIR Regime.

4.43 Even if Norman predates the LBIE Insolvency, he makes the valid point that it is also worth recalling that the brushing off of this risk by IOSCO, which was only formed in 1984 and only received a permanent secretary in 1986, did not stop the Group of 30 chaired by the then former governor of the Bank of England, Gordon Richardson to identify and tackle deficiencies in settlement that had become apparent out of the 1987 crash and put forward the “G30 Recommendations”, which focused on “friction costs of cross-border clearance, settlement and custody. It also identified “pipeline liquidity risk” i.e., the likelihood that cross-border settlement was made more expensive and complex by a lack of coordination in processing cycles amongst CSDs and payments systems. Whilst non-binding, the recommendations helped shape both market practice and regulatory response since then and not just in a manner limited to making DvP de rigeur across transaction types and thus evidence of a voluntary regime perhaps achieving action where legislative rulemaking did not dare to tread. That being said, Norman points out, is that these global efforts failed to break through the national silos of the FMIP landscape and proffered that international comparability must grow out of the national landscape, a fact that has not taken route to date as prominently as some might hope for. The European efforts came through the World Exchange of Federations focussing on the cross-border

122 This view, despite taking aspects of systems theory, which along with contract theory, has some real application to the collateral ecosystem, fails to account for transmission channels spilling over or self-replicating themselves due to perception of fear or such fears actually manifesting themselves in a global financial system.

123 See page 93 Norman.
links between (I)CSDs and CSDs. Both of these responses pre-dated the Giovannini Barriers and workstreams that have largely stalled, save for T2S since then. Radical initiatives voiced by the G30 to create a global CSD or common shared processing have stalled in delivery, even though it assisted in advancing EU thinking, notably ultimately in shaping, but not breaking, the Giovannini Barriers.

4.44 Nearly 20 years later, as 2007 turned to 2008, the GFC’s full eruption of risk propagation tested the Collateral Ecosystem, notably by adversely affecting security arrangements, Custody arrangements and various types of Collateral Assets from functioning as intended or being correctly valued. This even applied to those collateral arrangements backed by cash and high-quality liquid financial instruments, such as government bonds, which were considered to be highly resilient to stress and thus quasi “risk free”¹²⁴. In short, the GFC did not spare the Collateral Ecosystem; rather it subjected it to selective as well as system-wide stresses and raising “shadow banking” questions. Singh describes this as:

“The market mechanisms in this area have given rise to a new area of attention, often pejoratively dubbed “shadow banking”. Often misunderstood, this system of intermediation provides important liquidity to the market and has a vital role to play. Of course, greater transparency[¹²⁵] is required as a minimum, of only to increase the understanding of the “shadow banking” sector and to identify any risks that it may harbour. The link between collateral used by “shadow banking” entities and monetary policy is another area that has seldom been explored in great depth.[¹²⁶] The repo market is directly affected by monetary policy measures and can have implications for the connection between regulated firms and activities of the “shadow banking” sector.”

4.45 The GFC’s systemic seizure rapidly accelerated, driving weary market participants to greater risk aversion in terms of new and existing business. In the EU, this slowdown

¹²⁴ A risk free asset has no legal definition, but is generally accepted in the market that the financial asset or collateral asset has limited risk susceptibility and/or high risk resilience that it is equivalent to the prevailing interest rate. G-8 Sovereign Bonds are typically considered to be risk-free assets.

¹²⁵ Measures such as a “look-through” concept and establishing proxies of risk exposure in transaction chains, as advocated herein, would be one step beyond the regulatory measures taken in 2016 in the form of SFTR which introduces regulatory reporting to Trade Repositories starting in January 2018.

¹²⁶ Until now! At least in a non-mathematical analytical sense.
began with a reluctance to engage in cross-border activity and rapidly accelerated, certainly after LBIE’s failure in September 2008, to even domestic markets and activity seizing-up. The resulting wide-scale retrenchment impacted a breadth of financial instruments, including perceived ‘safe haven’ assets in terms of their marketability and liquidity. What constitutes ‘liquidity’ is often debated by regulatory and supervisory policymakers as well as market participants.

4.46 This thesis prefers to expand the definition of “liquidity”, as summarised in Saguato 2015:

“…is a central concept for the study of financial market[s]. Scholars identify three main dimensions of liquidity (1) ‘market liquidity’ indicates the ability to trade a security quickly at a price close to its consensus value; (2) ‘funding liquidity’ refers to the access of sufficient cash reserves or the ability to obtain credit at acceptable terms; and (3) ‘monetary liquidity’ describes “broader monetary aggregates” as explored in 2014 by Thierry Foucault, Marco Pagano Alisa Röell in “Market Liquidity – Theory, Evidence and Policy.”

4.47 This thesis would also propose that a specific fourth dimension of liquidity exists, “collateral asset liquidity”. This is different to CAF (see Para. 2.56) and the market liquidity/fungibility of those Collateral Assets, rather it focuses on how the collateral asset can be mobilised along transaction chains and across relationship exposures (concepts defined below). Applying this to a hypothetical practical example, a government bond, mobilised as a collateral asset by way of a repo, using English law documentation and principles so that title transfers absolutely, is comparably more liquid for the collateral taker than if the collateral asset is mobilised by way of a security interest that does not transfer title absolutely. One reason for this is because a title transfer will, without limitation, permits the reuse of the collateral asset by the collateral taker as it takes absolute ownership with a contractual obligation to return the collateral asset or an agreed

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127 A term that has no precise legal meaning is used in the market to describe financial instrument, which may include those used as collateral assets that are expected in times of heightened risk/uncertainty to substantially retain (gain in) their value despite prevailing adverse conditions.

equivalent. The higher the degree of collateral asset liquidity, the higher the fluidity of the collateral asset and their collateral velocity.

4.48 The GFC’s lack of liquidity also put strain on the very availability and functioning of mobilisation channels in the Collateral Ecosystem. This adversely affected the functioning of core components of how money, financial instruments and other Collateral Assets move in payment systems, financial markets and the very liquidity of the Collateral Ecosystem. In particular in relation to the Collateral Ecosystem, the GFC inter alia caused:

(a) rapid closing-out of transactions in financial instruments and/or Collateral Assets;
(b) a general squeeze on collateral asset in terms of their availability, liquidity, mobility and pricing;
(c) loss of confidence and blockages to key mobilisation and funding channels of and for Collateral Assets, notably SFTs;
(d) increase in asset Haircut/Overcollateralisation requirements;
(e) pressure to either supplement, or in some instances, replace transactional relationships, including across transaction chains that were historically undertaken solely by TTCAs with SFCAs and/or separate credit support;
(f) pressure from market participants, regulators and central banks to accept ‘higher quality collateral’ despite central bank-led supporting measures to shore-up confidence;
(g) sudden or wide-spread ‘withdrawals’ from repo, SecLend and SFT exposures; and
(h) failure of a number of market participants as well changes to FMIPs and their processes.

4.49 A “withdrawal” in this context, is a market terminology term that refers to a financial services provider previously providing a given liquidity in an asset class in a set of transaction chains, and/or a service/product, and then ceasing to do so. Such withdrawals
occur when a party to relevant transactions whether as collateral taker or provider, asks for differing (often higher) Haircuts and/or refuses to enter into new or continue (rollover/refinance) existing transactions thereby removing financing and/or stock of Collateral Assets.

4.50 Upon a withdrawal, if there is no readily available replacement or alternative this leaves a void in either liquidity in the given asset class or the service. In the context of origination of collateral asset channels or more pressingly in the case of mobilisation channels in the collateral ecosystem, withdrawals not only pressure valuations in asset classes, cause pressures to find suitable collateral assets but, especially when withdrawing completely from asset classes, can bring the system to stress, sometimes even a halt, and may cause certain channels to dry up completely. In the case of distressed or depressed markets, a withdrawal from a relevant transaction can have knock-on effects.

4.51 As an example, in the case of a repo a withdrawal might prompt the collateral provider to need to ensure it has sufficient funding liquidity. This will be a priority in order for it to complete its obligations to return cash, and, in exchange, for the other party to perform is obligations to return the collateral asset or alternatively, the collateral provider with the repayment obligation, may elect, rather than sourcing the cash, that it will part with the Collateral Assets instead as settlement and discharge of its obligations. A withdrawal can cause blockages and stops in these arrangements. Equally, on the other side of this deal, a withdrawal may raise questions on the suitability or resilience of the collateral asset itself, both when taken and in terms of re-delivery. It may put pressure on other collateral relationships as well.

4.52 As introduced in Chapters 1 and 2, the GFC caused EU policymakers but equally those in individual jurisdictions to take individual actions. Whilst these different levels sought to coordinate with one another, full calibration i.e., harmonisation across all levels and jurisdictions to drive convergence, including by eliminating conceptual gaps and CTR, to move to a true “level playing field” remains a work in progress. That work is complicated by a number of EU-MS and Eurozone members often, as in prior to the GFC, failing to implement EU legislation fully or by the relevant timelines.

4.53 This is the case despite the 2009 G-20 Pittsburgh Commitments setting goals for each of the various levels of decision takers and policymakers to implement a progress review
and reporting period. From increased regulatory capital standards, to de-risking OTC derivatives, a range of the regulatory actions of the EU have differed (in various degrees) from their global peers, including notably the U.S.

4.54 Along the way, a number of items diverged between jurisdictions (primarily EU v USA). Thinking and priorities changed as set out in the Financial Markets Law Committee Discussion Paper: “Coordination in the Reform of International Financial Regulation: Addressing the Causes of Legal Uncertainty” published for comment in February 2015\(^{(2015\text{ FMLC Paper})}\) in particular that:

“Overlaps, inconsistencies and conflicts have emerged between respective national rules contributing at times to the impression that the regulatory and legal framework which supports the financial markets is beset of legal uncertainty.”

4.55 In other words, the legislative and regulatory rush to push the global reform project along, has possibly led to propagation of regulatory fatigue that contributed to CTR and thus legal uncertainty and a general weariness on suitability and ability to comply\(^{(130)}\). This is quite the contrary of what was supposed to happen or indeed would be prudent to happen. Examples of publically disclosed inconsistencies and the legal uncertainties to which they give rise are set out in the 2015 FMLC Paper’s annex. A lot of the work on finalising implementation may be nearing completion but as Part III points out, policymakers, now with CMU and the Collateral Ecosystem, need to overcome challenges that derail from delivering the actual reforms and thus harmonisation. This includes focusing and committing institutional resources to convergence, an area that each of the ESAs, ECB-SSM and members of the ESFS have on their work agenda and deliver with various degrees of success\(^{(131)}\) and which Part III assess whether a dedicated function in the EU Publications Office might be better placed to deliver that even if the aforementioned

\(^{(2015\text{ FMLC Paper})}\) See: \(\text{http://www.fmlc.org/uploads/2/6/5/8/26584807/fmlc_g20\_discussion\_paper.pdf}\)

And this consensus is shared by a number of financial services regulatory professionals that have, according to a range of estimates including that of the Financial Times on 5 December 2016 (see: \(\text{https://www.ft.com/content/788f3ad8-e886-11e6-961e-a1ac0976622d}\) benefitted, at least from U.S. retail banks surveyed, from ca. USD 200 billion in consultancy fees since the onset of the GFC.

institutions, notably the ESFS, which has undergone further reform to its founding legislative provisions, has “come of age”, with the ESAs being seen to be capable and pragmatic technocrats in discharging their rulemaking and supervisory powers in relation to their respective mandates.

4.56 Part of this lack of progress may be excused by the GFC’s economic problems still driving a firefighting mentality and ultimately Brexit driving political questions about the EU, its identity, goals, political integrity, the lack of full political union, fiscal union or at the very least a coordinated fiscal policy being tested, before driving the EU-27 to greater unity. Concerns remain on the competencies and abilities of various EU-MS and their national authorities to deal with fiscal and financial market issues, especially given that these, despite receiving greater powers, partly in response to the GFC and partly in response to the Europeanisation, have not received, aside from the SSM, much in the way of additional institutional resources allowing them to conduct comprehensive regulatory stocktakes to “level the playing field”. Nor have they, aside from regulatory data collection, quantitative driven stress-testing, the impact of current post-GFC reforms from a true qualitative manner, possibly considering that some reforms such as CCPs and interconnectedness, may hardwire risks, absent solutions that could contribute to the next financial crisis in CCPs and cause risk propagation through various channels.

4.57 Ironically, the fallout of the GFC was caused and driven by the too-big to fail institutions and Concentration Risk, and the post-GFC reforms, have largely driven market participants to concentrate more risk with these institutions and FMIPs, where the largest members and often shareholders are the same systemically important institutions thus increasing Concentration Risk and CEPCR. This is further complicated by a range of post-trade post-GFC FMIPs offering or reliant upon services offered by non-EU headquartered credit institutions acting as FMIPs (specifically Bank of New York Mellon and J.P Morgan) or Concentration Risks relating to EU headquartered FMIPs themselves including Euroclear and Clearstream – which often go un-fined in the event of regulatory breaches. If market participants and other stakeholders thought the GFC was costly, then risk failings in the Collateral Ecosystem, including as a result of the new and largely untested scenarios of resolving market infrastructure systems and/or systemically important FMIPs – specifically CCPs and CSDs would be ever so much more.
4.58 In addition, some of the GFC reforms that have tackled the Collateral Ecosystem, such as SFTR focus more on transparency and regulatory reporting rather than resilience. Surprisingly, as Saguato 2015 summarises, action on reforms to fix the Collateral Ecosystem’s structural vulnerabilities and externalities, specifically in relation to repo and SFT, have caused these transaction types to be labelled incorrectly as part of the “shadow banking” system. It should be noted that these transaction types and mobilisation channels are in fact the lifeblood of liquidity for both credit institutions and their clients they engage with in capital markets and banking business.

4.59 The possible explanation for this political label is that a number of policymakers have historically barely engaged with technical experts let alone explored or fully understood the specifics, principles and/or terminology used in the Collateral Ecosystem. Instead, given that these transactions are largely concluded and executed on an OTC basis, and prior to the GFC, were largely unreported and thus considered opaque. The pejorative term of “shadow banking” has attracted stigma from supervisors despite these items being so very crucial to the functioning of the markets including the parts of what would be the “transparent” part of the banking system. This has remained the case despite increased regulatory pressures from individual EU reforms:

(a) driving market participants to collateralise transactions and relationships that may previously not have been collateralised including centralising multilateral and bilateral exposures into central counterparties (CCPs) or trading venues i.e. execution venues;

(b) leading certain market participants to engage in CUT practices or extend collateral transaction chains to source higher quality collateral;

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132 See however original work and subsequent publications and policy decisions building off the Financial Stability Board paper “Strengthening Oversight and Regulation of Shadow Banking Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos” (published 29 August 2013) available from http://www.financialstabilityboard.org/publications/c_130829b.pdf or a somewhat earlier yet still exceptionally influential driver of policy thinking, including in the EU, despite its U.S. context on tri-party reforms and benefits available from the Federal Reserve Bank of New York’s “White Paper on Tri-Party Repurchase Agreement (Repo) Reform” (published 17 May 2010) both of which were considered and assisted in the protracted journey to a much-critiqued EC ‘Communication’ and ‘Green Paper’ on ‘shadow banking’ (available: http://ec.europa.eu/finance/general-policy/shadow-banking/index_en.htm ) leading ultimately to legislative proposals that would become the SFTR a piece of legislation that copies much of the principles that were developed for EMIR and applies them (with some would argue little consideration) for repos, SecLends and SFTs.
(c) pushing certain market participants to manufacture Collateral Assets and instruments specifically for collateral purposes;

(d) changing how SFTs, CCPs and other FMIPs are regulated and how market participants interact with each other and FMIPs; and

(e) central bank-led action to step-in and support confidence in the Collateral Ecosystem through new mobilisation channels (including expanding the range of eligible Collateral Assets) as well as the outright purchases of asset classes for both monetary policy transmission purposes but equally to encourage commercial market participants (by way of a trickle-down effect) to mobilise broader sets of Collateral Assets, notably credit claims. Nevertheless, mobilising credit claims as Collateral Assets remains a challenge and one that is of differing degrees across the EU and the Eurosystem.

4.60 However, despite all the progress in sophisticated financial markets to trade more volume, integration still is reliant on reforming principles affecting collateralisation techniques, transactions in and security interests in respect of accounts, cash, commodities and financial instruments notably the impact on post-trade processes discussed in Chapter 6 and which still cause issues that lead to the Giovannini Barriers and EPTF Barriers stubbornly being in place. This merits looking at the roughly 150 plus years of evolution of laws, regulations and supervisory engagement as well as expectation – which would be beyond the scope of this thesis. These in turn are based on, and driven by, legal principles and concepts as well as jurisprudence that have evolved in the

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In 2007, the Eurosystem began accepting credit claims as eligible collateral for its MonPol operations. This meant that a credit claim granted by a creditor (i.e. the loan originator) to the debtor could be mobilised, whether on a standalone or pooled basis, to provide security for a loan granted by the Eurosystem to the loan originator. Repayments from the underlying debtor flow through the loan originator. If the loan originator fails to comply with its repayment obligations to the Eurosystem, the Eurosystem, as security taker in respect of the mobilised collateral assets (i.e. the credit claim) could enforce on that loan. Changes to the EU-FCD in 2009 expanded the regime and insolvency safeguards to credit claims and thus make these attractive collateral assets. Both in terms of reduction of the legal obstacles as well as the operational issues including mobilisation/communication interfaces. As an example an Irish law credit claim might use an Irish law floating charge to mobilise the credit claim, thus not requiring any notification under Irish law to the debtor of the credit claim and use an e-filing process with the Central Bank of Ireland as collateral taker. A Greek law governed loan, for example, might use a Greek law pledge (enechiro) notification to the debtor and use a paper-based filing format with the National Bank of Greece. This divergence in mobilisation techniques, notification formalities (both issues of law of the Member States) as well as unharmonised systems in Eurosystem National Central Banks have historically posed a problem since non-marketable assets began to be mobilised.

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(current) EU-MS plus UK, independently of each and in keeping with various schools of legal thought – while Irish courts might look to British courts it may not do so actively. Equally, the absence of an EU Financial Markets court (see Part III) means a German, French, Italian etc. court or other dispute resolution venue might not look to others.  

4.61 This divergence and difference makes harmonisation potentially, if viewed through a perspective of limitations as opposed to opportunity, a difficult challenge, that post-GFC integration projects, including CMU will require decisive action as opposed to “just” consultation as was mostly the case in CMU 1.0 and which hopefully will not be the case for CMU 2.0. As discussed above, security interests, concepts of ownership and insolvency laws remain national-law driven and thus trapped within national boundaries. This hardwires conceptual gaps and CTR even where EU-level action seeks to harmonise. Paech 2015136, drawing similar conclusions as Bosomworth on preserving national-interests, an area the 2015 FMLC Paper also flags as in need of tackling, summarises causes, continuing challenges and constrictions in that (emphasis added in bold):

“…Courts and statutes over time have supported three subsequent developments in the mercantile practice, all of which aim at increased efficiency and liquidity: first, the concept of easy and safe transfer on the basis of negotiability or register entries; second, the centralisation of settlement through account structures involving multiple layers of intermediaries [, holding structures and legal interests therein] and, last, the globalisation of finance and capital flows, allowing for assets being traded and collateralised in much wider and deeper markets. However, the development of the law became heavily path dependent and idiosyncratic, as legislators in many countries tried to uphold the ideas of chattel-like rights even though there were no paper certificates any more.”

4.62 National barriers, fragmented markets, differing legal and operational systems and lack of support for on-going work to develop greater standardised documentation all restrict more efficient mobilisation of Collateral Assets. This failure to fix fragmentation in market and legislative elements allows conceptual gaps and CTR to add to barriers to

135 See also M.D. Huertas and K.A. Schaffelhuber in “Resolving English Law Financial Disputes Post-Brexit: Is Now the Time for the EU-27 to Create Its Own Specialist Financial Court?,” Journal of International Banking Law & Regulation.

building a true Single Market. Moreover, a major school of thought, both for policymakers, including those engaged with the resolution of the Giovannini Barriers as well as academics, including Paech 2015 and contemporaries, concentrate their focus on resolving barriers by looking to resolve clarity on conflicts of laws issues, which in itself has been cemented by this concern into a key challenge, as opposed to bypassing this as some FMIPS and market participants have done.

4.63 For transactions shaped by English law or laws based on common law, any concern with conflicts of laws are typically resolved pragmatically, including by contractual agreement or by looking through to the governing law chosen by the given FMIP. This pragmatic approach drives certainty. Looking at the substance of how transactions work as opposed to overtly resting on preserving various degrees of legal fiction that frustrates free movement of collateral, has contributed to ensuring that the majority of financial market participants, certainly those transacting across borders, use English law governed documentation for their Financial Market Transactions as well as their Collateral Asset arrangements. Similarly, operational and infrastructure improvements such as TARGET and T2S, have assisted, certainly in the Eurozone, to bring the constituent markets closer together as its operating rules provide consistency and certainty based on a relatively ‘Jurisdiction-Agnostic’ and pragmatic set of rules.

4.64 While the preceding paragraphs provide an overall demonstration of how the GFC impacted the Collateral Ecosystem, its mobilisation channels and some of the changes it is also important to understand, market participants’ roles and their bargaining power that shape arrangements in the Collateral Ecosystem. These issues are discussed in the next Chapters.
5. After the trade

5.1 This Chapter sets out an overview of the role(s) that market participants play in the Collateral Ecosystem and what this may mean for the identification, mitigation and management of the range of risks discussed herein. Where applicable, specific considerations that are relevant for financial counterparties and non-financial counterparties are distinguished. In addition, differences in terminology used in the legal and non-legal operational sense as well as issues relevant for quantification of CTR are addressed here. The risks discussed herein arise not only in the actual relationship/arrangements but in the documentation that aims to (accurately) capture, reflect and document the agreed relationship. As a result, having an understanding of the roles of market participants, how these roles have evolved and been shaped, and how the roles and relationships are documented is important in framing the risks that arise. This also means having an assessment of the provisions and gaps between the legal and regulatory framework in which these roles, relationships and the risks arise, exist and operate.

5.2 Historically the market has been dominated by prime brokerage businesses, which may have a Custody servicing offering that is provided by the prime broker itself or an affiliate of the prime broker entity. That business has been dominated by around 20 market participants (dealer entities and/or FMIP including custodians/depositaries) who operate on a global scale in USD trillions worth of business on a daily basis. Changes in the regulatory environment and market practice since the GFC, have changed the Collateral Ecosystem and what, where and how market participants undertake the breadth of activities in their business model or strategy.

5.3 These changes, even where risk and chains of bilateral exposures are being replaced with multilateral or centralised exposures, still merit a shift to a more sophisticated approach to traditional schools of risk identification, mitigation and management, but an appreciation of Coll-RR, Cust-RR and CTR as new elements of risk or, in the case of CTR as a subset to legal and documentation risk. Just as the Collateral Ecosystem and
market participants’ roles therein are changing, the methods and metrics used to identify, mitigate and manage relevant risks need to adapt and this is explored in Parts II and III.

5.4 Prudent risk management therefore merits having a clear overview not just on one’s own terms/exposure, but equally system-wide plus individual exposures to market participants and with whom one may have direct and/or indirect exposures. This also means assessing and estimating exposures in relationships between counterparties of one’s own counterparty and assessing whether an event occurring in that relationship might have an adverse impact on one’s own primary relationships and collateral exposures or ability to recover collateral and/or mitigate financial loss.

5.5 For all market participants, including collateral takers, collateral providers and collateral centres (FMIPs and non-FMIPs), this consideration is important not only at inception, but throughout the transaction lifecycle as well as across the value chain. This is also important, as the Collateral Assets that these market participants deal in will change hands, including change ownership or control multiple times. Equally, these changes occur in different forms. They also occur across and in various tiers of accounts that facilitate the transfer of ownership and payment. These changes are motivated in relation to, and/or in order to satisfy, the range of often very different needs and objectives of the respective market participants. These differing needs and objectives may also be influenced by, and reflected in contractual exposures, information asymmetry. These objectives, motivations, information asymmetries and bargaining power, including (if contract theory applies) in differing states of dynamic contracts, apply not only between market participants in their different roles vis-à-vis one another, but equally in respect of direct or indirect interaction/use of FMIPs.

5.6 Equally, as multifaceted as each of the market participants’ roles in the Collateral Ecosystem might be, it is important to not lose sight of the fact that respective business models might in some transactions/products be complementary to one another but that they could also be in competition with one another. This fact applies irrespective of asset class, transaction type or jurisdiction. These business models are not only drivers of motivations, but equally barriers or opportunities to documenting relationships, exposures
and arrangements (including with respect to collateral) in a manner that appropriately identifies, mitigates and manages risk.

5.7 The way relationships evolve is also influenced by the degree of information asymmetry at formation and during evolution of the relationship as well as more generally the legal and regulatory culture in which the relevant parties and stakeholders to a documented relationship operate in that relationship as well as across the other multifaceted roles they may perform. Documented relationships are likely to have different degrees of fluidity. Consequently, change across the different tiers of relationships may also be subject to a ripple effect. This means that a change in one agreement or market practice, including in unconnected relationships, can affect one’s own exposure.

5.8 The same can arise due to technological advances that change systems, operations and thus documented terms. As much as technology shapes relationships and trading/collateral arrangements and can assist in accurate capture and documentation management, people, their cultural bias, their preferences, and the framework, they and their business operate in shape the complexity of relationships and the documentation evidencing that. The deciding factor, and the question of how clear or how muddled, these documented and operational relationships are, as well as the degree of exposures and transactions created within that relationship framework, will also be shaped by how a particular relationship has evolved over time.

5.9 At a basic level, the majority transactions, whether they are spot or a derivative, whether traded on a Regulated Market or a non-regulated market or other execution venue, whether documented by a bilateral agreement, standard terms and conditions or a master agreement, they will all involve the following processes that occur after a transaction has been “traded”.

5.10 The following paragraphs describe those core processes. The relevant concepts are rooted in market terminology, some of which have been adopted or influenced by legal terminology. Some of this terminology finds its origin in the trading of physical instruments or mercantile trade with a legal principle of direct holdings and physical location accounts, have, irrespective of dematerialisation and book-entry i.e. the indirect holding of financial instruments and cash, only slowly become more of a pre-trade consideration.
Whilst there are of course common elements to EU post-trade processes, and these are partly shaped by FMIPs or EU regulation (where it exists), historically the plumbing of each EU-MS evolved differently in types of operational and legal issues. These processes are crucial to ensuring parties get paid and ownership or control over the relevant asset (financial instruments or cash) moves to where it is intended by the parties to move.

With “traded” one refers to the execution of a trade, i.e., the binding commercial agreement between counterparties has been concluded to exchange one or more financial instruments for value at a specific date. Once that trade is concluded, the post-trade processes that affect the transaction chain and the holding tiers over the course of the trade lifecycle begin.

A trade is only finalised once the post-trade processes that follow the exchange of a trade confirmation are completed and the trade is cleared and settled. The respective back and middle office of counterparties to that trade are involved in those post-trade processes, which in turn involve a number of FMIPs including CSDs and (I)CSDs as well as Custodians/Depositaries and SRIs. These typically occur in tandem to the generation, exchange and receipt of trade confirmations and its “booking”. Care should be drawn to differences in terminology and concepts or the incorrect use of terminology driving market practice used in relation to these post-trade processes. One example is the concept of where a transaction is ‘booked’.

The concept of booking a transaction was historically important as it also determined where a financial instrument was booked i.e., the office that executed the trade and where the financial instruments/collateral was located i.e., custodied or held with a Depository commonly referred to as the location accounts.

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137 Reliable, interoperable and safe payment systems are a sine qua non for the majority of economic interactions and for financial market transactions and collateral transactions much is built upon the context of no payment, no trade.

138 A trade confirmation is effectively a receipt of the commercial, and in some instances, additional legal terms applicable to a trade. In a number of transaction types as well as asset classes, specific rules apply in relation to the content and timely exchange of confirmations. These rules stem either out of efforts of industry associations or from regulatory policymakers or their amendments of the industry associations previous efforts. The impact of the timely trade confirmation obligation imposed by EMIR on derivatives documentation, including ISDA Master Agreements is a prime example of regulatory change requiring documentation change and gaps and CTR occurring between the two.
With a move to dematerialisation of trading and holding of financial instruments/collateral, the notion of booking or location accounts has become blurred. This has occurred in part due to tiering of accounts, but equally the breadth of where information technology might be based and whether EUR denominated financial instruments traded by a London office can actually be attributed to being held by a precise server of Euroclear that is physically located in Belgium.

Euroclear has sidestepped this issue, by making it clear in its Rulebooks that Belgian law applies to its EUR business and the accounts offered by it. This does not mean that other governing laws may apply to different tiers and chains of ownership/entitlement (see below), irrespective of the notion of where the transaction was booked at execution and the equivalent of a location account along the different tiers/chains of entitlement. The absence of a choice of applicable law, the booking and location of where an account is maintained may have a determining factor in establishing the applicable law to a given account and the financial instruments held therein.

In certain trading documentation, including ISDA documentation, the concept of booking is still reflected in the concept of Offices, Multibranch parties in Section 10 of the ISDA Master Agreement. For purposes, thereof counterparties may elect in the Schedule to the ISDA Master Agreement to add other Offices as parties that assume the same obligations as the head office entering into the agreement. The decision on which Offices apply or whether a party is a Multibranch Party in respect of Transactions sets out that it can enter into Transactions and make payments and deliveries to any respective listed Office. By way of a simple example, this has some follow on effects in relation to when and how contractual netting and set-off may be applied as well as any transfer mechanics in relation to events of default or termination events in the ISDA Master Agreement. One reason this concept still exists is to support the legal fiction of when what laws apply but also because the documentation suite predates the full electronic era of trading.

More generally, and for the sake of assessing Coll-RR, the legal fiction/concept of where transactions are booked may also have a determining factor on which applicable law is applied in certain insolvency proceedings (or proceedings of analogous effect) in respect of certain accounts and relevant holding chains.
6. **Holding chains and tiering**

6.1 Irrespective of some differences between how post-trade processes operate for direct held financial instruments and those of indirectly held financial instruments and cash, the processes have common features in relation to categorising types of financial instruments and post-trade processes and one can distinguish between:

(a) **Certificated financial instruments** circulated as:

(i) a **direct holding**: legal entitlement in financial instrument is recorded in, and derived from, registration in the issuer’s books and is evidenced by a certificate, and the respective securities are transferred by execution of a transfer instrument and registration of the transfer. A direct holding therefore has limits if any holding tiers exist;

(ii) **in bearer form**: legal entitlement vests in the holder of the certificate and is transferred by delivery, as the title is not recorded on the issuer’s register. A direct holding therefore has limits if any holding tiers exist even when bearer form securities are entrusted to a custodian/Depository;

(b) **Immobilised** and/or **dematerialised** financial instruments:

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139 As Goode 4th ed. notes in Footnote 4 of 6-02 a legal principle that is of relevance both for English and Irish law, as well as to the (I)CSD for the UK and Ireland. “Though registration is necessary to confer or transfer the legal title, it is only prima facie evidence of ownership, and a person with a superior right to the securities may apply to the court for an order directing that he be placed on the register in place of the existing registrant.” (Re Bahia and San Francisco Rly Co (1868) L.R. 3 QB 584.

140 To recap, immobilised securities refer to financial instruments, typically debt securities or equity securities in which a physical certificate has been placed in, historically, a vault or with a depositary, often from 1980 onwards such certificate taking the form of a global instrument that represents the entire amount of the issuance. This approach is taken so that subsequent transfers can be made by book-entry. Immobilised financial instruments are typically held in such a manner if the relevant settlement system, usually due to legal/regulatory requirements, requires that financial instruments are held this way. Financial instruments will take a dematerialised form when physical securities or documents of title representing ownership are eliminated and replaced by accounting records or book-entry.

141 In principle, as Goode 4th ed. describes in relation to CREST (now Euroclear UK & Ireland) and the Uncertificated Securities Regulations 2001 (see: http://www.legislation.gov.uk/uksi/2001/3755/contents/made), which is relevant for the operation of Euroclear in the UK and for Ireland is that a person that holds dematerialised/uncertificated securities may, to the extent not prohibited, present them for reconversion into certificated securities.
(i) **indirect holding**: rights in and to the relevant financial instruments are derived from credits to a respective account held with a nominee, custodian/Depository or settlement relevant intermediary (as defined below), with transfers made by book-entry. Indirect holdings, require holding through different tiers, each of which only extend privity \(^{143}\) between the tiers. As a result tiers (C) below has no privity to tier (A) but only to tier (B), irrespective of any duties imposed at law or regulation:

(A) **the first tier-intermediary**: whose nominee, usually a CSD or (I)CSD, holds the financial instrument direct from the issuer. An example might be a global note, which is immobilised with the CSD or (I)CSD and represents the entire issue of financial instrument held with the CSD/(I)CSD. In the UK and Ireland, dematerialised financial instruments may be held directly by an investor as a member of the CRESTCo, whilst a Recognised Clearing House despite providing clearing and settlement functions of a CSD;

(B) **the second-tier intermediary**: as participants of the CSD or (I)CSD and thus first-time beneficiaries of the global note, who will then either issue definitive certificates to the third and subsequent holding tiers granting a direct relationship with the issuer (either through delivery of bearer securities or more commonly, registration), which whilst negotiable are more commonly referenced in entitlements that are transferred by book-entry when cleared and settled; and

(C) **third and subsequent holding tiers**: who hold, or arrange holding of either definitive certificates or the more common entitlements with a custodian/Depository, which in turn may have further chains of holdings as described below.

\(^{143}\) Granting one party rights and interests to a direct exposure.
6.2 Tiering allows the issuer to deal with a limited number of counterparties, who hold accounts for a greater number of participants who in turn hold further accounts and so on. As Goode 4th ed. Notes at 6-10, the effect of tiering, indirect holdings and book-entry securities is:

“...substantially to reduce both the volume and the movement of paper involved in the issue and transfer of securities and holdings in undesignated pools of intangibles held by a securities intermediary in an omnibus account facilitates book-entry transfers of those securities from one customer of the intermediary to another, thus enabling a substantial volume of transfers to be effected in-house. A transfer need be executed and registered only if and when a customer exercised his right to require delivery or redelivery of the securities credited to his account.”

6.3 Tiering also should be considered in light of conflicts of laws where differences in degrees of account structures and segregation as this affects fungibility of assets as well as who has a claim against whom and when in the various holding tiers as well as across respective transaction chains. As a general rule as pointed out by Goode 4th ed. at 6-10, English and Irish law, as in most EU jurisdictions recognises that privity of contract exists only between the respective tiers as introduced above. However, absent a clear hierarchy of who has priority of claims in holding tiers, conflicts of laws can emerge unless conflicts of law rules are clear and/or harmonised as to who has the requisite interest in the financial instruments and this could impact Recoverability Rates as multiple parties across holding tiers may have competing claims to the same assets or interests in those same assets.

6.4 The post-GFC focus on asset Segregation also means that market participants need to ensure that the type of Segregation and levels of protection are the same throughout the

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144 Goode 4th ed. elaborates in relation to an omnibus account that “Where the transferee holds its account with a different intermediary, it is necessary to effect the transfer through the books of a higher-tier intermediary common to the intermediaries of transferor and transferee, if there is one, or if not, to go up the chain until a common intermediary is reached.” This is a consideration that is important when assessing how multiple transaction chains and complexity of holding tiers, may absent client asset or client money protections, affect a party’s Recoverability Rate in relation to a particular instrument. In financial instruments with sufficient liquidity and principles of fungibility, this is less of a problem.

145 Notably at 6-10 of Goode 4th ed.
holding tiers. If not, then Segregation offered at one tier may not be mapped through the entire holding chain. This has an impact on fungibility but equally on CAF. As a result, the resilience of Recoverability Rate in respect of Collateral Assets is impacted by the degree of fungibility of the financial instruments and/or cash and the level of Segregation of the relevant accounts.

6.5 Despite market-led initiatives of best-practice and increased use technology to assist with the execution, management and confirmation of trading and the post-trade processes, the necessary convergence and harmonisation has (regrettably) not occurred (as of yet). Alternatively, where it has occurred it may only be confined to certain asset classes and transaction types.

6.6 A large part of that depends not solely on the regulatory regime applicable in a respective jurisdiction, but due to the absence of the trading documentation or relationship documentation of market participants being upgraded to focus on these new realities. It also depends on the relevant systems being able to interoperate with another as well as documentation to naturally interlink and be harmonised across the breadth of relationships.

146 For a study of these issues in practice in relation to EMIR driven legislative/regulatory changes, what this means for operational practice of trading and relationship documentation, including ISDA documentation and susceptibility to CTR please refer to Huertas [2015] EMIR Handbuch
7. Core-post-trade processes

7.1 These processes can be summarised, in a non-legal manner as below and usually involve back-office systems of trade counterparties including brokers interfacing with FMIPs such as an (I)CSD, SSS and/or custodian/Depository. It is important to note that post-trade processes (inter)operate concurrently so that financial instruments moving in one direction usually have a cash or other financial instruments moving in the other direction. These post-trade processes, which are not subject to EU-wide rules or accepted voluntary standards (although the could be) include:

(a) **Verification**: the process of comparing and if necessary reconciling discrepancies in the transaction or settlement details. Verification is a pre-requisite to clearing and settlement;

(b) **Clearing**: the process of establishing settlement positions, possibly including the calculation of net positions and the process of checking that financial instruments, cash or both are available and establishing the respective obligations of each of the counterparties to the trade;

(c) **Settlement** (whether in central bank money or commercial bank money):

(i) of financial assets (other than cash or non-cash payment instrument) which the EC termed in simplistic fashion as “…the act of crediting

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147 Irrespective of EU policymakers having attempted to do this as early as Commission Service Working Document on Definitions of Post-Trading Activities, Working Document/MARKT/SLG/G2(2005)D15283 (the 2005 EC Report) and subsequent legislative initiatives since and probably a key necessity going forward in building a common functional market language (see below).

148 Clearing and settlement are often referred to in both technical language and legal/regulatory language by some as one process, whereas they are in fact two separate processes and FMIs and market participants engaged in those services are often referred to indiscriminately and interchangeably. Clearing is a pre-requisite to settlement.

149 A non-cash payment instrument is typically a means, irrespective of payment type or whether in durable medium (i.e. paper based) or electronic form, of authorising and submitting a payment (the authorisation from payer to its payment services provider or credit institution for funds to be transferred or the means by which the payee gives instructions to its payment services provider or credit institution for funds to be collected from the payer. It should be distinguished, using market as opposed to legal terminology that payment types, depending on the payer/payee relationship can be distinguished between wholesale payments and retail payments. Wholesale payments tend to be time-critical high-value payments that are settled between financial institutions and possibly during set settlement periods. Retail payments can include payments from NFCs and the rest of the market and are typically lower value. In its 2005 EC Report
and debiting the transferee’s and transferor’s accounts respectively with the aim of completing a transaction in securities.”;

(ii) of cash or non-cash payment instrument;

(d) **Reconciliation:**

(i) *between counterparties*;

(ii) *between respective counterparty and Custodian/Depository*;

(e) **Compression:** of trades (also referred to “tear-up”) usually this applies to derivatives transactions but can apply elsewhere and is a means to reduce, using netting and set-off, the number of outstanding contracts (and the corresponding notional amounts) but keep the same economic exposure between the parties. Compression may be conducted bilaterally between counterparties netting, setting-off and cancelling offsetting contracts in a portfolio (of exposures) or may be conducted multilaterally between an agreed group of counterparties with relevant multilateral exposures;

(f) **Asset servicing, corporate actions and/or event driven processing:** which includes the servicing and processing of operational procedures related to the financial instruments on an on-going basis or in relation to a periodic or event driven action in respect of additional payments or corporate actions (dividends/coupons/interest), exercise of options, conversion or process of maturity/expiry, voting, valuations, tax related items and the accurate maintenance of actual trading and collateral positions;

(g) **Post-trade remedial action:** which includes ensuring that counterparties that are delinquent with relevant orders\(^{151}\) agreed processes, such as settlement or delivery

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\(^{151}\) See *inter alia* Chapter III of Weiss, David “*After the Trade is Made: Processing Securities Transactions*”, 2nd edition, Penguin Group 2006 (*Weiss 2006*). Whilst now dated and more reflective of the Northern American market and infrastructure/practice of the time in relation to predominantly products on execution venues, *Weiss 2006* provides a very helpful insight into the most common forms orders for certain financial products traded on an execution venue. Transaction orders, once filled and executed will trigger the obligation to fulfil or deliver in relation to the collateral arrangement or security position.
failures or meeting maintenance calls for additional collateral (i.e. margin call) perform their obligations in a timely manner. Remedial action may include closing-out and netting other open positions, enforcing collateral held by the collateral taker or other forms of legal action;

(h) **Monetisation services**: which includes automatized or client directed securities financing transactions including repo or stock-lending of financial instruments for users. Typically an (I)CSD, whilst it may be permitted to within agreed guidelines, engage in securities financing transactions between users of such monetisation services, it would engage in such transactional activity in the open market for own purposes unless it is permitted. Such permitted transactions in offering financial instruments of consenting users to wider market participants is referred to in market terms as *Street Lending* and should be contrasted with broker to client margin financing. The purpose of *Street Lending* monetises Collateral Assets, increases collateral fluidity as well as nodes of liquidity and for the manager of *Street Lending* as well as the relevant user as lender, generates fees. Put otherwise, unchecked *Street Lending* may lower the actual Recoverability Rate for Collateral Assets specifically and may be unfavourable for Collateral Assets where a return of specific assets is necessary;

(i) **Margin financing**: which includes the provision of short term lending (margin loans) secured i.e. collateralised against the portfolio of assets. This may include any combination of collateralised loans, letters of credit and/or unsecured lending which, depending on the borrower’s risk profile may be used for the purposes of financing margin requirements. Typically this type of activity only takes place between the broker and its client counterparty;

(j) **Market and regulatory event driven and/or periodic reporting services**: various EU legislation requires that market participants, or where permitted, their brokers or counterparties, make market based trade reporting or regulatory reporting to various recipients either due to event driven circumstances or on a periodic basis. Whilst there is (regrettably) some remaining fragmentation between the scope and breadth of reporting required in relevant EU jurisdictions depending on transaction type, even after MiFID II/MiFIR tried to fix this, this reporting extends in circumstances (notably derivatives in scope of EMIR) to not only the
transaction traded, but the collateralisation arrangements, collateral asset values, rehypothecation/contractual right of reuse and netting arrangements. In the UK CASS 11 (See Annex 1) also imposes obligations on regulated firms providing prime brokerage services to report a number of items in respect of the use and location of their collateral to their client counterparty. This information, unless accounted for contractually, however does not apply to a counterparty or regulated firm that is not a provider of prime brokerage services. Consequently, if an AIFM, managing an AIF engages in a transaction with an IORP, the UK rules do not, and the Irish rules certainly do not, require similar information to be exchanged or reported unless this contractually catered for;

(k) **Accounting and recordkeeping**: which can be differentiated between on the one hand internal operational accounting related to the recording and treatment of transactions (including fail to delivers and/or breaks/illogical positions ), exposures and collateral operations, fees and commissions etc., for internal use as well as, to the extent applicable, for regulatory reporting purposes and on the other hand financial accounting relevant for the preparation of public financial statements and reports. Accounting in this sense, forms two purposes: control and presentation. Recordkeeping can equally be segmented in relation to internal recordkeeping, conducted either on an ad-hoc basis or in accordance with a policy or periodic requirement or regulatory driven recordkeeping. Recordkeeping obligations apply to generally all client files as well as all relevant material and information related or connected to a given transaction and/or collateral arrangement. The UK and Irish legislative and regulatory framework in relation to recordkeeping has specific rules that apply predominantly to regulated entities and to a lesser extent non-regulated entities; and

(l) **Ancillary services provided by brokers**: as described in para. 7.22.

7.2 **CCPs, clearing and settlement**

7.3 Whilst settlement and clearing, and respective FMIPs that perform/operate those functions, have long been established and have been necessary for the functioning of financial markets for as these have existed, the importance around the concept of clearing
has however evolved since the GFC and notably since the 2009 G-20 Pittsburgh
Commitments. As *Norman* sets out\(^\text{152}\) the EU uses the following terms, often, rather
confusingly, interchangeably:

(a) **Counterparty clearing**: the process by which a third-party interposes itself
directly or indirectly between the transaction counterparties in order to assume
their rights and obligations, thereby assuming the credit risk of the respective
transaction counterparties and possibly guaranteeing the payment obligations due
on the transaction; and

(b) **Central counterparty clearing** (i.e. CCP clearing): is distinguished from
counterparty clearing in that the CCP in CCP clearing also acts as the direct or
indirect buyer to every seller and the direct or indirect seller to every buyer
through novation of trades or analogous means,

Correspondingly Party A and Party B engaging in counterparty clearing using a clearing
house (CH1) will have their counterparty risk exposures taken on by CH1 but will still
have a bilateral relationship between Party A and Party B (and equally between their
corresponding custodians/depositaries). By contrast in CCP clearing CCP1 will be the
counterparty to Party A and equally the counterparty to Party B as well as the counterparty
to each of Party A and B’s respective Custodian/Depository.

7.4 Counterparty clearing, and more importantly CCP clearing have existed in certain asset
classes and have been used by certain market participants prior to the GFC. Nevertheless,
as a result of the GFC and the 2009 G-20 Pittsburgh Commitments they have become a
centrepiece for EU regulatory policymakers as a save all to unwinding a web of
multilateral risk exposures in multiple transactions and replacing these with mutualising
risk in bilateral exposures of each counterparty to the CCP. Aside from the CCP
concentrated with system-wide risk, initial transaction chains and holding tiers are
compressed in that risk node, without any greater transparency of the mobilisation and
transaction channels emanating or feeding into that risk node – See para. 3.3.

\(^{152}\) *Norman* page 10.
Moving markets to and letting CCP take centre stage reinforces that clearing and settlement are the backbone of the plumbing of financial markets. As Norman describes, this area of the financial markets is the least glamorous in that they sit in the post-trade part of the transaction value chain, ensuring the transmission channels (the pipes) allow the relevant financial instruments, cash and other assets to travel through those pipes and reach the storage tanks of the respective account holders. Clearing and settlement is the process whereby the transfer of assets from seller to buyer and/or between collateral provider to collateral taker takes place as well as the process that ensures payment flows occur between the respective parties. These processes are facilitated by providers of settlement services that include a CSD and/or a (I)CSD, SSS and payment systems and any relevant settlement relevant intermediaries. When counterparties to a trade transact in a financial instrument that is cleared and settled, say the purchase of an equity security, the counterparties may interact with settlement relevant intermediaries, who in turn interact with the execution venue and the (I)CSD. As explored below, even a simple transaction can have multiple touchpoints with differing legal and regulatory systems throughout the transaction value chain including the roles exercised by the (I)CSD.

A CSD performs the key role in modern settlement infrastructure by moving financial instruments from one party to another, without the need, as for centuries of mercantile trade, for movement of physical securities to move between the parties. Since CSDs evolved along national lines, in the confines of respective national law, they perform different functions in different legal systems. In some, they act as public notaries due to the requirements in certain legal systems that account holders’ identity in the relevant electronic systems are the definitive record of title in that respective financial instrument. CSDs carry out a number of differing services relevant across the transaction value chain. Whilst EU harmonisation on rules applicable to CSDs, their conduct of business and capital requirements in the CSDR, are a relatively new development that followed the GFC, fragmentation on the rules, operation procedures and account models exist across a number of FMIPs generally and CSDs and (I)CSDs specifically. This makes comparability of services and thus competitive factors more difficult for users to assess, irrespective of the dominance of a number of operational functions by a handful of service providers. This absence of comparability however does not mean that competition is not present, in fact it is fierce amongst FMIPs generally and (I)CSDs specifically.
7.7 The fragmentation of post-trade service providers in the EU, owes much to the neglect that it has historically received from EU policymakers in their attempts to create a Single Market. These service providers have historically operated with a domestic bias and most post-trade tasks of clearing and settlement operate efficiently and with lower cost within national borders. Much of cost in post-trade services still lies with clearing and settlement\textsuperscript{153}. In order to service the nascent Eurodollar market that emerged in the economic boom of the 1960’s, U.S. credit institutions\textsuperscript{154} set up (I)CSDs with credit institution licences to service this stateless market and facilitate cross-border trading, clearing and settlement. Euroclear and Clearstream then divided the Eurodollar markets by jurisdiction, thus fostering integration respectively, the role of these dominant (I)CSDs also expanded its product range to become the cornerstones of post-trade operations across EU financial markets and collateralisation arrangements.

7.8 Whilst the rise of Euroclear and Clearstream has served to integrate certain markets due to the respective business needs of the (I)CSDs and its user-owners, this has occurred in the domain of the technical working around the legal/regulatory fragmentation, which was not eliminated by virtue of rise of these (I)CSDs. As the preparatory engagement to the work that culminated to the Giovannini Barriers noted specifically found\textsuperscript{155} describing the root of a problem common to mobilisation of collateral inasmuch as it also applies to transactions in financial instruments more broadly:

\textit{“Clearing and settlement are at the core of any financial system, inefficiencies in these processes have serious consequences. When clearing and settlement are too costly, or complex, financial transactions are discouraged. In the context of the}

\textsuperscript{153}As Turing 2012 correctly sets out on page vii, the issue of costs and its components as well as possible solutions deserves a more thorough and coherent study than it has received in legal literature.

\textsuperscript{154}As explored in further detail in below, the core of U.S. rules in respect of collateral, FMIP and provision of margin had long been harmonised since legislation that arose in the aftermath of the Great Depression and the U.S. Securities and Exchange Act of 1934. Much of these rules, the culture and the ethos of market practice or as a very stark contrast thereto directly shaped the evolution of modern EU financial markets.

\textsuperscript{155}Giovannini Group: ‘Second report on EU clearing and settlement arrangements’, Brussels, April 2003. Notably, Mr. Giovannini, as Norman reminds readers at the time of his publication in 2007, and sadly absent further EU reform at the time hereof, including full delivery of the goals of Banking Union and CMU, the “EU financial market cannot be considered an integrated entity but remains a juxtaposition of domestic markets.”
EU, the result is that national market have remained isolated: resources are not pooled efficiently, the allocation of economic resources across time and space is sub-optimal, the techniques that allow the trading of risk are too expensive and financial asset prices fail to convey all information that is available to market participants.”

7.9 As Norman succinctly summarises domestic bias and thus by extension continuing fragmentation, the aforementioned general barriers and the more specific Giovannini Barriers remain susceptible to persisting domestic bias where:

“...vested interests at all levels of the securities business, increase the cost of clearing and settling of securities across Europe’s internal political borders to several times the cost of a domestic trade. The EU’s fragmentation of financial infrastructure amounts to a significant impediment to the creation of a competitive continent-wide capital market for Europe.”

And as Giovannini notes in the foreword to Turing 2012:

“In recent years the structure of effecting financial market transactions, often referred to as the financial markets infrastructure, has become an area of growing interest for practitioners, policy makers and researchers. Such interest has stemmed from the structural changes in global finance – greater volumes of cross-border transactions, as well as the creation of integrated financial areas like the Eurozone.

Such is the importance of financial markets infrastructure that the latest (failed) attempt by the European Commission to deeply reform the system to make it more efficient, given the freedom to trade, the presence of a single currency and the development of a uniform set of rules, has arguably been blocked by political opposition fearing [that] such reform would have created a large and very competitive financial system in the continent of Europe.”

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156 Norman page 6.

157 Turing 2012 page v, which was published close to the Draft SLD workstream stalling.
7.10 In the EU, only two major champions have succeeded in, absent regulatory action, to draw the strands of fragmented post-trade services, notably in securities settlement together across national European borders, regulations and historical traditions. And these two FMIPs continue to dominate in the EU, namely, Euroclear and Clearstream. Their origin and as a result their historical origins, evolving ethos and culture could, however, not be more different. So too in relation to each of these behemoth’s supporters, split between competitors to each other and the buy side and sell side split. This split, may have eroded in modern financial institutions maintaining membership across multiple FMIPs, and certainly as a globally active provider, membership of Clearstream and Euroclear is paramount (so too is the cooperation between the two as well as links with other FMIP and (I)CSDs) in servicing one’s clients’ interests as well as operating as a market maker, custodian/Depository and asset manager.

Which Norman describes as follows (explanations in square brackets and background/conclusions, as provided):

- At page 37: “Euroclear was created to deal with the practical problem of a market [the Eurodollar bond market] in crisis and sought answers in efficiency, and gradually in automation. Cedel [the forerunner to Clearstream] was the answer to a second order problem of European banks not wishing to see a new financial activity monopolised by a US institution.”

- At page 38 quoting Stanislas Yassukovich, CBE, who amongst a number of chairmanships and directorships was Chairman of Merrill Lynch in EMEA and Deputy Chairman of the London Stock Exchange in the UK’s big bang of deregulation in the City of London and the general boom years of 1986 to 1989: “It’s philosophical, it’s cultural. It’s based on the respective histories of financial intermediation in the two different worlds. It’s based on different legal systems, between common law and prescribed Napoleonic systems…” As well as the general anti-American sentiment of the time. In many ways, this split in the legal/regulatory language of contemporary policymakers in the post-GFC responses is still present, if not now more deeply entrenched than during the late 1960’s.

- At page 38: “Whatever the reasons, continental banks were drawn to Cedel. Banks from France, Germany, Italy, Luxembourg and the Netherlands were prominent among its early backers. The case of Switzerland was somewhat different. There banks divided along ancient fault lines, reflecting their domestic priorities and rivalries. UBS was a major supporter of Cedel from the beginning. Credit Suisse and Swiss Bank Corporation [merged with Union bank of Switzerland to form UBS in 1998], which had stronger business interests in the securities markets, backed Euroclear.”

Which Norman summarises the cultural split between the sell and buy sides of the market in the quote on page 37 of Herschel Post, who in 1974 joined Euroclear as then head of operations: “You have a cultural difference that still is reflected in the Anglo-Saxon trading community and the continental European buying community. The big difference has always been traders versus custodians. Basically, the European institutions were representing the investors, and London participants in Euroclear were the people who were selling securities to those investors. So you might say it is a sell side versus buy side cultural split.”

Norman at page 38 remarks, in the context of historical evolution of Euroclear and Clearstream “But the market would have benefitted more had the two settlement organisations been able to work together more constructively. There was a need for
Equally, these differences are to a certain extent core in understanding how certain items of rules on collateral, settlement and Custody operate within those FMIPs, notably when acting as SSS, but equally how Coll-RR and Cust-RR arise and propagate, or, what and how appropriate mitigants may be structured and remaining barriers, silos or pockets of fragmentation overcome. Their development from the 1990’s, like most of the FMIP industry however evolved similarly to one another, albeit competitively. They, like other FMIPs also evolved in, as Norman suggests\textsuperscript{161}, in relative obscurity and “...in an almost tribal environment, where the members of the tribe are a coterie of experts versed in the intricacies of securities markets.” This statement applies more generally to financial instruments and mobilisation of collateral and in particular, where there are a handful of key service providers and decision-makers and no standardised terminology amongst industry. And whilst much of this might be attributable to EU policymakers having taken the note of needing to do something fundamental to ensure the vital plumbing of the Single Market flows efficiently, without a disproportionate use of intermediaries across the relevant value chain and/or holding tiers\textsuperscript{162}, the market terminology or “technical language” spoken at expert level within FMIPs and their users is often, and sadly in many points, remains distinct to and possibly in some areas unwarrantedly unintelligible or at odds to the regulatory and legislative language i.e., the legal terminology of policymakers and legislators – this itself can cause CTR and conceptual gaps to arise or be hardwired.

However, even amongst the speakers of market terminology, like to a degree the legal terminology, Norman makes the point\textsuperscript{163} specifically with respect to FMIPs, that “…such schisms amongst infrastructure providers can be a cloak for vested interests.” and thus contribute to regulatory capture. Furthermore, the gaps between the market terminology

\textsuperscript{161} Norman page 6.

\textsuperscript{162} When compared to U.S. capital markets, it is important to note that fragmented EU capital markets puts cross-border transactions at a competitive disadvantage due to additional generation of costs, irrespective of these costs having come down over the years, from the additional intermediaries required along the transaction chain and through the holding tiers in respect of financial market transactions or mobilising collateral across jurisdictions, legal systems and traditions, in which assets, notably collateral assets are not efficiently pooled in their availability, mobilisation and their liquidity. This also incurs higher costs of economic and regulatory capital for FMIP and the market participant users.

\textsuperscript{163} Norman page 6.
and the EU policymakers shaping of the legal terminology means, as Norman puts it,\footnote{Norman page 6.} that “Different words mean different things to different people. That makes it difficult for outsiders, such as policy makers, to master the intricacies of trade. In so far as practitioners have interacted with a growing EU public policy agenda on clearing and settlement, the result has been perplexity on both sides.” and thus points to other forms of Linguistic CTR.

7.13 The reason this language disconnect exists is as a result of failed or stalled integration, and more needs to be done to overcome it. The route to making that reality lies with policymakers engaging with industry and doing so using language that is clear, succinct, mutually intelligible and moreover functional to build a Jurisdiction-Agnostic \textit{common functional market language} for use in the EU for legislative/regulatory stakeholders as well as market participants. As Norman likens\footnote{Norman page 7.}, integration for FMIPs and market infrastructure occurs piecemeal, even where the language or interests of stakeholders is not mutually intelligible, between smaller clusters of markets and stakeholders.

7.14 As discussed Norman further expands this with an analogy of U.S. political and capital integration on a continent wide-basis where the respective railway companies each started from individual points, different standardisation of rail track gauges to only come to fruition “...once the final piece of track was hammered into place in the middle.” Like Norman and subsequent CMU benchmarking of the EU with the U.S., such integration does not happen overnight and does not come without challenge. In the case of the U.S., this standardisation and completion of transcontinental infrastructure facilitating commerce occurred with a 24-year delay and after a Civil War. In the case of FMIP and notably clearing, standardisation, whether driven by market and/or regulatory pressures needs to balance against innovation of FMIP and changes in the Collateral Ecosystem.

7.15 The European integration project was born out of a direct result of devastating conflict and tragedy. So too the first efforts at creating Single Markets and economic growth. As Norman points out more recent integration prior to the GFC only began to be a late priority for FMIP and had only done so:
“...long after technological advance, financial innovation and market liberalisation had wrought changes in structures that served national markets in Europe.”

Whilst the advent of the euro is acknowledged as having transformational effects on financial integration in Europe and certainly the Eurozone, cross-border integration was lacking, even for a number of (I)CSDs with cross-border expertise as well as ingrained cultural domestic bias irrespective of vertical integration or attempts at linkages amongst FMIPs and notably CSDs. Vertical integration however did not preclude horizontal activities. Sparse horizontal integration however remained silo’ed through only specific asset classes. As Norman notes that trends that were favoured in respect of FMIP, and which pose issues for collateral fluidity, as well as Cust-RR exist in part due to historical evolution of operational set-up but moreover the cultural attitudes of FMIPs, their users as well as an absence of a consensus of what integration should look like:

“Vertically integrated structures linking activities across the value chain from trading to clearing and settlement developed in most [EU] member states because this was judged the best way of securing fast and efficient straight-through processing of securities transactions. Also in vogue was demutualisation which turned securities exchanges and infrastructure providers into for-profit businesses. Although most at that stage still worked in the interest of their users, the link between user and owner was eroded in the 21st century when some of the demutualised exchanges obtained stock exchange listings.”

7.16 Norman’s concern on demutualisation remains valid, including for users of FMIPs who now interact with entities that were conceived as utilities, evolved with limited regulation,

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166 Norman page 5.
167 A model that would become to be known as “spaghetti model” of horizontal integration i.e., individual bilateral links amongst national CSDs. An alternative to a business model that rested on bilateral chains, and one that might be the first collateral highway or a precursor to T2S, was a blueprint for a Central Securities Settlement Institution (see Norman page 182) as well as the following Discussion Paper: http://ec.europa.eu/internal_market/financial-markets/docs/cesame/hwwa_discussion_paper_en.pdf.
168 FMIs tended to specialise and only do so in certain jurisdictions. In certain instances, the roll-out to other asset classes and jurisdictions, absent economic considerations, may have been constrained due to EU competition concerns and lack of transparency in costs.
169 Norman pages 5 and 6.
170 Norman Page 13.
have become systemically important pan-EU for profit institutions and now have CSDR attempting to regulate these key components of financial markets in a utility like fashion. A key question for policymakers going forward as well as for the non-dealer entities in the Collateral Ecosystem that are end-users of FMIPs, is whether it is equitable that a number of FMIPs, including (I)CSDs have ownership models that irrespective of conflicts of interest policies being in place, have ownership resting with a number of the clearing members who in turn offer services to users. This means that conflicts of interest are inherent in the competing needs of users, owners and managers of the respective systems. This is an issue that comes to fruit when assessing the degree of custodian specific risks in the Cust-RR assessment of a Custodian/Depository as set out below.

7.17 **Custodians/Depositories – their role as FMIPs**

7.18 A Custodian/Depository in its core proposition provides the safekeeping of financial instruments and/or cash on behalf of clients or settlement relevant intermediaries. Whilst (I)CSDs offer a number of these services and often the range of post-trade processes involve a range of custodian/depositaries that perform such services globally, but who are not (I)CSDs. These entities are referred to as global custodians. Some global custodians service all types of market participants across all asset classes, whereas others specialise. Equally, some global custodians perform settlement, others merely provide users a single point of contact and facilitate settlement with national CSDs and settlement relevant intermediaries and others offer a hybrid offering. There are certain jurisdictions in which say a global custodian does not operate, or where tax, legal, regulatory or operational requirements dictate that a local entity must provide custodial services. These entities are typically referred to as sub-custodians or agent banks and often themselves post Cust-RR that differs to that of the global custodian, either due jurisdiction-specifics relating to the Custody rules or equally Coll-RR. In some instances a client may not have

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171 This hybrid offering depends on volumes in certain jurisdictions. For some jurisdictions, due to volumes settled economics typically dictate how a global custodian’s coverage is offered to its users in that jurisdiction.
conducted due diligence on where its Collateral Assets are actually being custodied and whether at global or sub-custodian level.

7.19 It should be noted that increasingly, even prior to the building of collateral highways, that a number of the core propositions of custodians/depositaries have meant that (I)CSDs are competing with custodians/depositaries, many of whom are also direct users and owners of such (I)CSDs. Global custodians had in the lead-up to the GFC increasingly begun to focus on high-margin services, thus establishing a hierarchy between sophisticated services and breadth of liquidity/execution offered by global custodians and basic core post-trade services offered by (I)CSDs. Since the GFC, (I)CSDs, have also begun to steeplechase the provision of more sophisticated services and challenge the global custodians.

7.20 The role of Brokers in the post-trade process

7.21 Brokers remain involved in the post-trade process. They are also typically providers of ancillary services relating to the traded transaction or collateral. These ancillary services are either provided by the broker in relation to its role under the relationship documentation (prime brokerage or standard terms and conditions), the trading documentation (GMRA, ISDA or master netting arrangement). Irrespective of whether a broker may be a direct clearing member, they are likely to interoperate directly and indirectly with the whole palette of FMIP, payment and settlement systems irrespective of asset class or transaction type they deal in. That being said, not all brokers deal in all asset classes or transaction types. Historically, in the European use of market terminology, Brokers have been categorised as follows and this has an impact on collateral fluidity:

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172 As Norman recalls on page 13 from a conversation held in 2006 with Pierre Francotte, the then Chief Executive of Euroclear, “Things that global custodians were doing 10 years ago have become commoditised. They used to make margins of 30% or 40% and then everybody copied what they were doing, and they make margins of perhaps 10% on these services now. That’s when they push it to Euroclear. Proxy voting is an example. When I arrived at Euroclear in the early 1990’s, proxy voting was the most sophisticated thing. Within five years, people were saying why doesn’t CREST [the UK CSD in the Euroclear group] do it? And now CREST does it. That’s a cycle of things being very exciting, making a lot of money at the beginning, becoming commodities, and being put into CSDs.” As set out below standardisation and harmonisation is a pre-requisite to fostering harmonisation and actions of FMIs are welcome (if not necessary) to assist in pushing this journey along.
(a) **Market makers**: i.e. prime brokers and in the EU’s *legal/regulatory language* referred to in MiFID II *legal terminology* as “systematic interalisers”. They are often also clearing brokers and/or global custodians;

(b) **Clearing broker**: i.e. a broker that is a clearing member and who clears and settles its clients’ as well as their clients’ transactions;

(c) **Commodity broker**: broker specialised in commodities;

(d) **Correspondent brokers**: firms that use the services of another firm, such as a clearing broker to clear and settle transactions entered on behalf of their clients or themselves;

7.22 From an EU regulatory perspective brokers are typically MiFID investment firms or credit institutions or EEA or non-EEA entities regulated in the respective EU jurisdictions as respective equivalents. Their regulatory permissions in the UK and Ireland dictate what transaction types and asset classes may be offered or in which they might engage with and with which client types they can do this. In both the UK and Ireland, this distinction is differentiated between what is MiFID business and non-MiFID business. A number of ancillary services offered by brokers may be fully or partially a regulated activity in the eyes of the UK and/or Irish NCAs. Viewed through a market lens, the ancillary services they might undertake include those in listed in paragraph 6.5 but may also include:

(a) arranging CCP clearing;

(b) acting as valuation agent or calculation agent in respect of financial market transaction or collateral; and

(c) providing periodic and event driven regulatory reporting.
7.23 **CCPs versus tri-party arrangements and conflicts**

7.24 The GFC demonstrated conflicts of interest in bilateral and tri-party SFT markets. As *Saguato 2015* summarises, some of this is due to false assumptions by policymakers including that:

(a) clearing banks are simple agents (they are desks or affiliates of dealer entities as opposed to FMIPs that are utilities i.e., they have different interests/motivations);

(b) tri-party runs are unlikely (they are likely); and

(c) secured funding is durable and stable and that collateral is an effective risk mitigant (which can deteriorate rapidly),

These assumptions, as they applied to tri-party clearing agents, are still relevant and still might be false in relation to how they apply to transactions using CCPs or execution venues, which, even as utilities take multilateral and bilateral exposures and compound and centralise the risks.

7.25 Whilst the concepts are used often interchangeably, including by regulatory policymakers, some key differences are worth noting between how CCPs and tri-party clearing differ, namely in that:

(a) tri-party clearing agents, typically clear and settle transactions on their own balance sheets and those balance sheets may be closely connected, affiliated or otherwise the same as relevant dealer entities operating in the relevant market;

(b) a tri-party clearing arrangement does not necessarily partition liquidity by segregating client assets, client money or transactions in the same way a CCP or clearing house does;

(c) a tri-party clearing arrangement does not necessarily qualify as a system for EU-SFD purposes;

7.26 Conclusions in *Saguato 2015* focus on reducing conflicts of interest and improving repo resilience by reducing opacity through increased reporting and a general move of standardise repo transactions to execution and clearing using CCPs. This is also coupled
with a suggestion to move more generally to ‘narrow banking’. Each of these proposals are regulatory workstreams that are underway at the EU level, in the form of SFTR, which *inter alia* obliges reporting of repos, SecLends and SFTs to trade repositories.

7.27 However, SFTR and other EU reforms also do not create, as proposed herein, an ability for market participants to use actual risk metrics or proxy values to apply a direct and ‘look through’ risk assessment through and across various collateral relationships. Other areas to alleviate issues include reforms in terms of collateral, at the UK and Irish national level through improvements to CASS and CAR and various narrow banking structural reform efforts. In relation to reporting to trade repositories, Saguato 2015’s conclusions, many of which are sensible and are already underway in the EU, whilst focusing on the US repo market, being possibly overtly optimistic on the resilience of CCPs, makes the valid point (see page 39) that (subject to emphasis added):

“…much like derivatives expanded in the OTC world, a marketplace dominated by private information in which public information and transparency cowered in the background. Repo [, SecLend and SFT] market opacity is not only a threat, at a macroprudential level, to financial stability – posing a risk to authorities trying to effectively oversee the market – but also represents a market inefficiency at a transactional level vis-à-vis market participants, preventing them from effectively assessing and pricing the risks underlying the repo [, SecLend and SFT] transactions – namely [but should not, as proposed herein, be limited to] counterparty risk and liquidation risk.”

7.28 The above paragraphs have introduced some of the key roles that market participants undertake as well as fragmentation they face. These issues impact Coll-RR and Cust-RR and are accentuated by CTR. Adopting a prudent approach to existing and new documentation may assist in reducing the adverse impacts of these risks, but also, for existing documented relationships, brings challenges that are discussed in the next Chapter.
8. Documentation architecture and bargaining power

8.1 From a documentation architecture perspective, trading/Custody relationships are usually comprised of multiple components (any multitude of combination of standalone agreements, master agreements, general terms and conditions etc.) and these typically evolve over time as the relationship changes. Each of these components will also have legal, operational, administrative and commercial characteristics reflecting differing as well as common interests of the parties to the relevant component. In turn, these components are shaped by any multiple of jurisdictional, product- and party-specific considerations or variations. This is the case irrespective of any regulatory or industry (both market- and association-led driven) standardisation of documentation for trading product documentation and certain collateral arrangements. Not all of these may have an established hierarchy.\(^\text{173}\)

8.2 Equally, this is also the case irrespective of certain parties possibly having a ‘house style’ or preferred drafting position. This is important both in the context of standardised financial market transaction and/or collateral asset documentation inasmuch as it is for bespoke documentation. The choice of documentation, including how any regulatory upgrades are to be made to such documentation, in light of much of the financial market and collateral asset transaction documentation pre-dating the GFC’s reforms, lies on a combination of solutions that are dependent on each party’s circumstances and possibly also the (differing) aims of the parties.

8.3 These choices may also be influenced by whether a party has an active compliance obligation to maintain operational procedures or specific preferences in how it generally amends documentation. These issues were explored by the author in part 4 “Overview of EMIR’s Risk mitigation techniques and the impacts on ISDA documentation” in “Handbuch EMIR”. As noted therein the following point on bargaining power and contract theory (if applicable) also applies in addition to the aforementioned points on

\(^{173}\) See Para. 4.27.
\(^{174}\) See footnote 41 on page 407.
style, preferred position and of course on the aims and objectives of the transactions and thus this includes necessary consideration that:

(a) in many instances, the documentation decisions may be dictated whether correctly or incorrectly by the dealer entity to its client counterparty to whom it is offering the trading relationship to and where typically the client, especially if a non-dealer entity has lesser bargaining power. This can still be the case where a client has a multi-dealer relationship and/or where may have lower information asymmetry scale thus have higher bargaining power but given that the dealer entity is in the driving seat by offering the transaction capabilities means that any bargaining power is kept in check;

(b) if contract theory applies then irrespective of a number of efforts by gatekeepers and their efforts in relation to master agreement documentation suites, the client is still left with a set of “dynamic contracts” that remain “incomplete” both in terms of obligations and state-contingent, but when constituted together may be reasonably viewed as “complete”. A distinction should be made in how the individual agreements are categorised from a contract theory perspective within and across master agreement documentation suites as well as when compared with relevant collateral and Custody agreements that sit outside the master agreement documentation suite but are required to interrelate and interoperate with that documentation; and

(c) from a legal risk management perspective, non-dealer entities may wish to ascertain their position(s) across the contractual relationship with the relevant counterparty to gauge compliance, resilience against regulatory and legal risks, CTR and remedies ex ante and ex post counterparty default (including cross-default) its contractual/statutory enforcement speed (and thus Recoverability Rates) and whether, on the basis of these considerations this merits arguments for a change in pricing for services/obligations and collateral to be taken as envisioned in the given relationship.

8.4 Whilst the aforementioned standardisation efforts have helped shape markets or expand liquidity in them, as for example as the GMRA has done for repo transactions, the GMSLA has done for securities lending and the ISDA has done for OTC derivatives or
to a lesser uniform degree as user agreements and rulebooks have for certain FMIPs and execution venues, there are still a host of other key components forming the trading/collateral relationships, as well as interaction with FMIPs, where standardisation does not exist as fully and adverse effects or barriers due to fragmentation persists.

8.5 Equally, there is also a continuing lack of standardisation of interoperability across documentation suites and/or solutions. This lack of standardisation also may compounded by the existence of CTR between the legislative and regulatory framework and what standardised or individual documented arrangements provide. Moreover, the number as well as the nature of documentation used to capture those (multifaceted) relationships can have varying degrees of complexity in design as well as content. These legal and operational issues, when viewed through an economic lens in connection with collateral liquidity and fluidity of Collateral Assets means that one can in a number of instances draw a correlation between a lack of collateral liquidity and fluidity that stems from not just the barriers that exist between a fragmented financial market and Collateral Ecosystem across EU jurisdictions, but bottlenecks in operational and legal terms in and across the documented relationships.

8.6 The degree of complexity of these (multiple) exposures and transactions is also (potentially) complicated by the fact that trading/Custody relationships and the documentation architecture used may differ from provider to provider. It may also differ from when one provider is dealing with entities in the same corporate group. Some providers may prefer uniform global terms whereas others may document agreements on a standalone basis. These choices and preferences evolve over time, often piecemeal and not always a mutual decision of the contracting parties. Much of how documentation architecture options are chosen by respective parties and whether to use global terms may also be influenced by the degree of complexity and number of parties that need documenting and how that might be done in bilateral\textsuperscript{175} and/or multilateral designed documentation suites.

\textsuperscript{175} It should be noted that a number of documentation suites, such as the GMRA, GMSLA and ISDA master agreements are designed to reflect bilateral relationships notwithstanding the ability to have collateral obligations and/or credit support provided by a third-party on behalf of one of the bilateral counterparties or for event of default or credit based triggers to reference parties (including affiliates) connected to the relevant bilateral counterparties.
8.7 Part of this complexity may be driven by multiple trading vehicles, each being affiliates of one another, having trading relationships with their respective counterparties, who in turn are also affiliates of one another. Hence, having a clear oversight of which entity is documented under which relationship and what the differences of terms are across the relevant affiliates of the various entities is quite useful in establishing a global view of terms. As described below, there is merit in having a detailed and periodic update of this information in order to proactively approach risk management in respect of the issues discussed herein.

8.8 Following on from the need to have an oversight of the nature and exposures relevant to transactions and collateral arrangements, these relationships could all have obligations (including with respect to collateral fluidity) that are capable of being netted and have cross-acceleration/default terms. There are also situations where interdependence across connected entities is set out in the documentation by way of a cross-default provision for example, but where there is no cross-affiliate netting or contractual set-off permitted or contemplated across documented relationships. Consequently, in addition to establishing who and what is documented where, the degree of interdependence of the documented arrangements on another is an important element that merits periodic and accurate capture and monitoring in the form of a versatile and sufficiently granular documentation risk management framework. Moreover, in assessing such interdependence, it is crucial to map any divergences or discrepancies between terms as well as hierarchy thereof as well as to document and, where possible, rectify Documentary CTR and relevant legislative as well as regulatory obligations.

8.9 Care should equally be drawn in benchmarking how restrictive, permissive or ‘friendly’ documented terms are. In most instances, dealer entities or the custodian/Depository will have the greater bargaining power and its counterparty greater information asymmetry so that documented terms are, even with negotiation and accommodation of the clients’ needs, effectively favour the dealer entity. This bias may also exist in certain pro forma trading/product documentation. Consideration may also be warranted when discussing with a counterparty, that documented terms, even where these are taken to be ‘market standard’, may not be client friendly but disproportionately favour the dealer.

8.10 Equally, what is market standard changes over time and thus, non-dealer as well as dealer entities have a vested interest to ensure that the terms they are receiving are appropriate
to their needs and any legacy terms are updated to reflect market standards. This review should not wait until a regulatory change prompts an update to documentation, as has been the experience with EMIR affecting derivatives trading and collateral documentation.

8.11 Put simply, what was considered as ‘market’ before the GFC is certainly no longer market standard now and unless such legacy documentation is amended, those terms will apply. Adopting this proactive type of approach means having a sophisticated documentation management system both in terms of capture and analytical storage of key terms, but suitably qualified professional advisers that assess the material importance of each documented relationship and periodically schedule reviews of appropriateness of terms. In that regard, market participants should appreciate that some counterparties may have more advanced documentation management systems that set out the granularity of agreed terms whereas others may have executed trading/collateral documentation without having captured the terms as accurately as might be necessary to accommodate required changes or suitability review, or may even have done so on a “file and forget” basis.

8.12 As an example, the individual affiliates of Multinational Widgets plc may all have separately documented arrangements that have evolved separately or piecemeal over time when interacting with Bancogrande. This may have occurred either on an individual basis or through Multinational’s treasury office. In contrast, when dealing with Megabank, Multinational Widgets’ trading vehicles and collateral centres may benefit from having uniform global terms, with jurisdiction, business or product specific terms supplemented where appropriate. In other words, the documentation approach with Megabank means having a global set of, possibly framework terms, with a set hierarchy trailing down to the individual jurisdiction and product specific arrangements. Unfortunately, the reality for most market participants is more likely that the documented relationship and the documentation architecture used, is a jumble of legacy arrangements, global terms and conditions with product and jurisdiction-specific terms plus any bespoke arrangements. All of this potentially weighs in on the Documentary CTR and thus also Coll-RR and Cust-RR that Multinational Widgets plc faces in its overall exposure with Bancogrande (differing terms may restrict ability to recall or enforce on collateral) as opposed to Megabank, where the terms may be clearer with specifics and agreed optionality being modular in design.
8.13 Whilst it is perhaps (sadly at present) utopian for the majority of market participants, running complex businesses, to adopt some of the aforementioned considerations and establish full oversight and uniformity of all their contractual and non-contractual arrangements relevant to their framework, trading and collateral arrangements there is merit in certainly starting to do this with relationships that are considered material and do proactively instead of reactively. These material relationships may be those that are a primary relationship or other relationships that have a material impact if something occurs within that relationship.

8.14 From a documentation risk perspective and in facilitating the reviews suggested above, this proactive approach merits identifying, mitigating and managing not only the suitability and appropriateness of terms per documented relationship, but rectifying any inconsistency in terms and terminology or content, any cross-references to such items across the entirety of documentation and those of its affiliates and establishing a hierarchy as to what applies when, how and to whom. From a resource perspective, this means investing in documentation management systems and moving largely paper-based or word-processed based archiving and capturing of terms to more sophisticated technological solutions.

8.15 This process may have already begun to build some traction with more sophisticated financial market participants, but one area that may not be as advanced, remains dealing with CTR and ensuring consistency in and across relevant documented relationships. A concentrated investment in that direction should enable financial counterparties and non-financial counterparties an ability to more proactively and efficiently manage both their financial and non-financial risks, in a changing market and FMIP interface affecting the range of financial market transactions and the Collateral Ecosystem underpinning them. All of this effort leads to building a map of one’s risk exposures and interconnectedness with the risk exposures of others as well as resilience to those risks. Having greater transparency on risk exposure means more efficient allocation of economic and/or regulatory capital.

8.16 The above paragraphs have introduced some of the key considerations that market participants face in documentation of trading and Collateral Asset arrangements. These impact Coll-RR and Cust-RR and are accentuated by CTR including Documentary
CTR and the EU, UK and Irish legal framework in which these arrangements operate in.
The next Chapters provide an overview of this legal framework and its interaction.
9. The current pillars of EU financial collateral legislation and interaction between EU and EU-MS national laws

9.1 As introduced above, the globally agreed reforms, most of which build off the 2009 G-20 Pittsburgh Commitments\footnote{See: https://www.oecd.org/g20/summits/pittsburgh/G20-Pittsburgh-Leaders-Declaration.pdf} that marked the first globally coordinated response that have followed the GFC, have not named collateralisation specifically but have emphasised central clearing through CCPs as a key priority. This focus on CCPs was seen as the structural solution to place a risk absorber in the middle and have market participants’ financial market transactions subject to new rules. These together would de-risk the opaque interconnectedness that precipitated, certainly in policymakers’ planning the core risk propagators that exploded in the GFC.

9.2 While such reforms and a move to new super-centralisation and concentration of risk have put the need for mandatory collateralisation of transactions as a priority and request much more of it, these reforms have done little to look at the resilience of Collateral Assets themselves until the emergence of the concept of HQLA. Moreover, while making these changes and since, aside from some studies, legislative and regulatory policymakers on the global stage nor the EU stage have not put much in the way of a concentrated view on the adequacy and abundance of Collateral Assets, the ease of mobility or the very mobilisation channels themselves as well as the Custody, Client Asset and Client Money as well as financial collateral considerations, beyond say the following laws that predate the commencement of the first part of the CMU project, which is being reborn, even if these do deliver on some parts of the 2009 G-20 Pittsburgh Commitments:

(b) MiFID II\textsuperscript{180} and MiFIR\textsuperscript{181} (the MiFID II/MiFIR Regime), which entered into force across the European Union on 3 January 2018, which updates the former MiFID regime that was born out of the EU’s FSAP; and

c) Regulation (EU) 2015/2365 (SFTR)\textsuperscript{182}, which entered into force across the EU on 12 January 2016 along with a number of delegated acts, implementing acts and technical standards relating to SFTR that entered into force on 11 April 2019.

9.3 The MiFID II/MiFIR Regime and SFTR are each accompanied by a framework of delegated acts and secondary legislation as explored in Annex 1. This includes in particular directly applicable EU legislative acts (such as in particular Regulatory and Implementing Technical Standards and Delegated Regulations), national legislation and regulation implementing and/or further specifying MiFID II requirements as well as interpretative guidance issued both on EU level (in particular by the European Markets Supervisory Authority (ESMA)) and national level (in particular published by the relevant national competent authorities).

9.4 Despite all of this, there are also regional divergences between the U.S. and the EU, and in the case of the EU, often across EU-MS, in how each bloc has already or plans to implement the 2009 G-20 Pittsburgh Commitments. Moreover, much has changed both in market practice, technology and how transactions in financial and Collateral Assets are sourced, structured, priced, provisioned, resourced, collateralised, executed, custodied, booked, compliance and risk management brought in as a control function to identify, mitigate and manage and ultimately how firms are ultimately supervised and what they report. Much of what was agreed in 2009 has both been supplemented and expanded upon through successive and combination of various instruments of a legislative, regulatory and/or soft law nature. Documentation has changed and with Brexit and the SPoRs causing a shift away for a Collateral Ecosystem centred on London and Dublin, this too


ought to be a wake-up call for EU policymakers to act, notably since the core components of Collateral Ecosystem legislation, the EU-SFD and EU-FCD have not changed since 1998 and 2009, even where SFTR as well as MiFID II have made changes how these EU Directives that were conceived with a much simpler Collateral Ecosystem in place than is the case at the time of writing, operate. These core Directives include:

(a) Directive 98/26/EC (Settlement Finality Directive – EU-SFD)\(^{183}\), as amended, aims at reducing the systemic risk associated with participation in payment and securities settlement systems, and in particular the risk linked to the insolvency of a participant in such a system, and the scope of the protection coverage applies to those payment and securities settlement systems duly notified to ESMA\(^{184}\) as well as any participant in such a system, and to collateral security provided in connection with the participation in a system, or operations of the central banks of the EU-MS in their functions as central banks.

(b) Directive 2002/47/EC (Financial Collateral Directive – EU-FCD)\(^{185}\), as amended, notably by Directive 2009/44/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims\(^{186}\) and subsequent amendments, which applies to collateral takers and collateral providers in respect of eligible financial collateral arrangements.\(^{187}\)

9.5 The objective of the EU-FCD is to establish a minimum EU-wide regime for the provision of Collateral Assets service to contribute towards the integration and cost-efficiency of the financial markets as well as their stability in the European Union. The EU-FCD provides a simple, speedy, effective in uniform means of influence security overcast,

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\(^{183}\) See the latest consolidated version available here (NB does not include BRRD II amendments to Directive 2014/59/EU i.e. BRRD I): https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:01998L0026-20140917

\(^{184}\) As at 25 July 2019 this included the following: https://www.esma.europa.eu/sites/default/files/library/designated_payment_and_securities_settlement_systems.pdf

\(^{185}\) See the latest consolidated version available here (NB does not include BRRD II amendments to Directive 2014/59/EU i.e. BRRD I): https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02002L0047-20140702

\(^{186}\) See: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32009L0044

\(^{187}\) For further background please consult “Yeowart and Parsons”.

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financial instruments and credit claims throughout the European Union. The SFD aims to provide certainty on transfer in the event of a failing of a FMIP.

9.6 In order to achieve these aims, both the SFD and EU-FCD require EU-MS to disapply certain provisions of nationalism and “their” systems of law, in order to:

(a) remove those elements which inhibit the realisation of financial collateral and events of the insolvency of the collateral provider (Art. 8 EU-FCD);

(b) eliminate formality requirements on the creation (Art. 3 EU-FCD) or enforcement (Art. 4 EU-FCD) of collateral imposed that are subject to the EU-FCD by national law; and

(c) disapply with any requirement of national law that notice of intention to realise the collateral should be given to the collateral provider or that the terms of the realisation should be approved by a competent court exercising jurisdiction (Art. 4.4 (a) and (b) EU-FCD).

9.7 The EU-FCD is expressed to apply to financial collateral arrangements where both the collateral-provider and the collateral-taker fall within one of the categories set out in

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A credit claim is defined in the EU-FCD Art. 1(o) as: "credit claims’ means pecuniary claims arising out of an agreement whereby a credit institution, as defined in Article 4(1) of Directive 2006/48/EC, including the institutions listed in Article 2 of that Directive, grants credit in the form of a loan".

Importantly, unlike marketable securities, credit claims are normally tailored to the debtor’s needs. Consequently, in case the credit claim, as the collateral asset, needs to be realised, they are usually not convertible into cash quickly but rather the debtor needs to be contacted as to repayment – to the extent this is even possible. A crucial factor determining the value of credit claims as collateral assets also rests on their enforceability against the debtor – which thus contributes to Coll-RR. Moreover, in addition to their limited liquidity, credit claims differ from marketable securities generally but notably as collateral assets, as they are not generally recorded in electronic accounts, but “only” evidenced only by a credit agreement. As such, there is higher risk that the same credit claim could be posted as a collateral asset to a third party i.e. the notion of double counting. The idea behind a notification requirement is that if the debtor is required to know about the collateral arrangement, they can function as a possible information source regarding the existence of the credit claim collateral. As shown by stricter rules on formal requirements in some jurisdictions, if a (Eurosystem) central bank takes credit claims as collateral taker, formal acts protect the collateral taker from exposure to potential disputes with third parties on the enforceability and priority.

For further reading on the use of credit claims as collateral assets as well as the issues around multiple transaction chains please refer to: COM (2016) 430 Final: dated 29 June 2016 in the form of a “Report from the Commission to the Council and the EP on the appropriateness of Article 3(1) of Directive 2002/47/EC on financial collateral arrangements.” available here: https://ec.europa.eu/transparency/regdoc/rep/1/2016/EN/1-2016-430-EN-F1-1.PDF
Article 1(2)(a)-(e). Articles 1(2)(a)-(d) include specified types of public sector body, central banks, financial institutions subject to prudential supervision, central counterparties, settlement agents and clearing houses. Article 1(2)(e) covers a person other than a non-natural person, and specifically includes an unincorporated form or partnership.

9.8 The EU-FCD includes an option to permit an EU-MS to implement the EU-FCD more narrowly by providing that both the collateral-provider and the collateral-taker must fall within one of the categories set out in article 1(2)(a)-(d), and excluding (e). This would have the broad effect of confining the protections available under the EU-FCD to participants in the wholesale financial markets. EU-MS have adopted differing approaches when implementing the EU-FCD into national law. The scope of the regime applicable in each EU-MS requires careful attention in cross-border transactions. Only one EU-MS (Austria) exercised the full opt out. Five other EU-MS (the Czech Republic, Slovenia, Sweden, France and Germany) applied a partial opt out. Ten EU-MS (Belgium, Denmark, Estonia, Finland, France, Germany, Italy, Luxemburg, Spain and the UK) widened the personal scope of the EU-FCD to cover also entities not mentioned in the EU-FCD. Ireland kept aligned to transactions roughly between one financial institution with another or with a public authority and thus in keeping with the original EU text.

9.9 The EU-FCD has also been integral in setting clear rules on the validity of a collateral arrangement in the context of conflict of laws in the treatment of book entry securities. Prior to the introduction of the EU-FCD, the law relating to financial collateral differed considerably across the different domestic jurisdictions of the EU, with differing consequences and uncertainties. This complex “patchwork” created a fragmented set of financial market and collateral transactions and problems for cross-border business, which was becoming increasingly necessary with various pressures on the financial markets and its participants. As this thesis argues, this patchwork may have been patched

189 EU-FCD, Art. 1(3).
up, and in some placed better than others and less so with regards to credit claims, still is subject to the risks of differences between how the EU-FCD and SFD were implemented in individual EU-MS nor the very risks as they apply to the Collateral Assets as well as market participants themselves.

9.10 Prior to the EU-FCD the validity of the collateral arrangement was generally governed by the law chosen by the parties party to the collateral agreement and this may not have reflected all interests in or applicable to the Collateral Assets either from say FMIPs such as custodians or other transactional parties including where Collateral Assets moved in chains. In addition, in cross-border arrangements, it was much less easy to identify with sufficient certainty prior to a transaction being entered into whether the collateral taker had obtained and mobilised the collateral asset legally and whether the title was good

See Pages 8 and 9 of COM (2016) 430 Final, which correctly concludes, including by reference to materials provided by DG-Legal of the ECB at the time in a related project, to which the author contributed, that the following problems as they apply to credit claims still exist:

“As the overview of implementation showed, differences in the formalities and techniques available to collateralise credit claims still persist between Member States. Nevertheless, even when credit claim collateral remains subjected to national formal requirements, once they are complied with, the collateral benefits from the ease of enforcement introduced by the FCD (e.g. credit claims collateral can be realised by sale or appropriation and set-off and no formalities as to prior notice or prescribed manner of realisation or the elapsing of a period of time will apply).

In terms of the extent to which the objective has been achieved, it cannot be concluded that all legal obstacles to the use of credit claims as collateral within the EU have been removed. In particular, the cross-border use of credit claims collateral is still subject to legal uncertainty due to the effect of different national requirements and the incomplete harmonisation of conflict of laws rules at EU level.

Although harmonised conflict of laws rules exist for the law applicable to the relationship between the debtor and the creditor of a credit claim (relationship 1 in Figure 1), the collateral provider and the collateral taker (relationship 2 in Figure 1) and the collateral taker and the debtor (relationship 3 in Figure 1), the law applicable to the effectiveness of the provision of a credit claim as collateral against third parties, e.g. which formal acts are required to ensure enforceability against other claimants and the order of priority between multiple transfers of the same credit claim (relationship 4 in Figure 1), is still determined by national conflict of laws rules in the Member States. As such, the collateral taker may assume he has priority because formal requirements of Member State A have been complied with, while the third party relies on formal requirements of Member State B and also believes that it has priority over the rights of the other.”
against third parties. In particular, there were difficulties determining the location of intangible securities, in particular where there were one or more intermediaries involved.

9.11 This situation could also (still as of the date hereof) apply in certain circumstances and even where relevant contractual agreements or rulebooks were (or still remain) in place regulating conflicts of laws. Whilst the policymakers behind the EU-FCD had considered amending substantive law by creating a new type of interest in securities, which was to be driven by the location of the account and thus the law in force there, this was found to be too radical of an approach and ultimately would have favoured certain jurisdictions over others. There may be merits in doing so.

9.12 EU policymakers, working then on the EU-FCD as well as now on the CMU often draw parallels to the U.S. capital markets as the desired state of integration. Whilst the focus of this thesis does not, and could not within the constraints of this narrowly focused research, extend to the fascinating transatlantic study of how convergence and integration in the U.S. yielded standardisation, harmonisation and uniformity, and how the EU seeks to emulate this, it remains sufficient to say, that capital markets and the Collateral Ecosystem in the U.S. constituent jurisdictions had more time (ca. 90 years of integration) and narrower gaps to close.

9.13 The work on harmonising security interest reform relating to Article 9 of the U.S.’ Uniform Commercial Code\footnote{For a detailed overview of the evolution of the United States’ Uniform Commercial Code please see contribution by Winship, Peter in Chapter 3 in “Secured Transactions Law Reform – Principles, Policies and Practice” edited by Gullifer, Louise and Akseli, Orkun, Hart Publishing, 2019 (Gullifer & Akseli). Winship assesses the evolution of Article 9 (Secured Transactions) of the UCC by stating: “If Article 9 of the Uniform Commercial Code (UCC) were a computer code the present text of the article would be identified as version 3.1 [the latest official edition of Art. 9 was published Sept. 2014 in Uniform Commercial Code: Official Text and Comments (2014-2015 edn) (Thomson Reuters, 2014)]. First adopted by its co-sponsors – the National Conference of Commissioners on Uniform State Laws and the American Law Institute in 1951 (version 1.0) and modified significantly in 1972 (version 2.0), the official text was thoroughly overhauled in 1998 and promulgated in 1999 (version 3.0). Since 1999 there have been several patches, most importantly in 2010 (version 3.1). As of July 2015, all States have enacted the official text as modified in 2010, albeit with a number of relatively minor non-uniform amendments introduced by individual States.”} started in 1951 and was only “completed” in its current state ca. 60 years later in 2010. Article 9 of the UCC in the U.S. is based on a
functional concept of security. This is in contrast and in place of the traditional approach in other Common Law jurisdictions whereby a security interest is by reference to its nominal form. Instead, UCC 1-201(35) defines a security interest as any interest in personal property that functions in substance to secure the performance of an obligation thereby creating a unitary security interest.

9.14 During that journey\textsuperscript{193}, the U.S. had narrower conceptual gaps to close and thus less CTR between individual member constituent states of the U.S. The UCC’s first export of Article 9 to inspire the Canadian Personal Property Security Acts (PPSA) to harmonise the approach of Canada’s nine common law provinces and three federal territories was its first success story. Since then various other Common Law jurisdictions have emulated some form of PPSA. Despite that change, back at the heart of the Common Law, the law of credit and security in England and Ireland are largely similar. Both jurisdictions at law,  

\textsuperscript{193} And in closing these gaps between national Member States and their differing legal cultures, one cannot forget that certain national EU Member States may have differing agendas. In many ways this is no different to what the U.S. and Canada faced during the 18th and 19th Century and the squabbles between individual territories or the primacy of federal versus subordinated legislation, the integration of the nations, their legal systems and their capital markets were built on pragmatism. The commodities trader from Chicago, Illinois seeking fortunes in San Francisco, California knew he needed the (dis)intermediated financing out of New York City, New York just as much a Montreal, Quebec based institutional investor would look beyond its own provincial borders to seek investment returns in the tar sands out of Calgary, Alberta and secure that investment with securities admitted to the Vancouver Stock Exchange, British Colombia.

Free movement of capital, as in the EU, was the driving force of pushing financial and political integration ahead. Whilst individual territories retain legislative power both the U.S. and Canada’s elimination of state borders for financial services and much else is delivered through federal legislation that is perhaps more unifying, perhaps because arguably individual gaps are smaller, execution venues and settlement systems merged continent wide or facilitated interoperation across the U.S. and Canada and more so because the constituent legislatures/governments are less obstructive to the benefits, economic growth and value add to be delivered when joining together as a union to get things done. The euro, MiFID and diverse other financial reforms to date, SEPA, TARGET 2 for payments and T2S for securities and the Banking Union is a step in making that happen. Yet those initiatives are not as all-encompassing as CMU intends to be.

Equally, standardisation and harmonisation in North America, took place through strong and Federal centralised legislative measures built on assertion as well as consensus. In comparison EU financial integration over the past 30 years has seen certain key deliverables implemented by way of harmonising directives and regulations. And whilst these have overall seen significant benefit, the authorities have tried to fix remaining and emerging deficits by responding through legislative and regulatory measures in a reactive fashion as they go along rather than setting far-reaching objectives that are reasonably achievable and deliverable. The EU’s use of regulations (as opposed to directives) and increasingly regulatory and/or implementing technical standards post-crisis to build a more resilient financial market may attempt to achieve that approach.
and in regulation, lack a unitary security interest. Instead they retain\textsuperscript{194} the traditional distinctions (at law) between mortgages, charges, pledges and liens while equally recognising a range of quasi-security interests while struggling with the difficulties in the characterisation of a transaction and often complex issued on the application of priority rules\textsuperscript{195} and in Ireland, the issue that the overhauls of Irish company law, culminating in the Companies Act 2014, causes continuing confusion, as evidenced in Annexes 1 and 2.

9.15 Instead of creating a new type of security interest (similar to the UCC/PPSA reforms), in a manner that would harmonise such concepts across national laws and schools of thought, EU policymakers drafting the EU-FCD decided to instead forgo that missed opportunity and focus their approach strictly on the conflict of laws treatment. This would involve the creation of a legal concept and a provision in EU legislation that, where securities were held through the chain of intermediaries, the law applicable to the creation and protection of the security interest in respect of the Collateral Assets that were the subject of the EU-FCD, would be the law of the intermediary through which the collateral taker of held its interest. This approach, known as the “place of the relevant intermediary approach” (PRIMA), introduced in the EU-FCD was the one already adopted by Art. 9(2) SFD – for a discussion on how this applies in the UK-FCARs and Irish-FCARs please see Annex 1. The approach taken in PRIMA means that a relevant market participant need “only” satisfy, with certain exceptions, the requirements of one law for validity and priority, even if the securities provided as Collateral Assets are held through a multi-tiered system and originated in many jurisdictions.

9.16 PRIMA was considered to be not only desirable from a practical standpoint but to have a sound technical basis as the only place it which there is this evidence of the collateral take his interest is on the books of the immediate intermediary. This was important conceptually, as the further one went up the collateral asset chain of intermediaries, particularly in the case of Collateral Assets held by way of a security interest of a pledge (or analogous nature), there was often no record of the collateral taker so it made sense to refer to the location of the immediate intermediary to determine the rights of the collateral taker. As this thesis argues, digitisation of the financial markets means that some of that

\textsuperscript{194} Despite some interest in the UK and the Company Law Review Steering Group’s work – see pages 272 and 273 of Gullifer & Akseli.

\textsuperscript{195} Notably as evidenced in the Irish case of Re JD Brian Ltd [2015] IESC 62.
approach may now be antiquated and that the risk exposure between collateral provider and collateral taker might not “just” be limited to the immediate intermediary.

9.17 When drafting of the EU-FCD began almost 20 years ago, the EC concluded that there were different ways of achieving greater certainty and respect of collateralisation so as to protect Collateral Assets from the application of the insolvency laws of EU-MS. One possibility that was open to and certainly considered by policymakers was to create a new type of security interest (as under the UCC) or in a similar fashion as 29th Regime to create a new model collateral law – which could be more encompassing and far reaching, whether for collateral specifically or markets more generally would an ‘EU UCC’ be that quantum leap?

9.18 As a practical example of how this might be applied: Megabank trading in Frankfurt, Germany and BigFund sitting in Dublin, Ireland, managed by BigBucks LLP, in Jersey, with Custody, clearing and settlement conducted through Euroclear UK & Ireland sat in London, England, could either choose to have various transaction documentation governed by laws of the jurisdictions of their domicile, or as is more typically the case for those contractual relationships where there is no explicit rule or market practice to have a particular law govern the relationship could elect to choose to apply (as is typically the case) English law to govern their relationship. This may still have the factual issue that multiple laws across jurisdictions nevertheless interact with the English law governed relationship and the stakeholders. Whilst conflict of laws may be less of an issue, if the parties were to agree to apply a 29th Regime, not only would transaction costs (process agents etc.) likely be reduced, but there might be greater legal certainty and ease of doing business. Whilst this is largely based on the assumption that any 29th Regime would be all-encompassing and well drafted, comparisons to the transformational effects that the U.S. UCC had are certainly tempting and thus something which EU policymakers may wish to take into account.

9.19 Irrespective of those efforts, the disproportionate costs, in particular between domestic and cross-border trading, clearing and settlement have remained\footnote{\textsuperscript{196}}, including those costs

\footnote{\textsuperscript{196} Whilst costs have sunk between 2001 and 2011 according to \textit{Paech 11/2012}, one area where there has been absolutely no development is in improving consumer and wholesale market participants’ access to clear, transparent and not misleading information on how execution, clearing and settlement as well as Custody costs compare in a cross-border arrangement compared}
that are directly as a result of legal risk from the cost of uncertainty in security interests and enforceability\textsuperscript{197}, fragmentation of rules that restrict or disproportionately restrict the efficient mobilisation of collateral on a cross-border basis, as well as the general lack of competitiveness across national borders in EU capital markets.

9.20 Will CMU 2.0 be any different in what CMU 1.0 could not deliver for collateral? Whilst delivering on short(er) term goals, medium term and long(er) term goals are desirable to ensure the project is built, the EC should not lose sight of what it considers a blueprint for what CMU would look like if built from the bottom-up\textsuperscript{198}. Once that blueprint is established, policymakers can decide whether it makes sense to ensure certain pillars are implemented in the market (from a collateral perspective such as Draft SLL, a CASS Rollout as well as a host of convergence or improvement measures as suggested herein)

to domestic arrangements. \textit{Paech} summarises the following cost differences for equity securities in relating to cross-border clearing and settlement versus domestic transactions with the following factors as a result of cross-border legal and technical discrepancies, economies of scale, variations of cost models by financial centre and services provided:

<table>
<thead>
<tr>
<th></th>
<th>For fund managers</th>
<th>For custodians</th>
<th>CSDs</th>
<th>Brokers</th>
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<tr>
<td>2.0</td>
<td>3.4</td>
<td>3.8</td>
<td>4.1</td>
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Certain jurisdictions with more established rules and user-friendly trading, collateral and Custody practices and documentation, such as the UK, Ireland, Luxembourg or Germany and the general “ease of doing business” in those jurisdictions make these more favourable and cost-efficient venue for various transactions and financial market infrastructure providers. \textit{Paech 11/2012} focuses in part three on cost being driven primarily by legal fees as opposed to other transactional fees although in 3.1 he concludes that there “…would be no way of extrapolating excess cost due exclusively to legal uncertainty.” Whilst clients may always query their professional advisors’ fees, without any meaningful substantiation in particular as weighted against the reward aspects, this may be an over exaggeration, especially when compared against legal costs incurred in U.S. domestic or cross-border transactions. Whilst \textit{Paech} proffers in 3.1 that “…the circumstances that produce legal risk differ just as, for instance, holding arrangements differ, including the length of the holding chain and the involvement of foreign law.” In the absence of using a Coll-RR, Cust-RR and CTR model and weighting the components to generate a quantitative view of one’s risk, then one might be able to support \textit{Paech}’s conclusions with conviction, in the alternative, using the risk models proposed herein could assist in quantifying and better preparing for risk.

\textsuperscript{197} See private contribution of a leading commentator on transatlantic regulatory reform, Patrick Kenadjian, Attorney in the State of New York and a Japanese Bengoshi then Senior Counsel at Davis Polk Wardwell which was presented in connection with the ILF’s May 2015 CMU conference in Frankfurt. Please refer to: \url{http://www.ilf-frankfurt.de/fileadmin/user_upload/Article_Kenadjian.pdf}
or whether political will, means that a 29th Regime may be more capable of delivering the principles.

9.21 The likely result, as recent EU legislative has shown is that there may be an unhelpful muddled middle ground between the two approaches, which, unless carefully steered by the ESFS could lead to more fragmentation. Political will by EU-MS’ governments\(^{199}\) and competent functional drafting by the EC, assisted by the ESAs and the ECB (and institutional improvements in addition to reforming TARGET2 and T2S), will hopefully allow CMU 2.0 to get serious on collateral and ensure that the ecosystem can expand and operate without fragmentation and minimal adverse friction. The European project and appetite for integration in (perhaps simpler) financial services over 20 years ago was a different one when compared to the current 2019-2024 legislative cycle.

9.22 Given the US’s path to the UCC was far from easy, and that where each of the 50 federal states share a similar school of law, the EC of then may have been compelled to focus on a more achievable goal in ensuring the EU-FCD could deliver the transformative effect it was designed to do. As an exception, it was recognised that certain rules of insolvency law would need to be modified and protections created to meet the aims of this new legislation that became the EU-FCD.

9.23 Turning back to the rationale at the time, the legislative policymakers behind the EU-FCD decided to not seek it to change the laws of EU-MS relating to fraud, dishonesty, breach of trust as well as the tracing of assets into the hands of third-parties. Those

(national) laws would be left untouched, thus leaving these open to continued fragmentation.

9.24 Responsibility also lies with national-level stakeholders as the EU-SFD\(^2\) and EU-FCD\(^2\), are each transposed into the legal and regulatory regimes of EU EU-MS, each themselves as amended or expanded by statutory measures or rules of the relevant national competent authority (NCA) as explored in Annex 1 or relevant case law of competent courts exercising jurisdiction, as highlighted in this thesis.

9.25 EU-MS, thus the UK (until Brexit) and Ireland, have an obligation to implement EU Directives into their national laws and take note of the binding nature of the outcomes so as to achieve the result envisaged by the legislative instrument while being free as to form and method of implementation.

9.26 In applying national law, UK (currently) and Irish courts are required, as far as possible, to do so in light of the wording and purpose of the relevant EU Directive (*Marleasing SA v LA Commercial Internacionals de Alimentation SA* Case C-106/89, European Court of Justice [1990]).

9.27 EU-MS’ courts accept as authoritative rulings of the ECJ on matters of EU law, including how Directives should be interpreted. While there is no definite statement of principles of interpreting EU legislation, the basic approach at the EU level of interpreting a legislative instrument is:

(a) to start with its terms of the legislative instrument, including the preamble (which may often have operative measures “hidden” in it);

(b) where necessary to turn to the *travaux préparatoires* (literally preparatory works i.e., the materials used in preparing the ultimate form of law – in the case of the

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\(^{2}\) For an overview of the national (statutory) transposition measures communicated by the EU Member States for the EU-FCD please see: [https://eur-lex.europa.eu/legal-content/EN/NIM/?uri=CELEX:32002L0047](https://eur-lex.europa.eu/legal-content/EN/NIM/?uri=CELEX:32002L0047)
EC this might include Impact Assessments or Staff Working Documents – which are measures that are much more common now than were the case then);

(c) where necessary, to consider the usual meaning (non-legal but also possibly non-market terminology) of expressions used, including comparing the different language versions of the instrument; and

(d) if this does not resolve matters, to consider the purpose and general objectives of the legislative instrument.

9.28 As discussed in para. 9.25 et seq. above, for periods that any jurisdiction, such as Ireland and the UK, remain EU-MS, they are required to comply with the “Lamfalussy Process” and implement measures set out in “Level 1” i.e., primary EU legislation (Regulations i.e., which have direct effect and require no transposition or Directives i.e., which have indirect effect and require transposition into national law) or “Level 2” i.e., secondary legislation (Commission Delegated Regulations, Regulations of the ECB in its central banking capacity or in its SSM role or regulatory and/or implementing technical standards (RTS/ITS), or ultimately “Level 3” i.e., tertiary level instruments that are either binding such as Level 1 and 2 instruments or non-binding but persuasive or part of “supervisory expectations” and thus quasi-binding that are set by the ESAs, the ECB-SSM and/or the national competent authorities of the ESFS. Level 4 effectively refers to ensuring that other levels are correctly enforced.

9.29 The Lamfalussy process has acted as a catalyst for delivering wide-ranging and, on the whole, effective financial markets legislation and supervisory instruments. It aims to foster integration of the EU’s Single Market for financial services and to make a more level playing field across the EU as well as the Economic and Monetary Union i.e., the Eurozone. The Lamfalussy process was significantly strengthened by the creation of the ESAs with EU-wide responsibilities and powers and the “EBU” with a core Eurozone focus.

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9.30 Even if the UK’s relationship is changing, given that it will continue to apply the UK-FCARs and presumably, even if its rulemaking, as is expected\footnote{203} diverges, wishes to have some interaction with the EU- and Irish-rules. It stands to reason that EU policymakers might be persuaded to bring EU-level rules up to the standard of where the UK has expanded scope of protections prior to Brexit and before losing London and the likelihood that the EU may not grant UK “equivalence” decisions.

9.31 Legislative equivalence is a matter that is assessed by the EC and is subject to specific rules, which at the time of writing are being reformed and are thus beyond the scope of this thesis. Equivalence can only be granted by the EC, provided the relevant EU legislation allows for it, and this may be only in relation to specific provisions as opposed to all provisions. That being said in the absence of a third-country regime being assessed as equivalent the access to and interoperation between various jurisdictions becomes difficult. As pointed out in Langenbucher & Tröger, the EU-SFD does not contemplate an equivalence mechanism and (clarifications added in parentheses):

“… a third-country settlement system [such as that of the UK] may become a ‘designated system’ under the SFD [and thus benefit from the SFD protections] provided that the system is governed by the law of an EU Member State as chosen by its participants. This requires that the participants choose the law of a Member State in which at least one of them is headquartered. [The] UK transposed the SFD though the Financial Markets and Insolvency Settlement Finality Regulations. However it might be necessary to amend the UK regulation, otherwise it is possible that the finality protections afforded in the UK would cease to operate. UK-based designated systems might be required to change the governing law of the rules of their system to an EU Member State law in order to maintain the existing SFD designation and thus protection.”

\footnote{203} See \textit{inter alia} comments on the FCA’s future model of its rules: \url{https://www.fca.org.uk/news/speeches/future-financial-services-regulation-uk}
10. **The UK’s and Ireland’s approach to interpreting EU legislation affecting collateral**

10.1 The ECJ has adopted a more liberal policy to the use of background materials in the interpretation of EU legislation than UK courts apply in the interpretation of purely domestic legislation. However, where UK national legislation implements a Directive, UK courts may follow the same interpretative approach as the ECJ and take into account the *travaux préparatoires* as in an aid to interpretation. Where a clear literal interpretation of the relevant wording is not possible, the *travaux préparatoires* may be relevant in considering the purpose of the EU Directive concerned and the context in which the relevant wording is used. The *travaux préparatoires* relating to the EU-FCD and the SFD as regards linked systems and credit claims (*SFD/EU-FCD Amendment Directive*) and were examined in detail by Briggs J in the English courts’ consideration of the *Lehman Extended Liens* case.

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10.2 Whereas the EU-FCD has been implemented into Irish law in S.I. No. 1/2004 - European Communities (Financial Collateral Arrangements) Regulations 2004, as amended, *inter alia* by the S.I. No. 626/2010 - European Communities (Financial Collateral Arrangements) Regulations 2010, (collectively the *Irish-FCAR*) almost verbatim, the rules of the Irish NCA, the Central Bank of Ireland, may have supplementary measures.

10.3 Where an EU Directive such as the EU-FCD has been implemented more widely into UK national legislation i.e. the Financial Collateral Agreements (No. 2) Regulations 2003 (SI...)

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205 Although the UK courts have the discretion to consider the *travaux préparatoires* if necessary, it appears that these will not be used so as to cast doubt upon a clear literal interpretation. The circumstances of the case may also be relevant. In *A and others v National Blood Authority and another* [2001] All ER (D) 298 (Mar), Burton J stated: ‘that it is proper to look at *travaux préparatoires* to glean such [legislative] purpose, but with caution, always chary of early discussions or disputations which may have been overtaken by later events, or of documents which may always have been internal or confidential and not reflected in the decisions’ (para. 15). See also the decision in *Pepper v Hart* [1993] AC 593 that permits British courts, if primary legislation is ambiguous or obscure, in certain circumstances take account of statements made in Parliament by Ministers or other promoters of a Bill in construing that legislation and thus not breaching Parliamentary privilege.

206 [2012] EWHC 2997 (Ch), paras 104-114.

2003/3226\(^\text{206}\), as amended, *inter alia* by The Financial Collateral Arrangements (No. 2) Regulations 2003 (Amendment) Regulations 2009\(^\text{209}\) (collectively the *UK-FCARs*) referred to in the quote below as the “Regulations”, it is still necessary to ensure that UK national law does not derogate from the Directive, as pointed out by Briggs J in 2012 in the *Lehman Extended Liens* case:

“It is common ground that this Directive [the EU-FCD] is a minimum harmonisation directive: see Recital (22). It is therefore the obligation of each Member State to implement it by domestic legislation in a manner that is at least as broad as the original scope of the Directive, although Member States may go further. In the present case the UK went substantially further than the Directive in one important respect, namely by extending the scope of the regime to arrangements between any non-natural persons (see sub-paragraph (d) of the definition of security financial collateral arrangement) whereas the Directive was designed to create a regime limited to a much more restricted class of public authorities, central banks and financial institutions: see Article 1.2. But the gold-plating of a system for the implementation of a minimum harmonisation directive in one respect does not justify derogation from it in another. Accordingly, it is for the national court to construe the domestic legislation (here the Regulations) as far as possible in a manner which does not derogate from the intended scope of the Directive, once that scope has been accurately identified as a matter of construction of the Directive.”\(^\text{210}\)

10.4 Certain phrases and concepts in EU Directives are required to be given an autonomous meaning. In order to apply them uniformly in all parts of the EU, their meaning is determined within the context of the instrument and not by reference to the laws of EU-MS. Whether or not a phrase or concept in an EU Directive should be given an autonomous meaning depends on whether there is a need for uniformity in its application throughout the EU. The argument for an autonomous interpretation may be stronger where the phrase or concept is novel. One example is the concept of ‘centre of main


\(^{210}\) [2012] EWHC 2997 (Ch), para. 92.
interests’ used in Regulation (EC) No 1346/2000 on insolvency proceedings, which has since been recast following the EP approval of Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (Recast EU Insolvency Regulation), which expanded the scope of the previous regime to collective rescue and restructuring proceedings. The ECJ rules in a 2006 case that, ‘The concept of the main interests is peculiar to the Regulation. Therefore, it has an autonomous meaning and must therefore be interpreted in a uniform way, independently of national legislation.’²¹¹

10.5 In the English case of Director General of Fair Trading v First National Bank plc,²¹² the House of Lords considered how an English court should be interpreted in the UK regulations implementing Directive 93/13/EEC on Unfair Terms In Consumer Contracts. Lord Steyn stated:

“The Directive is not an altogether harmonious text. It reflects the pragmatic compromises which were necessary to arrive at practical solutions between member states with divergent legal systems. But, despite some inelegance and untidiness in the text, the general principle that the construction must be adopted which promotes the effectiveness and practical value of the system ought to overcome difficulties. And the concepts of the Directive must be given autonomous meanings so that there will be uniform application of the Directive so far as is possible.”

10.6 The UK Privy Council has accepted that ‘appropriation’ in the EU-FCD should also be given an autonomous meaning but not be applied rigidly to require a concept of ownership that exists in the English legal system (and not in civil law systems) to be disregarded.²¹³

10.7 The preceding paragraphs have assessed how English law interprets EU law and applies it. This is important as evidenced below as well as notably in Annexes 1 and 2. In summary, the UK’s interpretation and extension of laws on collateral have in areas created conceptual divergences by moving away from EU common principles, thereby

²¹³ See Chapter 12, para. 12.38-12.43.
creating/stretching further the degree of vertical CTR and thus also distancing itself from how other EU-27 EU-MSs, in the case explored herein, Ireland, have implemented the same common principles thus creating horizontal CTR. As Annex 1 and 2 demonstrates, the UK’s range of jurisdiction-specific rules and concepts that have not inspired EU measures, nor been followed by Ireland, skews this relationship further. This is also true in relation to the pillars of collateral regulation across the EU, the EU-FCD and EU-SFD and how these are implemented in the UK through the UK-FCAR.
11. Implementation of the EU-FCD in the UK and key provisions of the UK-FCAR

11.1 HM Treasury, as the legislative policymaker, consulted widely on the implementation of the EU-FCD into the UK’s legislative and regulatory regime. The UK-FCARs do not follow the EU-FCD verbatim, rather EU EU-MS were free to enact broader provisions. Equally, in keeping with a number of other EU EU-MS, the UK went further than the EU-FCD requires by extending the scope of the UK-FCARs to entities not covered by the EU-FCD. Moreover, in the UK, judgments, notably those of the English courts, expanded the interpretation of key provisions of the EU-FCD as transposed by the UK-FCAR. This divergence, while beneficial to business transacted in or through the UK, can cause conceptual gaps and CTR to occur between UK (i.e., UK-FCARs) and EU law (i.e. the EU-FCD), irrespective of the primacy of EU law.

11.2 The UK-FCARs apply in Scotland and Northern Ireland as well as England and Wales. The UK-FCARs, like the EU-FCD, are not limited to Collateral Assets taken in the EU nor collateral arrangements concluded by parties present in the EU. Neither the EU-FCD nor the UK-FCARs require either the collateral-provider or the collateral-taker under a financial collateral arrangement to be an entity incorporated in an EU-MS, let alone in the same EU-MS. The UK-FCARs apply not only to transactions which are entirely domestic to the UK but also to transactions between parties neither of which is located in the UK or any other EU-MS, provided that the arrangement is governed by English law.

11.3 The travaux préparatoires to the EU-FCD show that the omission of any territorial limitation was deliberate. In the original draft of the proposed Directive, ‘the collateral-provider’ and ‘the collateral-taker’ were both defined in terms, which were expressed to apply ‘whether or not that party is from a Member State’.\(^\text{214}\) As the EC explained in a Memorandum on the proposed Directive issued in March 2001, even though the problems of enforcement were due mainly to the patchwork of different legislation in the EU-MS, the aim of the proposed Directive was to create an integrated financial market for collateral in the EU. The Directive therefore “…has to apply to a collateral arrangement

whenever it was subject to the laws of an EU-MS”. In an Explanatory Memorandum dated 27 March 2001, the EC explained that the inclusion of collateral-takers or collateral-providers from third countries was not intended to give the Directive extraterritorial effect, because it only applied to the extent that the parties were subject to the law of an EU-MS. In the course of widespread consultation, no suggestion appears to have been received from any consultee that the Directive should be restricted to transactions between parties from an EU-MS. For this reason, definitions of ‘collateral-taker’ and ‘collateral-provider’ in an early draft EU-FCD were later deleted as ‘unnecessary’. Any such restriction would have drastically reduced the scope of the proposed Directive in a manner entirely inconsistent with the conclusions drawn from the consultations.

11.4 The definition of ‘non-natural person’ in the UK-FCARs expressly includes (note differences to the EU-FCD) entities incorporated outside the UK; and in this context is clearly not restricted to entities incorporated in another EU-MS.

11.5 The EU-FCD was intended to apply to collateral arrangements in financial instruments irrespective of the place of incorporation of the issuer. In today’s global financial markets, multinational companies often hold large and diversified portfolios of financial instruments of issuers incorporated in a range of different countries, both inside and outside the EU. They may well manage these portfolios aggressively and frequently use them as security to raise funds to finance their businesses or corporate acquisitions. The EU-FCD enables them to offer their investment portfolios as a single package of collateral governed by a single set of rules. The collateral-taker’s consent is often sought to the substitution of collateral from time to time, without having to take any steps to ensure that the substituted collateral is governed by the same rules as the collateral for which it is substituted.

11.6 Neither the EU-FCD nor the UK-FCARs contain any provision governing the choice of applicable law save in respect of the situs of book entry securities collateral,

217 In an early position paper (dated 13 December 1999) it was stated that the ‘collateral-taker’s interest must remain clear and robust irrespective of where the securities to which the interest relates are located’ (see the Position Paper on taking of securities as collateral in the European Union by G. Morton and R. Potok, p. 2).
compromising shares or other securities the title to which is evidenced by entries in a register or account maintained by or on behalf of an intermediary. 218

11.7 UK legislation does not, of course, apply worldwide even though conceivable in general terms. It is impliedly by the territorial jurisdiction of the legislature. UK legislation does not normally apply in a context that has no relevant connection with the UK. In the Cukurova cases (see below), 219 the necessary connection was provided by the parties themselves, who agreed that the security should be governed by English law and expressly incorporated the right of appropriation conferred by the UK-FCARs.

11.8 The UK-FCARs apply whenever both parties are non-natural persons, including unincorporated firms, partnerships or bodies with legal personality except an individual. 220 In other words, the proviso that one of the parties must be a financial institution or other specified entity is omitted. 221 This was the result of a conscious decision by HM Treasury, which was made for policy reasons with the support of consultees. 222 This wide implementation led to a subsequent challenge that the UK-FCARs were ultra vires.

11.9 Some of the choices and suggestions of HM Treasury have given rise to challenge. In Cukurova, 223 the claimants applied for permission to challenge the validity of the UK-FCARs by way of judicial review. Cukurova argued that HM Treasury had acted ultra vires.

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218 UK-FCARs, Reg. 19, implementing the EU-FCD, Art. 9.
219 See Alfa Telecom Turkey Ltd v Cukurova Finance International Ltd and Others (Cukurova), unreported 16 November 2007 (High Court, British Virgin Islands) and unreported 22 April 2008 (Court of Appeal, British Virgin Islands)
220 See the definition of ‘non-natural person’ in reg. 3. It includes entities constituted under the law of a country or territory outside the UK and entities constituted under international law.
221 UK-FCARs, Reg. 3, para (d) of the definition of ‘security financial collateral arrangement’.
223 The relevant shares, which are subject of the security interest in dispute in the Cukurova case where equity securities in two British Virgin Islands incorporated private companies that were “…not listed on an exchange or market or publicly traded” (point 6 of the agreed statement of facts set out the judgment of British Virgin Islands Court of Appeal). As a result, the questions in the court were, as noted in Footnote 33 of Yeovart and Parsons the questions, whether the private shares were financial collateral within the meaning of the UK-FCAR’s Regulation 3 and concluded that they were.
viros under section 2(2) of the European Communities Act 1972 when implementing into domestic law the provisions of the EU-FCD.

11.10 Cukurova argued that the EU-FCD had been unlawfully implemented in the UK by reference to its purpose and in particular disregarded the careful balance struck in the EU-FCD between rights of unsecured creditors and those of collateral-takers. The extension of the scope of the EU-FCD to all non-natural parties represented a significant inroad into the rights of unsecured creditors in an insolvency. Cukurova argued that the EU-FCD’s central purpose was to ensure stability of the wholesale financial market. The judge was not persuaded by this argument. In his view, an important objective of the EU-FCD was to achieve stability of the financial markets generally. By far the greater inroad into the rights of unsecured creditors had already been made by the EU-FCD itself, since financial collateral arrangements involving at least one entity falling within article 1(2)(a)-(d) are far more common than those made between two companies neither of which falls within those categories.

11.11 The objective of the EU-FCD is not limited to the wholesale financial market and these markets are not referred to in the EU-FCD. The judge in Cukurova considered that the dividing line between the wholesale financial market and the financial market generally was in any event blurred and difficult to identify.

11.12 Although the UK-FCARs, as then implemented, struck a different balance between the rights of unsecured creditors and collateral-takers than did the EU-FCD, the greater protection afforded to secured creditors by the UK-FCARs enhanced the stability of the financial market generally. The UK-FCARs furthered the aim of the EU-FCD by widening the scope of the protection. They certainly did not undermine that objective. The UK-FCARs also avoided the difficulty of drawing a line between the wholesale financial market and other financial markets. If it were not for the widening scope of the UK-FCARs, two parallel but distinct systems would otherwise operate in the UK. For these reasons, the judge had considerable doubts as to whether Cukurova could succeed. He accordingly refused permission for the judicial review to proceed and also refused to leave to appeal against this decision.

11.13 There is a risk that another collateral-provider (or an insolvency practitioner) might bring a similar judicial review challenge in the future. However, it was generally considered
that such a challenge would face formidable difficulties both on grounds of delay and on the merits. An extension of time would again be required, and any challenger would face similar potential objections to those identified by Moses LJ in Cukurova. The risk of a successful challenge seemed to be diminishing with the passing of time.

11.14 The above question has been re-opened (but not decided) by Lord Mance who delivered the leading judgement of the UK Supreme Court in The United States of America v Nolan.224 This case concerned, among other things, whether the different regulations under section 2(2) of the 1972 Act were ultra vires because they conferred protection going beyond that required to implement or enable the implementation of the relevant Directive or to deal with matters arising out of or related to the Directive or its operations.225 He referred to the decision in Cukurova:

“Moses LJ was concerned with a question whether Cukurova should be allowed an extension of time within which to challenge the vires of [the FCARs]. Ultimately, all he did was express such ‘considerable doubts’ about Cukurova’s prospects of success in its challenge as to lead him to a conclusion that justice did not demand an extension of time. Nonetheless, it is worth looking at this case more closely, because in my view Moses LJ greatly underestimated the force of Cukurova’s challenge.

... I find it difficult to see how this [the implementation of the EU-FCD so as to apply to arrangements between non-natural persons neither of which falls into one of the specified categories] could be regarded as having been for the purpose

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225 The regulation examined in Nolan were The Collective Redundancies and Transfer of Undertakings (Protection of Employment) (Amendment) Regulations 1995 (the ‘1995 Regulations’) which amended the Trade Union and Labour Relations (Consolidation) Act 1992 (‘TULCRA’). These went beyond Directive 77/187/EEC (or now Directive 98/85/EEC) by extending a right to be consulted (prior to redundancies) to employees of public administrative bodies where there was no trade union representation. The Supreme Court held that s. 2(2) of the 1972 Act was just sufficient in scope to enable the 1995 Regulations to be effective but found it a ‘difficult and borderline case’. It was sufficient because Parliament had by its original enactment of TULCRA established a unified domestic regime which drew no distinction between different parts of TULCRA which it had or did not have an EU obligation to implement. Parliament could be taken to have created, for the domestic purposes of s.2(2) of the 1972 Act, a relationship which the Secretary of State was ‘entitled to take into account and to continue it by and in the 1995 Regulations’ (Nolan, para 72). Lord Carnwath (dissenting) found it difficult to avoid the conclusion that the extension was outside the power conferred by the 1972 Act.
of implementing or enabling the implementation of the EU Directive. Equally, the extension did not arise out of the obligations in the Directive and was not related to them ... under the United Kingdom constitution and the 1972 Act [it was] a matter which was not for the executive to decide, but for Parliament to consider and, if thought fit, to agree as a matter of primary legislation.”

11.15 Although Lord Mance’s critical observations introduce new legal uncertainty, several points may be made. First, the above observations are obiter dicta and made without HM Treasury being represented before the Supreme Court to make submissions on the above question. In particular, the question was not examined in the context of the UK-FCARs as fully as it was in Cukurova.\(^\text{227}\) It is unclear whether Lord Mance’s comments were intended to cast doubt on the validity of the UK-FCARs or simply to limit Cukurova as a precedent for a more liberal interpretation of section 2(2). Secondly, the lapse of time is still a relevant factor as more than 12 years have elapsed since the UK-FCARs came into force. Thirdly, even if a challenge were to succeed, it seems unlikely that an English court would declare the whole UK-FCARs to be ultra vires.\(^\text{228}\) While it appears that no secondary legislation made under section 2(2) has to date been declared ultra vires, it is strongly arguable that (if this were to happen to the UK-FCARs) only those provisions which go beyond the scope of the EU-FCD should be declared ineffective. If so, then a financial collateral arrangement would continue to be protected by the UK-FCARs where either the collateral-provider or the collateral-taker (or both) fell into one of the categories specified in Article 1(2)(a)-(d) of the EU-FCD. Fourthly, even if a financial collateral arrangement between two non-natural persons (neither of which fell into a specified category) lost the protection of the UK-FCARs, the arrangement would not be automatically invalidated (except where the parties had not registered a charge under

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\(^\text{226}\) Nolan, paras 67-69. In the view of Lord Mance and the majority, ‘provisions extending an EU regime domestically into areas not covered by or specifically excluded from the EU regime contemplated by the Directive may well fall outside both paragraphs of section 2(2)’ (Nolan, para 66).

\(^\text{227}\) The question had also been considered by the FMLC in its paper of July 2008, ‘Issue 132 – Alfa Telecom Turkey Ltd v Cukurova Finance International Ltd and Cukurova Holding AS: Legal assessment of an issue raised in the above case, namely the extent to which the Financial Collateral Arrangements (No 2) Regulations 2003 are ultra vires the European Communities Act 1972’, which concluded with the view that the UK-FCARs were validly made under s. 2(2) of that Act.

\(^\text{228}\) In Cukurova the claimants altered their original case and argued before Moses LJ that the UK-FCARs should be quashed only to the extent that they extend the personal scope of the EU-FCD and not be quashed in their entirety (which would otherwise put the UK in breach of its EU obligation to implement the EU-FCD). Moses LJ did not have to resolve this issue: Cukurova, paras 44-46.
11.16 As part of post-crisis financial regulatory reforms, notably on recovery and resolution planning, the UK’s Banking Act 2009 includes a wide power to make further regulations about financial collateral arrangements. Section 255 enables HM Treasury to go beyond the scope of the EU-FCD. The Treasury may introduce any provision that it considers necessary or desirable to enable financial collateral arrangements to be commercially useful and effective. It may also provide for anything done under or in reliance on the UK-FCARs to be treated retrospectively as having had effect despite any lack of vires. Section 255 has not been brought into force at the time of writing. It is suggested that, although the existence of section 255 may be a disincentive to discourage a further challenge, the better course is for the Treasury to bring section 255 into force and exercise its power under it to place the validity of the UK-FCARs beyond the possibility of challenge.

11.17 Irrespective of whether proceedings are commenced before a UK court or a foreign court, it is likely that the relevant court will apply its own rules of private international law to determine whether English law (including the UK-FCARs) is applicable to the substantive legal issues involved. Where the UK-FCARs are applicable, the UK-
FCARs cover four distinct areas: the modification of the law requiring formalities, the modification of insolvency law, the rights of use and appropriation, and conflict of laws.

11.18 If the issue concerns formalities, the English court will apply the UK-FCARs if the formality is imposed by English law. So, if an English incorporated company creates a security interest under New York law over securities held on its behalf by a custodian in New York, the question of whether the security interest is registrable as a charge at Companies House is an English law issue. The UK-FCARs will apply in determining whether the security is exempted from the registration requirement under regulation 4(4) of the UK-FCARs.

11.19 Likewise, if the issue is whether the New York security interest should be characterised as a floating security and be subject to potential invalidation under section 245 of the Insolvency Act 1986, the English court will look to the substantive law governing the insolvency proceedings to determine whether section 145 applies at all and, only if it does apply, will regulation 10(5)\(^{231}\) of the UK-FCARs be relevant. Where the collateral-provider has entered into an insolvency proceeding which is an English administration or liquidation, section 145 (and therefore regulation 10(5)) will obviously apply. Less obviously, section 245 (and therefore regulation 10(5)) could also apply to a foreign insolvency proceeding where a foreign representative makes an application under article 23 of the Cross-Border Insolvency Regulations 2006 for an order under or in connection with section 245.

11.20 Regulations 16 and 17 of the UK-FCARs (The right of use and appropriation) would apply only where, under English rules of private international law, the law governing the security interest or the security financial collateral arrangement is English law. This is because regulation 16 only applies if a security financial collateral arrangement ‘provides’ for the right use and regulation 17 only applies if the ‘terms’ of the security

\(^{231}\) UK-FCARs, reg. 10(5) disappplies s. 245 to a charge created or otherwise arising under a security financial collateral arrangement. See Chapter 5, Part B.4.
financial collateral arrangement include the right of appropriation, thus making it clear that it is the governing law that is relevant.

11.21 Regulation 19 of the UK-FCARs (Standard test regarding the applicable law to book entry securities financial collateral arrangements) requires a court applying English rules of private international law to determine certain issues in relation to book entry securities collateral by reference to ‘the domestic law of the country in which the relevant account is maintained’. The issues in question include the legal nature and proprietary effects of book entry securities collateral and Regulation 19 is relevant wherever the court in question is bound to apply English rules of private international law.

11.22 The preceding paragraphs have assessed the UK’s approach and explained the background to the UK-FCARs, which have been far more innovative in their approach, in particular by extending EU-FCD’s scope of who can benefit from the protections to an exceptionally wide range of counterparty types. The Irish approach, which is discussed in the next Chapter is far more conservative and sticks closer to the wording of the original EU-FCD text in keeping with the Irish legislators approach before the GFC and subsequently to favour a “copy-out” transposition unless absolutely necessary – such as in the Irish MiFID Regulations (See Annex 1).
12. Implementation of the EU-FCD in Ireland and key provisions of the Irish-FCARs

12.1 As discussed in the preceding chapters, the EU-FCD was implemented into Ireland through the Irish-FCARs. Ireland made use of the option to confine the protections of the EU-FCD to transactions between certain categories of company and/or public authority and by stating that both parties to a financial collateral arrangement that is protected by the Irish-FCAR must be, pursuant to Regulation 3(2) Irish-FCARs, in effect, either a public institution such as a central bank or a regulated entity. The UK-FCAR does not follow that approach – see Annex 2 for a further review of differences.

12.2 While the Irish legislative policymakers have prior to and since the GFC generally favoured copying out EU legislation into domestic Irish law, some of this is not free from error, conceptual gaps and/or home grown CTR as explored in the next paragraphs, including in relation to the CBI, as NCA for Ireland, as well as the CBI and Ireland being a full member of the EBU, having undertaken well intentioned reforms that have gone wrong. From lack of and/or contradictions and thus confusion on provisions and their interpretation caused by confusion on the hierarchy of legal instruments to legacy guidance documents of the CBI continuing to be in force, albeit “orphaned” following the revocation of the law that the guidance covered, Ireland has a multitude of patchwork issues despite favouring to stick conceptually closer and have less jurisdiction-specific rules, and possibly less vertical and horizontal CTR in its rules.

12.3 The Irish-FCARs are supplemented by guidance (qua rulebooks) issued by the CBI. Frustratingly the good intentions of reforming and consolidating Irish companies law in the form of the Companies Act 2014 (CA 2014) has led to conceptual confusion due to duplication. Part 7 of the CA 2014 addresses the perfection of “financial collateral”. The CA 2014, despite being primary legislation does not repeal the Irish-FCARs – which as a statutory instrument are subsidiary to primary legislation. Crucially, Section 408(1) of the CA 2014 establishes a general principle that all charges and mortgages, whether created orally or in writing are to be included within the registration system that the Act expands on. This contradicts the provisions of Art. 3 of the EU-FCD, which, as an instrument of EU law, takes precedence over Irish primary legislation i.e. the CA 2014.
Section 408(1) excludes certain categories of assets from the definition of a charge for the purpose of a registration requirement and this applies to:

(a) Cash;
(b) Money credited to an account of a financial institution, or other deposits;
(c) Shares, bonds or debt instruments;
(d) Units in collective investment undertakings or money market instruments; and
(e) Claims and rights (such as dividends or interest) in respect of categories (b to d).

12.4 If this conceptual gap (read poor drafting) of Section 408(1) of CA 2014’s relation to the EU-FCD or the Irish-FCARs were not bad enough, the exclusion list does not follow the types of assets that are exempted from registration and to which formalities are disappplied. Section 408(1) misses credit claims, which were added as a matter of EU law in 2009 in changes to the EU-FCD nor does it account to other forms of interests in funds. The wording in limb (b) is also not in keeping with the spirit of the EU-FCD in that “account of a financial institution” appears, certainly as proposed by McGrath in Gullifer & Akseli to refer to a charge over an account in which the account holder is itself a financial institution rather than, as in other EU EU-MS and the spirit of the EU-FCD, situations where the charge is over money held by a company in an account held with a financial institution. This CTR and frankly poor drafting could be corrected by statutory instrument, as catered for in Section 408(2) CA 2014 but leaving it as is creates confusion.

12.5 Further confusion exists in relation to the practice of registration (often done defensively/pre-emptively) of floating charges. The reasons for this is due to English case law as a result of Gray v G-T-P Group Ltd [2010] EWHC 1772 (Ch) (Gray v G-T-P) and Re Lehman Brothers International (Europe) [2012] EWHC 2997 (CH) substantially expanding the meaning and scope of possession and control causing English law to expand whereas the Irish courts have not yet had an opportunity to consider the meaning of these terms in Ireland. This creates its own state of conceptual gaps and CTR in relation to English law bolting ahead and forging new concepts that may impact its neighbours. It also runs the risk that if Irish courts were to consider the concepts that there is no certainty,
in particular when the UK ceases to be a member of the EU, that it would not reach a
different conclusion – thus accentuating CTR further.

12.6 Putting these points of known risk aside for the moment, the absence of the definitions of
these terms and the wording of the Irish-FCARs means that market participants often had,
prior to the application of Section 408(1), registered floating charges in the company
charge register as a matter of caution. What is noteworthy is that the all Section 408(1)
excluded charges will be exempt from the obligation to register and thus the
 corresponding protection regardless of whether the chargee has possession or control of
the collateral and Section 408 provides no alternative safeguards to enable third parties to
discover the existence of a relevant floating charge.

12.7 Moreover other problems of certainty and clarity exist in relation to, Section 408(1), as
Gullifer & Akseli discuss, alters (even if one puts the point aside on whether that section
is conform with EU and existing Irish law to begin with) the position created by the
national option and discretion applied in Regulation 3(2) Irish-FCAR. Section 408(1) CA
2014 disappplies the perfection requirements for the CA 2014’s list of financial collateral
for security interests created by all companies. If Irish policymakers are looking to revisit
the narrow(er) application of Irish-FCAR protections then the change needs to be made
in amendment to the Irish-FCAR and ideally at the same correct the drafting mistakes in
Section 408 CA 2014 as opposed to leaving a confusing and multi-tiered system of
 protections to market participants under two acts that are not fully interoperable with one
another.

12.8 The same issues highlighted above are also abundant in Ireland’s client assets and client
money regime. When the Central Bank (Supervision and Enforcement) Act 2013 (Section
48(1) (Investment Firms) Regulations 2017 (IFR 2017) came into force in the Ireland,
the national competent authority, the Central Bank of Ireland (CBI), indicated it would

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232 As described by Gullifer & Akseli as well as in Donnelly, The Law of Credit and Security (n 17) 602.
issue new guidance on Part 6 (Client Asset Requirements) and Part 7 (Investor Money Requirements) of that law.

12.9 While the CBI issued the IMR Guidance (see Annex 2 for a comparison of IFR 2017 and the IMR Guidance as it compares to the EU and UK rules) it did not indicate a timeframe for issuing revised guidance (read CBI rulebook and clarification on supervisory expectations) for Part 6 of the IFR 2017. The CBI instead, rather confusingly, while the IFR 2017 revoked the previous investment firm regulations issued in 2017 and integrated updated versions of the Client Asset Regulations 2015 (CAR 2015) and Investor Money Regulations 2015 (IMR 2015), the CBI announced it would be content to, at least until the new Part 6 guidance is issued, to allow the existing Guidance on Client Asset Regulations for Investment Firms of March 2015 (CAR 2015 Guidance) to continue to apply. This can be confirmed by the list of Regulatory Requirements and Guidance in force on the CBI’s website.

12.10 One reason for this could be the fact that the current Part 6 amendments in the “new” IFR 2017 did not go as far as planned in order to require a substantial revision to the CAR Guidance. The IMR Guidance was however amended, meaning that there is a chance that the Central Bank would issue more recent CAR Guidance in the near future. No such indications have been shown at the time of writing.

12.11 In summary, this status quo is problematic along with being confusing in that affected market participants (domestic and international) are held to supervisory expectations to a law that has been revoked even if the new IFR 2017 contain much of the spirit, but not the same substance, of the CAR 2015. That poses conceptual gaps and CTR along with potential for continued confusion.

12.12 Some of the key similarities between the CAR 2015 Guidance and the IFR 2017 include:

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Available here as viewed on 1 September 2019: [https://www.centralbank.ie/regulation/industry-market-sectors/client-assets/regulatory-requirements-and-guidance](https://www.centralbank.ie/regulation/industry-market-sectors/client-assets/regulatory-requirements-and-guidance)
(a) Client assets are to be used only in accordance with client instructions;

(b) When an investment firm is deemed to hold client funds or client financial instruments;

(c) What records an investment firm is required to maintain to segregate client assets for each client;

(d) The length of time an investment firm should maintain records to demonstrate compliance with the rules;

(e) The requirements as to designation of client asset accounts;

(f) What an investment firm should obtain from a third party in advance of opening a client asset account with a third party in respect of client funds;

(g) What an investment firm should do before it deposits client’s collateral with a third party;

(h) What must be reconciled;

(i) Who should carry out the reconciliation/daily calculation and what records should be maintained and what happens if the investment firm has failed to perform the reconciliation/daily calculation or if there are reconciliation differences;

(j) What the daily calculation is and what an investment firm should do if its client money resource is not equal to its client money requirement;

(k) What information an investment firm should provide to its clients regarding arrangements for holding client assets prior to first receiving client assets;

(l) What information an investment firm should provide to its clients regarding collateral arrangements;

(m) When an investment firm should obtain consent in writing from its clients;

(n) How the Irish jurisdiction-specific “Client Assets Key Information Document” should be presented to retail clients and what information should be included in
it, as well as how frequently its content should be reviewed and how an investment firm should inform clients of any material changes to it; and

(o) What the responsibilities of, what EU law sets as a common principle as a “single officer”, which in the Irish rules is the “Head of Client Asset Oversight” include as well as what the and aims of the jurisdiction-specific concept of the “Client Asset Management Plan” are and when it should be approved and by whom as well as its content.

12.13 Some of the key differences between the CAR 2015 Guidance and the IFR 2017 include:

(a) The current Regulation 48(1) IFR 2017 defines what “instruction” means and the CAR 2015 Guidance G3 (3) does not go in such a detail;

(b) Regulation 65 IFR 2017 dealing with the client asset examination also contains more details than CAR 2015 Guidance G9 (1)-(4);

(c) Regulation 61 IFR 2017 has no corresponding equivalent in the CAR 2015 Guidance;

(d) Conversely, the CAR 2015 Guidance has a specific section describing how an investment firm should hold client funds (G3 (4) and (5)) and another on how it should hold client financial instruments (G4 (9)-(11)) which are lacking in the IFR 2017;

(e) There is also a section in the CAR 2015 Guidance (G6 (5)) dealing with when an investment firm is required to notify the Central Bank of an excess or shortfall in completing its daily calculation, which is not explained in such a manner in the IFR 2017;

(f) The CAR 2015 Guidance also offers more information in relation to what information an investment firm should provide to its clients regarding a third party prior to first receiving the client assets in G7 (2) as well as where assets are held in another jurisdiction (G7 (3));

(g) The section describing what information is to be provided to clients regarding securities collateral in the CAR 2015 Guidance is also more detailed (G7 (5));
(h) The CAR 2015 Guidance is more detailed on when an investment firm should obtain consent in writing from its clients in G7 (8);

(i) The CAR 2015 Guidance is also more detailed on the timescale required for submission to the Central Bank and the period the of jurisdiction-specific concept of a Client Asset Examination (CAE) should cover and what is to be done with the findings arising from the CAE – G9 (5) and (6).

12.14 The preceding paragraphs in Part I, and notably the preceding three Chapters on the legal framework, have set out an introduction to some of the key issues discussed in assessing collateralisation and its relevant mechanics along with related risks. These Jurisdiction/Regulatory CTR risks stem from Vertical CTR i.e., divergence between UK rules that extend principles via Goldplating to that of the EU and also create Horizontal CTR i.e., UK rules differ to the Irish rules. Equally, the Irish rules differ to both the EU and UK rules in having some very Irish-specific requirements such as the Client Asset Examination and Client Asset Management Plan requirements that, while sensible, create additional jurisdiction-specific requirements. Moreover, the Irish updating of legislation but requiring market participants to comply with supervisory expectations of “old” guidance hardwires CTR and is not helpful, unless the EU were to plug those gaps as described in Part III.

12.15 Consequently, the status quo of EU financial services supervision and regulation being fragmented, can, as introduced above, be distilled down to a problem of substance and approach. Much of what has or is being advanced, is still, despite a recognition of the importance of convergence and consistency, being delivered in a fragmented manner against a fragmented landscape. This need not (and should not be left to) continue.

12.16 The notion that the functioning in the ecosystem has outgrown its legal and regulatory design is not a new concept. Equally, the merits of the proposals, which themselves are hotly debated amongst academic commentators and industry practitioners, that the existing body of legal and regulatory principles may no longer fit the needs of stakeholders in a Collateral Ecosystem that has been disrupted beyond the reality of the foundations that have made up the “modern financial system” and the Collateral Ecosystem are discussed herein.
12.17 Absent the creation of an EU UCC and a unitary security interest, or at least greater cross-border recognition and understanding, would some form of FinTech empowered solution have assisted issues in the Collateral Ecosystem? This is debatable, even if market and policymaker consensus has begun to embrace DLT as possible means to overcome the Giovannini Barriers and equally shifted to moving away from national options and discretions – especially in the Eurozone. It is also debatable where policymakers have begun accepting criticisms and proposed solutions by commentators, including *Gullifer & Akseli*, that some of established notions of security interests, particularly in light of dematerialisation, digitisation and possibly DLT and FinTech‘isation of financial instruments requires a major rethink on relevant approaches – even if using the EBRD’s Model Law, which was published in 1994\(^{239}\).

Part II – Putting new thinking into practice to tackle known problems

13. Standardisation versus comparability in the context of CTR, conceptual gaps and convergence

13.1 As discussed in Part I, standardisation has brought a number of benefits in sectors of financial markets. In other areas the existence of standardised transactional documentation or terms, has even created the very markets or their propagation across borders. Harmonising the Collateral Ecosystem will also require existing global (but mostly London-based) industry associations, that are the gatekeepers of the Collateral Asset documentation, including ISDA, ICMA in the case for GMRA and ISLA in the case for GMSLA to push greater standardisation and interoperability but also to create documentation, perhaps working together with the ESFS that is fit for use in the new “new normal” that a post-Brexit Collateral Ecosystem represents. Some of this results in short-term pressures such as re-papering, but also requires longer-term solutions.

13.2 Absent the European Master Agreement (EMA), which does not enjoy much in the way of market acceptance, much of the EU-27 market participants in the Collateral Ecosystem that form the bulk of mobilisation channels, are generally, at the time of writing, transacting:

(a) on “national” documentation suites such as German or French derivatives or repo-master agreements (that have considerably less optionality than those mentioned above),

(b) English-law governed transaction documentation suites, some of which may have been “re-papered” to account for Brexit-driven changes, including selecting an EU-27 dispute resolution venue;

(c) EU-27 copied versions of English law documentation suites such as the Irish/French law ISDA (there is currently no EU-27 equivalent for GMRA/GMSLA) which is only enjoying slow acceptance and remains largely untested by EU-27 (or English) dispute resolution venues.
Aside from this status quo being worrying, it raises questions of legal, documentation and regulatory risk but also Coll-RR and Cust-RR, that CTR might exacerbate. Moreover, different market participants as discussed in Chapter 9 have differing documentation preferences, bargaining power and individual terms with individual firms. Megabank may have any multiple of terms with Multinational Widgets, and in turn Multinational Widgets may have any multiple of permutations of terms with peers of Multibank with whom it itself has any permutation of primary, secondary, tertiary and ancillary relationships across transaction chains. Where re-papering exercises are being undertaken they may (despite the best efforts of legal counsel!) also not be coordinated between dealer entities, often competitors to Megabank, when facing Multinational Widgets. While the nexus of British and Irish exposures is easier to quantify, the wider relationships across the EU are more difficult, in particular once one starts to look beyond FCs and NFC client types.

As Gelpern\(^{240}\) explores in his contribution to the case for ISDA-style standardisation in the sovereign debt market:

> "Standardisation is not just part of the fabric of market expectations: international policy initiatives to prevent and manage financial crises rest on the assumption that sovereign debt contracts follow a generally accepted standard. Such initiatives would make no sense in the absence of standardisation."

This is not an issue limited to the sovereign bond markets. This is the case even in asset classes/transaction types, including those used in the Collateral Ecosystem, where due to absence of standardised documentation, or the upkeep of such documentation:

> "...it is common to see a handful of negotiated terms embedded in a mish-mash of different generation industry generation models, sprinkled with bits of creative expression that no one can explain, usually attributed to some long-forgotten lawyers."

\(^{240}\) See “The importance of being standard” by Professor Anna Gelpern in the ESCB Legal Conference 2016 (held 6-7 October 2017, compiled in January 2017 and made available on 7 February 2017) (Gelpern) available here: https://www.ecb.europa.eu/pub/pdf/other/eschblegalconference2016_201702.en.pdf?e2dea3a78485afe4c70d5d5010f368be
13.5 *Gelpern* surmises that some of that variation appears to be deliberate, other variation appears to be developed but, to the extent that it is inadvertent, such variation can be costly. One solution, such as to centralise production of standard terms “… would maximise the advantages of standardisation, amplify the signalling capacity of bespoke terms, facilitate the diffusion of optimal contract innovations…” [which assumes contract theory applies but that statement assumes that even centralised production of say an EU regulation, such as say EMIR, cannot have CTR change how certain concepts are operated and applied by the relevant supervisors across multiple EU jurisdictions.]

13.6 Moreover *Gelpern* proposes that in such an ideal world that embraces standardisation and diffuses optimal contracts and innovation in respect thereof: “Terms that have lost relevance through boilerplate iteration over time would revised or culled more readily than they are today[241]”.

13.7 Consequently, stakeholders, from users to policymakers in the Collateral Ecosystem should view standardisation as an end goal that follows increased comparability and convergence but one that is still susceptible to CTR and thus subjected to different risks.

13.8 As *Gelpern* correctly summarises most industry and statutory models of standardisation share three key features:

(a) central production of some terms (including boilerplate/framework);

(b) modularity (enabling combinations of customised and standardised terms, selected from a menu); and

(c) a commitment to revision…yet, as *Gelpern* does not however mention, that revision might include support through:

(i) legal risk comfort in the form of periodically updated or ad hoc opinions;

(ii) ability to upgrade the documentation from each industry generation through the use of standard of market accepted language, ‘protocols’ and/or agreements;

13.9 Stakeholders, including via various industry associations have moved to embrace centralised and modular contracting for financial market transactions. In most instances, industry groups work to supply core terms of ‘boilerplate’ for master agreement documentation suites and/or framework contracts that span entire markets, thereby improving legal certainty, allowing parties to focus on the reflecting the terms that are specific to the parties’ circumstances and/or the commercial context of the specific subject matter or transaction. *Gelpen* cross-refers to Choi *et al* and the important point that boilerplate itself is not immune to risk.

13.10 Specifically, Choi *et al* tests the erosion of a term, which causes a vacuum but variation that yields CTR (although they do not focus on the CTR point) within the context of *pari passu* clauses in litigation in connection with sovereign debt documentation and specifically how the New York courts assess the situation, where the:

> “Rote use[^242] of a standard form contract term[^243] can erode its meaning, a phenomenon made worse when the process of encrustation[^244] introduces various formulations of the term. The foregoing process, when it occurs, weakens the communicative properties of boilerplate terms, leading some terms to lose much if not all, meaning. In theory, if a clause is completely emptied of meaning through this process it can create a contractual black hole. A more frequent and thus potentially more pervasive problem arises when, as the term loses meaning, random variations in language appear and persist resulting in a grey hole.”

13.11 This grey hole problem is almost more an issue than the black hole as litigation is still, according to Choi *et al*, provoked over meaningless variations in the boilerplate language.

[^242]: The term rote use is taken here to mean that standardised terms are used so repetitively that they may become at risk of obsolescence ahead of possible loss their shared meaning i.e. become what Choi *et al* term a ‘ritualised incantation’.

[^243]: Which Choi *et al* take to have the benefit of forming and developing “…a uniform system of communication that is independent of any particular contractual context. Thus, parties in heterogeneous environments who wish to communicate a shared intent can embody that intent in a fixed and reliable formulation whose meaning does not vary the nature of the contract or its context”.

[^244]: Applying this statement to the EU means also assessing how drafting convention can be impacted.

The term encrustation refers to the deteriorative effect that “too much repetition” has on the intelligibility of the language and linguistic variations of a standard form clause when nuances are lost during repetition or habitual reliance on clauses which may erode the communicative properties of what the parties intended the boilerplate to actually mean or meant to document. Philip Wood QC, a former Allen & Overy colleague, is quoted by Choi *et al* as encrustation being akin to barnacles accumulating on a ship’s hull, with each new growth obfuscating the efficiency of the actual vessel but being so ensconced that it would be difficult to break off what has become standard.
Gelpern refers to Choi et al in order to promote the sensible argument for greater standardisation in the sovereign bond market as well as this author would agree, much to the distaste of fellow lawyers retained to assist in transactions in financial markets and the Collateral Ecosystem, to apply the same degree of standardisation and transparency to all assets classes and transaction types that are eligible for standardisation. This statement is made fully cognisant of the fact that standardisation would assist in minimising transaction and information costs and asymmetry, reduce (but regrettably not eliminate) CTR and increase more efficient allocation of capital and formation of contracts. In such a state, even where this is advanced without the help of FinTech, lawyers would still retain a role and all the boilerplate optimisation and roll out is conceivably still subject to updates driven by market forces, regulatory and legislative change as well as modular customisation to meet party specific needs and objectives. Standard form precedents used by lawyers and other transaction stakeholders (such as financial counterparties who may refer to a document as “house style”), even where standardised market documentation exits already are an example of standardisation assisting allocation of resources as parties focus on achieving the best negotiated outcome. Nevertheless, as mentioned above CTR can still arise in those situations. Especially, when as Gelpern notes in the context of footnote 3 in Choi et al namely that the risk of judicial misconstruction (i.e. CTR) is particularly high when old boilerplate terms remain in standard-form documentation despite losing all or most of their practical relevance.

13.12 Taking this step further, and as explored by this author in “Handbuch EMIR” a contractual black hole in say ISDA documentation failing to meet EMIR compliance without certain changes can accelerate failure to interoperate and cause CTR to propagate. This is also the case where, certainly in the EU, there is scope for a much wider range of drafting conventions in the constituent European legal schools of law (French civil, German civil, Common law etc.) which can be disconnected from the standard form contract terms that are being put in place. In such circumstances, CTR can also arise, so too in particular as a result of adjudication or, in certain cases judicial interference driving CTR. Where German drafting convention is say used in relation to a Custody agreement modelled on UK regulatory protections etc., then CTR can arise and further be complicated by judicial misinterpretation. Given that the comparative law application being explored herein relates to closely related legal systems with a shared heritage and common drafting
conventions, this important discussion is reserved for future research and work in this area.

13.13 Policymakers and industry associations need to continue to update their documentation. They also need, longer-term, to produce something better than the EMA or near-comparables, a multi-asset, multi-transaction type and multi-jurisdictional master agreement document suite that operates, conceptually on a Jurisdiction-Agnostic basis. The EMA, despite best efforts, has yet to enjoy let alone receive the degree of resounding degree of success in uptake in a similar fashion as the English law governed ISDA, GMRA, GMSLA master agreement documentation suites and the transnational private law framework underpinning that documentation have in terms of market acceptance and systemic penetration. Similar action may be required in relation to FMIP-Rulebooks. This is the case even where the English law governed documentation suites have at times been faced with inertia to revise terms or attempt to solve these, often hardwiring more conceptual gaps and CTR in by adopting merely patchwork fixes to avoid wholesale redrafting which would otherwise be useful to reduce the drift to grey or black holes.

13.14 Some policymakers and market participants are, perhaps as they are cognisant that the Collateral Ecosystem may be “too rigid to reform” are looking to bypass the need for greater standardisation and instead are relying on DLT-enabled solutions, including to breakdown the Giovannini Barriers and EPTF Barriers. Some of these risks that a move to such new solutions might entail are explored in the next Chapter.
14. **Blockchain and DLT as disruptive forces to break down barriers?**

14.1 New technical solutions, including those that exist as a result of, or, as empowered by, DLT, including solutions commonly referred to as the “Blockchain” are gaining attraction as means of sidestepping barriers in the Collateral Ecosystem. This technology, the multiple, often incorrect uses of (un-)defined terms of DLT\(^ {245}\), FinTech and Blockchain, has:

> “...captured the imagination of Silicon Valley and Wall Street alike, leaving behind its origins as the underlying technology of Bitcoin. Yet much of the discussion around its potential uses remain abstract. The focus is on the power of a distributed ledger to decentralize markets and undermine the control of existing middlemen [intermediaries].” and: “… In some cases, blockchain could disrupt markets and existing participants, while in others, it promises to help drive cost savings by reducing labor-intensive processes and eliminating duplicate effort. And in some instances, it can create new markets by exposing previously untapped sources of supply. The common thread is that by enabling a fundamentally new type of database technology that can be distributed across organizations, blockchain creates the foundation for solving problems or seizing opportunities that have eluded current systems.”

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\(^{245}\) For more detailed literature see inter alia:


14.2 Whilst the rise of FinTech has already begun to launch winds of change into even the most conservatively rooted types of financial market participants and FMIs, it is FinTech’s catapulting of “disruption” into the heart of these traditional business models and operative processes that has captured the imagination and transformed the notion of the “Blockchain” and FinTech away from being confined to niche communities into veritable buzzwords attracting serious interest and investment.

14.3 This technology has also been identified by market participants as having potential benefits in increasing efficiency in post-trade solutions and shifting the status quo of the Collateral Ecosystem. Specific proof of concepts being tested include trading of financial instruments, settlement and clearing, corporate actions and management of margin positions and collateral, facilitating greater ease in loan syndication, or record keeping.

14.4 Tokenisation of collateral and record keeping or repo and subsequent rehypothecation transaction on DLT – which as proposed herein, could help to increase the transparency of collateral positions, automate enforcement and clawbacks plus improve compliance with regulatory limits. Tokenisation of difficult to mobilise assets, such as the Daimler Schuldschein transaction are veritable good use cases but this does not mean all assets should (or can) move to DLT, especially absent updates to legal concepts and regulatory frameworks as much of DLT solutions operate beyond the (traditional) regulatory perimeter and/or may rest upon legal fiction.

14.5 As a wide-ranging (often grandiose) concept, the “Blockchain” is framed succinctly in Swan 2015246 (emphasis for Blockchain for settlement use proposition in bold) as:

“We should think about the blockchain as another class of thing like the Internet – a comprehensive information technology with tiered technical levels and multiple classes of applications for any form of asset registry, inventory and exchange, including every area of finance, economics and money; hard assets (physical property, homes, cars); and intangible assets (votes, ideas, reputation, intention, health data, information, etc.). But the blockchain concept is even more; it is a new organizing paradigm for the discovery, valuation, and transfer

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of all quanta (discrete units) of anything, and potentially for the coordination of all human activity at a much larger scale than has been possible before."\textsuperscript{247}

14.6 Before delving into the components of what DLT is and what it could possibly do or an assessment of the associated/new or transformed risks, it is important to distinguish Blockchain from another buzzword namely “Bitcoin” before looking at ‘smart contracts’ and ‘smart property’. As Swan 2015 sets out\textsuperscript{248}:

“In a precise and technical definition, Bitcoin is digital cash that is transacted via the Internet in a decentralised trustless system using a public ledger called the blockchain. It is a new form of money that combines the BitTorrent peer-to-peer file sharing with public key cryptography. Since its launch in 2009, Bitcoin has spawned a group of imitators - alternative currencies using the same general approach but with different optimizations and tweaks. More important, blockchain technology could become the seamless embedded economic layer the Web has never had, serving as the technological underlay for payments, decentralized exchange, token earning and spending, digital asset invocation and transfer, and smart contract issuance and execution. Bitcoin and blockchain technology, as a mode of decentralization, could be the next major disruptive technology and worldwide computing paradigm (following the mainframe, PC, Internet, and social networking/mobile phones)....”

14.7 As Swan 2015\textsuperscript{249} summarises the Blockchain in comparably non-technological plain English as:

“How it works is that a standard algorithm is run over a file (any file) to compress it into a short 64-character code (called a hash) that is unique to that document. No matter how large the file (e.g. a 9-GB genome file), it is compressed into a 64-character secure hash that cannot be computed backward. The hash is then included in a blockchain transaction, which adds the timestamp – the proof of that digital asset existing at that moment. The hash can be recalculated from the

\textsuperscript{247} Swan 2015 preface page vii.
\textsuperscript{248} Swan 2015 preface page vii.
\textsuperscript{249} See preface page viii of Swan 2015.
underlying file (stored privately on the owner’s computer, not on the blockchain), confirming that the original contents have not changed.”

14.8 As further expanded in GS 2016:

“The heart of blockchain’s potential lies in the unique properties of a distributed database and how they can improve transparency, security, and efficiency. Historically, organizations used databases as central data repositories to support transaction processing and computation. Control of the database rested with its owner, who managed access and updates, limiting transparency, scalability, and the ability for outsiders to ensure records were not manipulated. A distributed database was practically impossible because of technology limitations. But advances in software, communications, and encryption now allow for a distributed database spanning organizations.”

14.9 If since the late 1980’s financial instruments are not only dematerialised and thus stored and transacted by digital means, why not use blockchain as the avenue by which financial instruments are moved? The same applies for transmission channels and storage venues of the Collateral Ecosystem. These two thoughts have led many bright minds in the private sector and some in the public sector to assess how Blockchain can be used to transform the Collateral Ecosystem and financial markets. One of the most exciting areas where DLT based FinTech solutions can transform and open new markets is for those asset classes and transaction types, that have been left, relatively speaking, in the shadows where traditional Collateral Ecosystem and FMIP offerings have failed to provide solutions. Secondary markets trading in credit, mobilising receivables as collateral etc., are some examples as to where FinTech can transform or improve existing systems.

14.10 A key component of this FinTech led change, and one that is echoed by a number of post-GFC reforms with regard to assigning identifiers beyond ISINs and Common Codes (such as LEIs, UTIs and the like) to legal entities, transactions and asset types so as to facilitate greater reporting and risk management could, as Swan 2015, take a further leap, namely to embrace “smart property”:

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250 See preface page viii of Swan 2015.
“...the blockchain can serve as the public records repository for whole societies, including the registry of all documents, events, identities and assets can be tracked, controlled, and exchanged (bought or sold) on the blockchain. This means that all manner of tangible assets (houses, cars) and digital assets could be registered and transacted on the blockchain.”

14.11 With change however comes risks. Risks specific to the new technology, as well as the risk that the base upon which the existing Collateral Ecosystem’s components, that is to say, the documentation, operations, control mechanisms and to a degree the assumed schools of thought remain valid and fit for purpose. Conventional contract law as well as taking security over digital assets as well as application of netting and set-off, and whether these are even able to qualify as eligible financial collateral for purposes of the EU-FCD are key questions as well as whether there are suitable dispute resolution venues to adjudicate.

14.12 Difficulties also arise where dispute resolution venues are unable to adjudicate on matters that require new legal/regulatory concepts or “courts not being able to consider code”. See the Working Paper but equally work by Madir – notably Chapters 7 and 8, and, that in the EU, the further issue is that there, again at the time of writing, no harmonised nor standardised notion of the law of DLT, ownership interests in digital assets and whether these are, despite some jurisdictions taking unilateral action at the national level (such as Germany and/or the UK) as to how categorise certain digital assets, the continued problem, as in non-digital asset based transactions in financial instruments that the governing law or jurisdiction in respect of the creation or storage of digital assets or digital representations of assets on a DLT system may be separate to the distinct governing law and/or jurisdiction issues (which can be mutually exclusive but need not be) depending on the fact patterns.

14.13 Consequently, market participants wishing to bridge the gaps that exist in legacy systems will still need to ensure that the agreements that are employed (coded) in respect of digital assets and/or DLT, ensure, as Madir notes at 8.25:

“...that the governing law will recognise agreements concluded by electronic means, for intangible/digital assets or written in code, and that the agreement
meets the necessary formalities for contract formation in that jurisdiction, in order to give maximum assurance that the contract will be upheld.”

The parallels to difficult legal and regulatory questions that arise in relation to dematerialisation also present themselves when looking at DLT and FinTech transacted assets.

14.14 These issues also exist, as Madir explores in 8.36 et seq. and questions which governing law and ultimately which jurisdiction is applicable to DLT and FinTech transacted assets, even where there is an express choice by counterparties and/or like, in the attempts of using the approach referenced and discussed herein as PRIMA (see below) are proposed by Madir at 8.40 as the Place of the Relevant Operating Authority/Administrator (PROPA) or the Place of the Encryption Master key-holder (PREMA). Lastly, as valuably explored in Madir in Chapter 9, and by reference to a number of failings (some very public) DLT infrastructure and other FinTech is prone to failure and is not free from liability.

14.15 Arriving at an answer to some of the questions introduced above merits assessing the risks that are specific to these changes or those that result directly or indirectly as a consequence of these changes or, as some commentators call it, disruption. This disruptive effect and the risks they may bring deserves quantification and thus identification, mitigation and management. The following sections in this chapter seek to present an overview on how:

(a) DLT and smart contracts may assist in breaking down some of the Giovannini Barriers and some of its limitations;

(b) DLT technology and smart contracts may sidestep CTR but may not fully mitigate VARICGA and VARINCA or provide a sufficient failsafe against collateral loss/extinguishment;

(c) Regulatory authorities are approaching this area, notably that of the EP and the EC through the CMU and Digital Markets Union projects and efforts the ECB.

14.16 As GS 2016 equally sets out:
“Blockchain is not a “cure all” or a substitute for fixing broken business processes, but [Goldman Sachs] believe [certainly advocates, possibly with bias] it is particularly well suited to address a variety of problems:

- **Facilitating secure, de-centralized transactions among many parties in the Internet of Things:** Because of the inherently decentralized nature of the ledger, blockchain is particularly effective at handling distributed transactions among a very large number of parties. In addition, blockchain delivers a high-level of security for each transaction because of the cryptographic verification and validation among parties. As new distributed economic models evolve that cover tens or even hundreds of millions of assets (such as cars or apartments in the case of the Sharing Economy) or machines (the Internet of Things), secure, distributed transaction models will be needed to facilitate transactions...

- **Reducing fraud and increasing trust with increased security:** In many parts of the world, corruption can lead to counterfeiting or alteration of official records. For example, bribery might drive a government insider to change a record describing the amount of a payment made, or the owner of record of a particular asset. Similarly, a malicious actor might attempt to selectively alter or destroy records (for example a cyber-hacker changing payment records or trades between parties). Because each transaction is uniquely encoded via cryptography and this encoding is validated by other parties on the blockchain, any attempt to alter or remove transaction information would be detected by others and corrected by other nodes...

- **Increasing transparency and efficiency in multi-party transactions:** In any transaction involving two or more parties, the same transaction is typically entered separately by each party into that organization’s own independent systems. In the world of capital markets [and thus the Collateral Ecosystem underpinning those markets], the same trade order might be entered [often duplicate or multiple times in multiple systems] into the systems of two counterparties. In each organization, the transaction works its way through middle-office and back-office systems – at which point errors can create the need for costly [internal but also external] reconciliation processes with
significant manual intervention. By using a distributed ledger technology such as blockchain, organizations can streamline [mutualise functions in] the clearing and settlement process, shorten settlement windows, and avoid substantial capital and operating expenses.” Operational risk is potentially also reduced as new transaction channels are improved as “all to all” trading takes root or FMIPs’ improve their efficiency in economic and regulatory capital allocation terms.

14.17 This fits in with what Swan 2015 and other market participants and thought leaders set out as the stages of Blockchain e.g., Blockchain 1.0 is currency, the deployment thereof and alternative currencies, Blockchain 2.0 refers to contracts and financial markets i.e., the scope of what is assessed herein and Blockchain 3.0 refers to the application of Blockchain to the “real economy” i.e., or life beyond currency, finance and markets. It is important to note that Blockchain 1.0 still remains the ethos of how blockchain operates at present, namely, as distilled by Swan 2015:

“[The blockchain] is currently growing as miners add new blocks to it (every 10 minutes) to record the most recent [Bitcoin] transactions. The blocks are added to the blockchain in a linear, chronological order. Each full node (i.e. every computer connected to the Bitcoin network using a client that performs the task of validating and relaying transactions) has a copy of the blockchain, which is downloaded automatically when the miner joins the Bitcoin network. The blockchain has complete information about addresses and balances from the genesis block (the very first transactions ever executed) to the most recently completed block. The blockchain as a public ledger means that it is easy to query any block explorer (such as https://blockchain.info/) for transactions associated with a particular Bitcoin address... The blockchain is seen as the main technological innovation of Bitcoin because it stands as a “trustless” proof mechanism of all the transactions on the network. Users can trust the system of the public ledger stored worldwide on many decentralized nodes maintained by “miner-accountants”, as opposed to having to establish and maintain trust with the transaction counterparty (another person) or a third-party intermediary (like

251 See preface page x of Swan 2015.
The blockchain as the architecture for a new system of decentralized trustless transactions is the key innovation. The blockchain allows the disintermediation and decentralization of all transactions of any type between parties on a global basis.”

14.18 Some blockchain and indeed some Collateral Ecosystem stakeholders would argue that in an ideal world Financial Market Transactions and Collateral Asset Transactions ought to be conducted on digitised smart ‘smart contracts’ with the terms, as they apply across relationships and contractual agreements as well as the individual assets that are relevant, being tokenised and with exposures capable of being netted. The concept of a ‘smart contract’ has existed long before ‘digitised disruption’ emerged as a prevalent theme shaping the future direction of the financial system. The emergence of digitised solutions for the trading and post-trading environment of the financial system, including those solutions built upon DLT. There is at the time of writing no legal definition of what constitutes a ‘smart contract’ albeit a shared consensus of the role that they like DLT can play in a future world of financial services. These questions have accelerated notably since ‘Bitcoin’ emerged from the shadows in 2009 and have gathered pace as DLT led to a “Blockchain Boom Era” in the financial services sector, becoming a mainstream priority in 2015 and 2016 but ultimately through 2018 and 2019. For many the vision of how DLT might be able to disrupt or digitise large parts of financial services is quite clear. For others it is not and consensus is lacking. A technology expert might well have differing concerns and priorities than a finance or legal specialist. Stakeholders in T2S may find it difficult to source and apply budgets to new untested technology that may take longer to settle with less certainty than T2S does.

14.19 The common market terminology is that smart contracts operate in computer programs that exist and apply logic with reference to the DLT. Simple “if-then-else” logical statements are applied in much the same effect as a vending machine that performs the contract subject to a payment instrument being selected and a selection of good by the buyer having been indicated. The first generation of smart contracts have been logically binary. Second generation smart contracts have introduced an ability to deal with more complex transactions and operations. Based on popular programming languages, the
second generation ‘smart contracts’ can, according to a 2019 IOSCO Report\(^\text{252}\), use various techniques to self-execute and take control of assets on the DLT and communicate with relevant parties to the contract and third parties. Smart contracts would thus able to be, on the assumption that they are isolated from risks, able to take root in a number of Collateral Ecosystem and financial regulatory environment.

14.20 Moving to smart ‘smart contracts’ however requires legal finality. In contrast, the digital cash commercial solutions of DLT but more specifically Blockchain 1.0 do not require smart contracts. However, if DLT is to disrupt the Collateral Ecosystem and financial transactions in the way that many aspire it would, it will need contracts and those contracts ought to be digitised and hence the need for ‘smart contracts’. In many ways, this may require a rethink of legal principles and regulatory approaches. More fundamental questions such as “where do I Custody my blockchain assets...do I print them?” or “how do I enforce my contract? And how do I litigate my code and how do I prosecute against theft of a private key to my digital assets” these issues are explored now in turn.

14.21 In most legal systems, contracts are formed around the following minimum elements of law being satisfied and necessitate having:

(a) capable parties;

(b) certainty of subject matter (obligations, rights and responsibilities);

(c) legal purpose and mutual assent; and

(d) clarity of terms and when offer and acceptance occur.

Consideration, whether in monetary nature or other form of value, may be transferred as part of a contract or the performance of obligations thereunder. Smart contracts, as a concept, have been in existence prior to the digital revolution that followed the commercialisation of the Internet in the late 1990’s and early 2000’s. That notion of what constitutes a smart contract has evolved. Nevertheless, one key difference, and thus potential drawback to contracts other than smart contracts, even those that benefit from

\(^{252}\) See: https://www.iosco.org/library/pubsdocs/pdf/IOSCOPD627.pdf
Financial Products Mark-Up Language (FpML) has also emerged. This includes the fact that smart contracts, even in the current 2.0 version and certainly those that are strictly machine-to-machine, are deterministic by nature. They exclude the flexibility and optionality common in physical contractual agreements that have a human-to-human element. Consequently, the call for a failsafe to either halt or terminate certain aspects of the smart contract has almost preceded the birth of the full potential of smart contract evolution. In the Collateral Ecosystem, where failsafes are embedded, unless replicated, then digitisation could lead to higher levels of risks. Some of this was evidenced by other forms of smart contracts, algorithmic-based orders, causing various “flash crashes”\textsuperscript{253}.

14.22 Examples of ‘crude forms’ or the aforementioned ‘first generation’ of smart contracts still exist. They are diverse in nature and can include a point of sale mechanic or system ranging from an online payment protocol, to a handheld electronic payment instrument keypad (such as those used to accept credit or debit card purchases) to a vending machine, or algorithmic allocation of bandwidth or algorithmic execution of financial transactions. Regardless of whether users of crude smart contracts swipe, type or tap a payment instrument or other identifier to verify the transfer of consideration and/or affirmation or entry into terms of a contract, Szabo\textsuperscript{254} defines\textsuperscript{255} this as:

“A smart contract is a computerized transaction protocol that executes the terms of a contract. The general objectives are to satisfy common contractual conditions (such as payment terms, liens, confidentiality, and even enforcement), minimize exceptions both malicious and accidental, and minimize the need for trusted intermediaries. Related economic goals include lowering fraud loss, arbitrations and enforcement costs, and other transaction costs.”

14.23 Consequently a smart contract, certainly, in the first iterations, are not inherently smart. They rely on the computerised transaction protocol. As smart contracts continue to evolve, there is already consensus emerging that they need to be tiered in how they operate: a lower tier which would perform simple movements of assets including safe atomic exchanges (when two entities swap in a single operation some asset for some other

\textsuperscript{253} See: https://en.wikipedia.org/wiki/Flash_crash
\textsuperscript{254} See: https://en.wikipedia.org/wiki/Nick_Szabo - Szabo’s publications are quoted in Tapscott.
\textsuperscript{255} See Tapscott, Don, Tapscott, Alex (May 2016) “The Blockchain Revolution: How the technology behind Bitcoin is changing money, business and the world”
asset so there is no way that one entity can end up out of pocket), without resorting to smart contracts. An upper tier would allow participants to choose what degree of programming complexity they want, by storing smart contract code within the metadata of lower tier transactions. This would not interfere with the performance of the lower layer and enable every node to run only the code it needs to.

14.24 In each example of a smart contract, varying degrees of human input or interface is relevant or even required pre- and post-execution of the transaction. The contract is referred to as being “smart” due to an element of formation, performance or execution of the contract being digitised and controlling property (including digital property) by digital means. The long gestation period that existed since Szabo introduced the term ‘smart contract’ boils down to an absence of robust DLT and no venue or platform to enforce the terms of ‘smart contracts’. This is an area that would need to be redressed with standardised concepts, uniform rules and an appropriate institutional set-up so as to improve legal certainty as well as consensus on whether the terms of the smart contract, especially those resting on DLT platforms, should be made public. In contrast, privity of contract permits parties to keep certain terms confidential and this may be an issue even for some smart contract 1.0 solutions where sensitivity matters.

14.25 Another operational barrier to smart contracts gaining traction, and this is in addition to the questions raised above is, that the coding of contracts into smart contracts is new, takes time, is often discouraged given the divergent treatment across schools of legal systems and the fact that existing and new contracts, even when standardised are rarely machine readable or centrally located in a documentation management system. FpML could assist in changing that but this requires both comparability and standardisation of terms and considerable effort by counterparties. Moreover if ‘smart contracts’ are to be embedded as a viable tool for financial services (and quite possibly elsewhere) it needs consensus, in the EU, certainly at the EU level as to how laws (both national and EU systems) will establish a Jurisdiction-Agnostic treatment and recognition of smart contracts.

14.26 At time of writing, whilst such a move to smart contracts might reduce (but not eliminate) CTR, VARICGA and VARINCA, is still more a utopia than something that is to be implemented. The following paragraphs some of the risks but also solutions for the issues described in the Parts above affecting the Collateral Ecosystem. One work-around that
might balance interests in the Collateral Ecosystem is to adopt tiers of smart contracts as explored below but equally to have smart contracts that coexist in a modular format and interface with the non-digitised contract.

14.27 Moreover, DLT-solutions potentially disrupt a Collateral Ecosystem that largely rests on a legal and regulatory framework on collateral and/or security interests, which is heavily rooted or dependent on principles that emerged from the mercantilist concepts of the 19th century i.e., well before financial instruments were traded, custodied let alone issued or “manufactured” in dematerialised, electronified or now digitised form. Moreover, the advent of DLT systems undermine much of the technical and quasi-legal framework and other instruments of legal or private transnational regulatory regimes such as FMIP-Rulebooks that have been put in place across the Collateral Ecosystem to bridge divides across various schools of legal thought that affect and interact with touchpoints in the Collateral Ecosystem.

14.28 With post-GFC regulatory reforms pressing a need for greater supply of high-Collateral Assets to be available and also eligible – not all Collateral Assets are always eligible nor available to market participants as a certain portion may be blocked on accounts with central securities depositories, custodians or held in non-actively managed portfolios i.e., thus be passive participants in the Collateral Ecosystem with under-utilised Collateral Assets. DLT could solve some of that under-utilisation by easing the ability mobilise such assets and open new channels but also side-step perhaps established and entrenched legal principles that apply to collateral transactions even though there is considerable uncertainty as to how one might apply a conventional security interest to a digitised collateral asset in the DLT let alone if possible, if that digitised collateral asset could as a DLT represented interest be categorised as a collateral for the purposes of EU legislation on collateral and settlement finality.

14.29 Coding, or any form of quantum computing giving rise to the “singularity” is however unlikely going to eliminate CTR nor the existence of nor impact on Coll-RR nor Cust-RR, especially if the law does not evolve to recognise how to treat code and machine-driven solutions to matters that have been crafted conceptually on the foot of mercantilist

256 See also page xxv of Yeowart and Parsons.
concepts. In short, these risks still matter irrespective of the Collateral Ecosystem being subjected to change and ‘disruption’ by technological driven ‘FinTech’ providers some of whom have viable solutions. Those viable solutions are however likely to enhance the efficiency of the Collateral Ecosystem and also open up new mobilisation channels and/or revolutionise the cost of and thus the ability to monetise and mobilise assets to a greater potential, including as Collateral Assets. That is a welcome development in its own right, even if that is not necessarily going to give rise to a whole new inventory of HQLA.

14.30 Aside from FinTech and the emergence of RegTech\textsuperscript{257}, the plumbing that makes up the Collateral Ecosystem already has varying degrees of complexity. Consequently, ensuring that parts are interoperable and intelligible across the transaction value chain is important to the efficient and safe functioning of financial markets. FinTech can assist standardisation in the Collateral Ecosystem but the strength of that proposition lies also in the degree of standardisation in IT systems and technology standards used and their resilience.

14.31 For a number of FinTech solutions, being different is the unique value proposition but this is an issue that will need to be overhauled to avoid duplication and resulting drawbacks running solutions in parallel or absent the existence of interoperation protocols. In many ways, this brings the issues back to the issues on conceptual gaps and CTR. It also raises the notion of FinTech Related Risks an overarching term, which at the time of writing, has begun to emerge on the policy horizon of global and EU regulatory and supervisory bodies. When used herein this term refers to the risks that FinTech have on the Collateral Ecosystem and those that are innate to those FinTech solutions and their providers. Some of these issues are FinTech Specific Risks, which relate to FinTech lacking sufficient:

(a) harmonised standards: both amongst FinTech specific solutions but equally across the wider FinTech community. Consequently, in the absence of interoperability of technical standards as well as different regulatory policy

\textsuperscript{257} For a good overview of the birth of RegTech and how RegTech supports FinTech please refer to Arner, Douglas and Barberis, Janos, University of Hong Kong – Faculty of Law, and Buckley, Ross, University of New South Wales, Faculty of Law, in “FinTech, RegTech and the Reconceptualization of Financial Regulation, October 2016 available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2847806.
approaches means that FinTech might be more fragmented rather than harmonised uniform or interoperable standards;

(b) **harmonised commercial conflicts and business processes**: FinTech solutions, specifically DLT are only as good as the data and business processes that underlie it. Failure to reach a consensus amongst counterparties because of fragmented, divergent and/or CTR afflicted business processes or commercial conflicts could accentuate FinTech Related Risks due to lack of adoption/scalability;

(c) **privacy and/or security**: application of a distributed database to commercial transactions raises the question of whether FMPs and/or FMIPs want to share information about counterparties and/or in an environment which relies on “trustless” decentralisation which marks a radical departure from the current environment and the business and regulatory practices in which these transactions operate or that shape it. These concerns apply to public (permissioned) as well as private (permissioned), often called “bankchain” DLT systems. This rapid departure however is counterbalanced by trends that have emerged from the Shared Economy that relies on the “credentialisation” of those involved and thus translating into preferential terms. As proven in a number of P2P services (Uber, Airbnb etc. credentialisation is key to preferential terms and thus perhaps brings to the forefront some of the concerns that DLT, certainly permissionless DLT would need to overcome in order to cement itself in the world of finance where trust or at least knowing the counterparty is still very core to formalising, monitoring and executing business terms. There are a host of examples of DLT solutions being susceptible to financial crime and thus loss. Very public failings of specific financial institutions and/or DLT providers or other crypto-asset exchanges are just but one unnerving example that has prompted the comparably nascent concept of “cyber resilience” becoming a EU and global supervisory priority; and

(d) **speed and performance**: any distributed database is inherently slower than a centralised one. This begs the question whether DLT is appropriate for high-speed and/or high-volume applications. However, it should be noted that a number of DLT systems for capital markets transactions boast the ability for instantaneous, often real time gross, settlement. Whilst a majority of non-DLT
FMIP and Collateral Ecosystems offer this, the benefits of reduced settlement risk are replaced (see issue on SR3) with increased need for liquidity to meet the settlement obligation. This can increase the settlement risk.

14.32 Connected to the concepts of components, or drivers, or FinTech Related Risks are the supervisory priorities of ‘cyber resilience’. As a concept, this term encompasses more than cybersecurity and first became a supervisory priority of the SSM in the Eurozone’s EBU in 2017. Both of these concepts were highlighted, along with an assessment of FinTech’s disruptive benefits and drawbacks in a February 2017 ‘IOSCO Research Report on Financial Technologies (Fintech)” (2017 IOSCO Report)258.

14.33 As highlighted in the 2017 IOSCO Report, the notion of ‘Moore’s law’ and exponential growth as applied to computing power has so far been proven accurate. What IOSCO does not assess, but what is proposed herein is that FinTech’s disruption itself poses a quantifiable and controllable systemic risk in its own right. This is termed herein as Systems’ Resilience Replacement Risk (SR3). This measure attempts to capture the amount of negative impact that FinTech and specifically DLT’s effect on systems has on the resilience of the Collateral Ecosystem and market participants engaged therein. Specifically in relation to post-trade this SR3 includes following impacts:

(a) **interoperability of DLT and smart contract solutions with DLT and non-DLT systems including those of market participants and existing infrastructures.**

This is an idiosyncratic but also a systemic risk. For most financial market participants there is a reluctance to move away from committed capital investment plans for to commit financing to overhauling what in most places may be a collection of various tried and tested legacy systems. This will mean systems would have to coexist and thus this would duplicate costs and possibly deter interest to move to the new. Additionally, the lack of scalability for certain types of DLT make it inadequate for the range of solutions that FinTech providers are looking at in Collateral Ecosystem. As per the 2017 IOSCO Report (see page 60), absent any prediction on evolution of Moore’s law and summarised in relation to the Bitcoin Blockchain which is permissionless in its design: “...the

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number of transactions it can handle per second is not enough for real time settlement of securities. On the other hand, in a permissioned DLT, scalability is a lesser challenge.”;

(b) increased liquidity risk, as a result of DLT transactions replacing settlement risk with liquidity risk. In contrast to other RTGS systems that act as a central counterparty and thus use the benefit of their credit rating, DLT is trustless and thus may detract from the RTGS benefit that it is supposed to bring;

(c) replacing trust-based post-trade processes and Custody with trustless nodes. This not only changes the basic premise of how the Collateral Ecosystem operates but also the legal and regulatory framework in which it operates and absent dispute resolution venues that can handle such new risks and disputes, may increase legal risk.

(d) susceptibility to cyber-crime and degree of resilience: the concept of cyber-resilience refers to the ability to withstand failings due to ordinary events disrupting systems but also do to cyber risks. In a DLT world that operates using distributed trustless nodes, the issue with malicious nodes or cybercrime becomes an issue, especially as methods to perform validation checks are currently not standardised and some remain expensive. Moreover, theft and loss of ‘private keys’ i.e. that permit the control of the digitised assets have become commonplace.

14.34 A number of high-profile (almost uncountable) incidents of Bitcoin fraud and crypto-crime are recorded. These include the Mt. Gox incident in 2014, in which hackers stole USD 500 million worth of Bitcoin assets without breaching the Bitcoin Blockchain protocol and which eventually led to the collapse of the Mt. Gox Bitcoin exchange. Other incidents include known nefarious actions by rogue states using crypto-assets as means to obtain financial gain or destabilise or monopolise DLT systems. Whilst undermining the attraction of Bitcoin it also highlights a host of new known and unknown threats to crypto-assets generally.

14.35 Irrespective of the risks connected with issues around (lack of) trust, decentralisation and lack of oversight/transparency in who is doing what in the Blockchain when and how,
such a general change in making property “smarter” and increasing the transparency pre- and post-trade could also serve as a simplified solution to overcoming one of the areas that is flagged regarding the need for a “look-through” across transaction types and relationship levels to be able to trace assets and assess the likelihood of a return. Blockchain could assist in that – especially when it comes to difficult to trace assets or those that are considered too important to lose or have trapped or where fungibility is (or is capable of becoming quite) limited

14.36 Taking this thought a step forward, if the financial instrument and/or Collateral Asset is easier to trace and locate along a transaction chain and relationship level, thus allowing greater pre-emptive risk management and allocation, could this assist efficiency and safety? This alternative, could rather than, as historically the case, a return of such asset requiring an unwind of various transactions or return of equivalent assets or a cash equivalent, instead mean that the original collateral provider of such asset could step in directly to where that Blockchain identifier places that asset? If the asset has moved to, from the perspective of the original collateral provider, to a tertiary relationship, could the asset be retransferred with an equivalent Collateral Asset being substituted by the recipient and onward collateral provider for that Collateral Asset?

14.37 In other words, this could circumvent the need to unwind chains or post equivalent assets or cash and create a whole new method of more efficient return and replacement of chains of collateralised positions as Party A sees its Collateral Assets have moved from Party B via Party C to Party D. Rather than unwinding that transaction chain, Party A can trace the asset on the ledger of what would likely be bankchain-permissioned DLT and recall the collateral asset and have cash settlement take place with according parties. While this does not negate Coll-RR nor Cust-RR and probably also not CTR (could there be a notion of CTR in coding? Probably), it does make the question of “where is my collateral and how quickly and how much of it can I get back?” easier to answer

14.38 If exponential computing power is set to grow, then the importance of regulation, new thinking on risk as well as sufficient failsafes to ensure resilience are vital, in particular if the Collateral Ecosystem continues to be heading towards digitisation and possibly ‘smart contracts’. Both DLT and smart contracts, irrespective of current capabilities, relevance and risks to the Collateral Ecosystem and its users, are likely continue to
influence the conversation on the future of the Collateral Ecosystem and greater use-cases are likely to continue to emerge.

14.39 One area where there are tangible use being delivered is from HQLAX\textsuperscript{259}, a consortium of financial services providers and a central operator, Deutsche Börse Group, that permits collateral providers and takers to transfer interests in (often difficult to mobilise) financial instruments between users and across jurisdictions by means of tokenisation of the financial instrument. HQLAX uses R3’s DLT-system Corda. This means that the financial instrument in question is firstly immobilised as a collateral asset and an interest to it is create as a token. The contrasts to say traditional Collateral Ecosystem processes of creating mobilisable Collateral Assets is the absence of multiple layers of holding chains. Instead, the token, which is legally in most jurisdictions may not be treated as a legal interest but instead is a mere promise akin to an IOU. That token is nonetheless capable of moving on the DLT network and, as backers of HQLAX say in a network\textsuperscript{260}, in this case a private permissioned bankchain DLT i.e., a closed network only accessible to HQLAX participants, at a faster rate than would be comparably possible in a traditional collateral ecosystem setting. Whether that is entirely the case in terms of speed or resilience in light of added risks that are DLT-specific or indeed legal certainty remains a point to be proven as do regulatory policymakers’ attitude to use of HQLAX or how it will be supervised, possibly as a trading venue under the MiFID II/MiFIR Regime and whether it would qualify for EU-SFD protections. The first live transactions were executed on a prototype version in January 2018 and the platform launched in 2019.

14.40 Providers such as Luxembourg-based HQLAX are attempting to create much more stable bankchain permissioned systems and other actors have successfully settled financial instruments using bankchains. This is attractive for hard-to-mobilise, often paper-based financial instruments such as Schuldscheine or heterogeneous assets such as SME loans, but for more liquid markets in very fungible financial instruments and Collateral Assets the rise of DLT is unlikely to displace traditional mobilisation channels even if those are, as explored in the next Chapter on possible solutions, slowly becoming and needing to do more and do so quickly to become more digitised so as to leap ahead of another parallel of trading halting in a similar fashion as the 1960’s Paper Crisis if DLT-driven Collateral...

\textsuperscript{259} See: https://www.hqlax.com/
\textsuperscript{260} See: https://www.hqlax.com/operating-model
Asset transactions cannot settle. Other measures that EU policymakers will need to consider if the Collateral Ecosystem is “too important to miss” are described in the next Chapters of Part III.
Part III – Further best practices and outlook ahead

15. So, what else needs doing?

15.1 The preceding chapters have shown that the Collateral Ecosystem remains fragmented and in need of EU-wide reform, if the Single Market is to be built it needs to be built on a Single Rulebook. Greater use of standardisation is certainly welcome. DLT equally offers some interesting proposals. There are however, some other best practices and action points that Collateral Ecosystem stakeholders can apply regardless. The next sections assess what needs doing. This ideally ought to translate into action points for:

(a) market participants;
(b) documentation;
(c) risk and compliance management; and
(d) policymakers: this means revisiting and possibly dusting off legislative proposals that had been shelved and these include some key issues discussed in the next sections.

15.2 Action for market participants, in relation to their documentation, risk and compliance management

15.3 Market participants could, in addition to adopting some of the new thinking on risks inherent to as well as those driven by the Collateral Ecosystem, transaction chains and a need for standardisation also work to strengthen various infrastructure in the market through improvements to documentation based and non-documentation based workstreams.
As the markets in Collateral Assets continue to gather complexity, market participants ought to align, whether through individual industry association’s efforts or jointly their expectations and operational standards on:

(a) **to pre-contractual and pre-onboarding workstreams** – possibly creating greater use of standardised information request documentation for basic information requests and/or standard settlement instructions and identifiers (LEIs etc.) as well as relevant (regulatory and other) reporting agreements;

(b) **standardising master agreement and trading documentation further around common terms and/or regulatory and/or Brexit-driven changes**;

(c) **consider moving, where possible, contract design, documentation and execution to greater electronic negotiation and execution platforms**: which ought to use, what may ultimately become regulatory-approved, “common domain models” that digitally serve to represent key features and life cycles affecting transactions and can facilitate automated processing/reporting in much the same way as this has already been delivered to certain ISDA documented derivatives and which could be extended to represent digitally events of default and associated processes/notifications; and

(d) **improving pre- and post-trade risk and control functions reviews**: such as pre-matching, resilience testing of channels and ability to source fungible and less fungible Collateral Assets when required.

As one can see from the diagram in para. 1.36 the longer a given chain, the more muddled the interlinks and exposure issues become. From a risk assessment perspective, one main issue that is common in relation to the length of transaction as well as holding chains is assessing whether risk is exacerbated by the counterparty’s own counterparty exposure.

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15.6 Length of financial/collateral transaction chains can vary. Their length is not mutually
dependent on one another and depending on what each party does or is restricted from
doing in respect of an asset. As noted in the 2011 EP Report, the actual length of the
holding chain of intermediaries will vary much more depending on jurisdictional issues.
In certain jurisdictions, there are no other intermediaries involved and investors hold
instruments directly with the CSD. In other jurisdictions, the number of intermediaries is
limited to one and in others the number is not limited. Once financial instruments trade,
one they are collateralised and/or held across border the financial/collateral chains as
well as more importantly the holding chains may involve several intermediaries.

15.7 As discussed, absent any arrangement to ‘look-through’ (whether using a DLT-
empowered or other “traditional solution”) past the immediate counterparty, the risks, if
unmitigated could propagate Coll-RR and reduce Recoverability Rates. This is in
particular the case where the repo’d asset remains beyond the reach of the repo lender
wishing to recover and possibly use/dispose of the relevant asset that which would
continue to incur market risk exposure. Post-crisis EU legislative and regulatory
reforms\textsuperscript{262} have prompted financial market infrastructure providers to meet their clients’
needs and increasingly offer tri-party repo services and/or for these to be CCP cleared.
Work was also undertaken to rectify the defaults/concerns voiced in respect of certain tri-
party market arrangements.

15.8 Market participants ought to, in addition taking account of the risks in transaction chains,
also consider whether making greater-use of tri-party Segregation/Custody (on individual
seggregated account basis) but also tri-party repo arrangements. The answers to these
questions will be firm-specific.

15.9 A classic tri-party repo involves a tri-party agent, possibly also a clearing/custodian bank
(for purposes in this context “Party C”) appointed as a collateral manager, which may
also include sending settlement instructions to an (I)CSD or its affiliate, which interposes
itself as intermediary between a cash investor (on the cash leg of the repo) and a securities

\textsuperscript{262} See \textit{inter alia} regulatory intent that was set at the global level by the Bank for International Settlements’ Committee on Payment
and Settlement Systems Paper “\textit{Strengthening repo clearing and settlement arrangements}” available at:
https://www.bis.org/cpmi/publ/491.pdf

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lender (on the collateral provider leg of the repo). Each of the parties may engage in tri-party repo transactions differing Custody and settlement arrangements. This will affect how Party A and Party B interlink with each other but also with Party C. Tri-party repo has long been an established transaction arrangement in the U.S. and its attraction increased in European capital markets since the GFC. U.S. style tri-party repo operates differently to EU markets. 263

15.10 There are potentially a majority of benefits that not only tri-party repo can have in terms of client asset protection due to Segregation arrangements that improves Recoverability Rates. Tri-party repo typically does not involve a CCP but if including one this allows for potential greater multilateral netting of exposures vis-a-vis those eligible multiple counterparties, which can have sufficient benefits for users and reduce their bilateral risk exposures.

15.11 Provided CCPs are resilient, such arrangements can have merits for a range of financial and collateral transaction arrangements. Absent any look-through, concern on a counterparty’s bilateral risk profile remains sufficiently mitigated when trading via a CCP, even if there may heightened opacity as to who that ultimate counterparty is acting for. This goes perhaps against the grain of how repo historically evolved (like many transaction types on open outcry and/or voice broking), notably on the strength of trusted relationships and one’s perception thereof, i.e., the same counterparties traded bilaterally with one another.

15.12 There are also further arrangements in which the opacity of such transaction arrangements could be fully removed by greater use of integrated and interconnected technology. One example is to remove the intermediary and set up a B2B platform and move repo to exchange traded style trading in which collateral passes directly from end-seller to end-buyer. As rehypothecation is not needed due to the transfer being direct on a DvP basis for the cash leg and thus the velocity of collateral would equal 1. A number of platforms such as WeMatch or TradeWeb are leading the way on that transition

15.13 These suggestions above do not rely upon the proposed actions for policymakers to be successfully delivered – although any such reforms would certainly assist. Any action by

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individual, or preferably a consortium of industry associations would be best advised, in particular giving the shifts affecting the London market, where ISLA, ICMA and ISDA are traditionally at home to coordinate with EU-27 counterparts including counsel who are sufficiently cognisant of the EU-specifics versus those in the UK.

15.14 **Actions for policymakers**

15.15 The next Chapters assess some deliverables that EU-level policymakers and those within the ESFS (at both EU and national level) could advance on a Jurisdiction-Agnostic drafting approach to do away with some pre-GFC barriers to convergence and integration, such as the Giovannini Barriers and EPTF Barriers, as well as those that have emerged since including those related to FinTech. Some of these changes involve revisiting the Draft SLL, taking the best of CASS and CAR for EU-use but also in changing the patchwork ensuring that the EU’s Single Rulebook actually is a tool fit for purpose.
16. Getting serious on the Single Rulebook, convergence and standardisation

16.1 The EU’s legislative and regulatory framework is intended to be compiled in the Single Rulebook, a term first coined in 2009 and intended to reflect a unified regulatory framework for prudential regulatory matters. The term has since been broadened by policymakers to mean harmonisation of the regulatory framework in the EU. Nevertheless, the Single Rulebook, on prudential matters is also subject to incompleteness and inconsistencies. The non-prudential part does not exist in a single resource and the various components of non-prudential regulation and supervision are far from harmonised or converging. Policymakers often speak of the Single Rulebook but to date it is a patchwork of PDFs – that is not opportune and does little to eliminate the patchwork of rules and piecemeal changes being advanced in the EU.

16.2 As explored in para. 1.78 the wealth of rules in the EU could benefit from single office that acts as gatekeeper of the EU’s Single Rulebook upon which the Single Market for financial services is to continue to be built. While the resource EUR-Lex is (thankfully) already making much more use of “consolidated versions” showing the primary legislation as published, amended and corrected, and equally, while the ESAs (notably EBA and ESMA) are expanding their own “Interactive” Single Rulebook documentation tools. That is welcome but problematic as these do not interface with another and ultimately that creates fragmentation and further breeding ground for conceptual gaps and CTR. This absence of a centralised wholesome resource of rules poses a barrier to actually achieving more substantial completion of the EU’s Single Market irrespective of action to further the EBU or CMU. CMU’s efforts refers to reinforcing and expanding the Single Rulebook concept but beyond the prudential remit, without any mention of how it might be improved.

16.3 As it stands current public facing products of the EBA and ESMA’s efforts are narrow in its scope and neither all-encompassing nor truly uniform. In many ways, the project delivery remains stuck in the starting blocks with a differing understanding of where the finish line is drawn or even the route of the track to get there. From an EU policy perspective, the continued (politically driven) reference to an EU Single Rulebook Project as a solution to facilitate further European integration has an appealing sound to it. Yet
absent any marked action, absent further convergence and consolidation, these statements can be lost where the EU’s resource remains comparatively underwhelming and/or nebulous as to what a Single Rulebook actually is.

16.4 The term “Single Rulebook”, as it is used by EU regulatory and supervisory policymakers (notably the EBA based in London, which is familiar with the UK Financial Services Handbook264 as a concept) was in the EBA’s own words a term originally coined in 2009 by the European Council in the following statement to ensure accurate transposition of Basel III in all EU-MS, namely to establish:

“... a unified regulatory framework for the EU financial sector that would complete the single market in financial services ... It will close regulatory loopholes and will thus contribute to a more effective functioning of the Single Market.”

16.5 As a concept, it has been reinforced/cemented in a number of subsequent speeches addressing pending regulatory convergence and simplification efforts. Whilst these aims are of course beneficial, desirable and necessary for assisting in the convergence of the EU regulatory and supervisory environment, including with respect to EU-MS’ national legislation supplementing or transposing EU legislation, the EU Single Rulebook Project has not advanced much, beyond prudential regulation, and, as the EBA states “… the uniform application of Basel III in all EU-MS”.

16.6 Change could however do more and do so efficiently if policymakers were to push for that, albeit probably on staggered level and which focuses on building around those areas of EU financial services legislation, which are comparably self-contained/sectorial at the EU level first before tying in relevant national frameworks that exist at the EU-MS level. The latter could be done either by providing the content in the respective national languages or by presenting the convenience translation of such resources in a preferably consolidated approach offering comparability similar to the output conceptually, albeit in a much more attractive digitised form. In terms of the EU level, this would mean the codification and also collation of the following EU legislative hierarchy used to regulate financial services in the “Lamfalussy process”:

(a) the “Level 1 texts”, which refer to the legislative acts usually EU Regulations or Directives often as framework legislation;

(b) the “Level 2 texts”, which refer to the implementing measures drafted and adopted by the EC, following advice from the ESAs in the form of implementing or technical measures;

(c) “Level 3 texts” reflecting consultations, Q&A and guidance from the ESAs; and

(d) complemented by collating the “level 4 texts”, which refer to the supervision and enforcement measures that are principally enforced by the NCAs in accordance with national laws and frameworks and thus, as opposed to the above, merit collation for reference in the primary instance and, to the extent appropriate given the supervisory jurisdictional powers, establishing common approaches and/or guidance. Collation of texts and indexing them in one resource would still leave (some of the) respective texts in the language used by the NCA, but would provide a centralised common resource and access to common principles or comparative tools – similar say but much more digitised than efforts proposed in Annexes 1 and 2.

16.7 Any conformed versions of the relevant levels of EU legislative texts, i.e. in the forms of “Modules” or “Chapters”, which might be applied for conduct of business and prudential regulatory matters, could form an “EU Core Single Rulebook” combining Level 1, 2 and 3 texts of EU law. Such an EU Core Single Rulebook would of course need to interact with the wider framework that applies across and in each of the EU-MS depending on whether the relevant EU-MS would see benefit in consolidating and harmonising their rules with that of a centralised resource of an EU Core Single Rulebook. One could conceivably distinguish such a wider coverage as the “EU Uniform Single Rulebook” and, much like the UK FS Handbook, preserve EU-MS elements in “Specialist Sourcebooks” identifying/badging the relevant national elements as necessary/desirable.

16.8 Such an approach might create greater transparency but may also speed up harmonisation and deliver certainly on the EC’s priorities for completing the Single Market, by driving forward relevant integration. Such an approach in knowledge engineering/presentation would consolidate the EU texts, preserve the particularities of EU-MS’ regimes, but collate such elements in one centralised resource. This not only increases comparability
but moreover convergence—both a necessary prelude to further European integration—and it also circumvents the immediate requirement for translation of EU-MS’ language-specific resources.

16.9 New content could be added in much the same way as the UK FS Handbook’s approach tackled growth and development of content by adding to existing content or creating standalone chapters. Such chapters of an EU Core Single Rulebook could be complemented by a number of items that the CMU project seeks to deliver. This includes applying maximum harmonisation efforts (EU Regulations instead of Directives) and/or promoting enhanced cooperation (following for example BENELUX’s legislative cooperation/alignment) in relevant areas where EU-MS’ actions to implement measures have differed or where a “29th Regime” may be more efficient. Such areas include, but are not limited to, delivery of EU uniform standards with respect to client assets and client money protection or harmonisation of depositor guarantee schemes, and to a greater extent investor compensation schemes’ rules, which are necessary to promote greater integration of financial markets and deliver the CMU as a single harmonised market.

16.10 Policymakers could, concurrently with the building of an EU Core Single Rulebook, also agree standards amongst the ESAs and other relevant stakeholders of how such chapters/handbooks for 29th Regimes should be set out, or preferably follow an Irish/UK non-legalese approach, to present content that is both user-friendly and interoperable with other EU legislation, as well as, more importantly, the other parts of national EU-MS’ regimes that remain unaffected by the contents of any 29th Regime.

16.11 Consequently, the EU, and the ESAs and ECB-SSM might wish look to the EU Publications Office to build that tool, possibly by tendering law firms and legal tech providers to digitise acts and taxonomy along the lines of existing tenders that have been awarded by NCAs. One such NCA included the then UK’s Financial Services Authority and its Handbook of Rules and Guidance, which was replaced by the much more digitised version that continues to be maintained and expanded by the FCA. The UK’s Prudential

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Regulatory Authority (PRA) took its own rather PDF-heavy approach. Some of the lessons from that FCA’s experience and successes are transportable to an EU-wide solution and the creation of a truly centralised Single Rulebook for the Single Market. Moreover, it is conceivable that this would be deliverable, potentially at low cost, and thus creating the quality control gatekeeper on content but also as a closer of conceptual gaps and CTR. The following paragraphs provide an oversight of what that might look like for possibly the Banking and/or Capital Markets Union.

16.12 What made the FSA and what makes the FCA version of the UK FS Handbook so attractive and what could such an EU Uniform Single Rulebook aspire to? Any centralised resource curating the new and improved Single Rulebook might with to take note of the following key design attributes that make content functional and easy to use:

(a) **content is presented clearly:** as to scope of application to type of regulated activity and type of regulated person, as well as the content’s relevance and its interaction in the hierarchy of content;

(b) **content has clarity as to supervisory jurisdictional hierarchy:** it sets out clearly whether specific content is applicable to all regulated persons regardless of supervisory authority or solely to a person that is lead regulated by one NCA. This is achieved through the use of conceptual badging of rules to a type of regulated person;

(c) **consistency of cross-references and hyperlinked content:** within the components of the new improved Single Rulebook (i.e. between specific rules, modules and chapters), but more importantly, the pieces of legislation or regulatory rule-making instruments were/are, in the UK FS Handbook, also distinguished, where relevant and appropriate, with icons that made it easier to ascertain the jurisdictional scope or provenance of a rule, by using an EU flag or appropriate

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266 In relation to Banking Union and any further expansion or consolidation of pan-EU integrated supervisory jurisdiction, it is conceivable that consolidation of the EU Single Rulebook Project could also contemplate indicating where a rule is relevant to the European Central Bank’s jurisdiction and supervisory oversight in the Banking Union by badging a particular rule as say “SSM” or a rule specific to say a particular Member State by badging it accordingly. As explained herein, the UK FS Handbook had badging according to competency of NCA and effectively who “owns the rule” and whom it applies to, but equally important, the concept of the provenance of the rule. Both approaches could be applied in enhancing the EU Single Rulebook Project.
annotation “EU” to denote that the provision derives from EU legislation or a UK flag or annotation “UK”, i.e. to clarify that the provision derives from applicable UK legislative material, which may have predated an equivalent EU regulatory/supervisory requirement or concept;

(d) **content was not static but evolved over time and the respective presentation evolved accordingly:** as particular content changes, users cannot only quickly ascertain the date of entry of a particular rule, definition, principle or guidance note, but can see how the content has changed over time by users changing the relevant date of the webpage being displayed. This powerful functional feature is known as “time-travelling”. As a result, users can track the evolution of rules or revert to any date of an earlier or future version of the UK FS Handbook/successor resources as in force at the chosen date, and do so with reference to the rules in their entirety and not just the specific rule. This feature was quite useful in assisting the relevant users, their professional advisers and possibly the supervisors in having clarity in the extent of relevant compliance obligations at a given date or to help solve specific regulatory questions on particular subjects and how it fits into the overall framework in force; and

(e) **content of multiple NCAs/sources was presented in a single resource:** solely with relation to the UK FS Handbook in its existence as a single rulebook during the period that the components were badged as PRA or FCA rules, users could view these on a “Combined View” basis.267

16.13 The FCA Handbook brought with it, as a result of cooperation with law firms and legal tech:

(a) **an “improved” search function:** allowing users to search for key words or phrases. Although much like with the search function of the UK FS Handbook, the precision of results remains an area for continued improvement;

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267 It should be noted that more as a result of the new FCA Handbook and the PRA Rulebook being separated, and the Combined View function being disbanded, there is (currently) no function in the successor resources to time-travel before 1 April 2013. Any user wishing to break beyond this regulatory “space/time continuum” and access the legacy versions of the UK FS Handbook (albeit with perhaps issues of data capture) would now need to consult the UK’s National Archives site on this resource.
(b) **more tools to make sense of time travel**: subject to the limits of the new time travel tools described above, the power of time travel as a navigation feature has been retained in the new FCA Handbook and PRA Rulebook. However, the FCA Handbook includes an interactive timeline to show when previous changes to the selected provisions were made, as well as when proposed changes are to be made which helps establish points of reference. The PRA Rulebook is not quite as advanced as the FCA Handbook and merely indicates when a provision is to be amended and how;

(c) **introduction of a “rule tracker”**: as with the UK FS Handbook, users of the new FCA Handbook and/or the PRA Rulebook can either set up alerts (requires an account) if changes to a particular provision are proposed or made or periodically click the “What’s New” function on the respective website;

(d) **ability for users to open content in PDF**: both the new FCA Handbook and the PRA Rulebook have a better functionality to open up relevant content as a PDF which may be helpful for some users – even though this is, in the EU publications world, long a given baseline function; and

(e) **faster finding of relevant regulatory forms**: both the new FCA Handbook and the PRA Rulebook have a considerably more efficient way to access relevant regulatory forms, as these were often contained in the actual modules or chapters of the UK FS Handbook or other online resources of the FSA.

16.14 Any more centralised attempt to harmonise the EU Single Rulebook Project could certainly benefit from some of the items above to increase user accessibility. These are items that are relevant to the functionality of the design and interaction of a resource that consolidates various levels of legislation. Moreover, they are equally jurisdiction agnostic. The collation and presentation of forms, submission methods and/or where such items are otherwise located could be replicated in a manner that distinguishes between EU forms, that are common across the EU, and those that are jurisdiction-specific.

16.15 Whilst this project will take time, it can be built in parallel to other EBU, CMU and Single Market workstreams. Contrary to the current arrangement with the EBA/ESMA and its efforts on the EU Single Rulebook Project, it might be beneficial to have a neutral party act as host and coordinator of ESAs, the ECB, NCAs and DG-FISMA. Such a
neutral party should, as a centralised data repository, be tasked with the hosting, construction, management and quality assurance of the components making up this enhanced single rulebook resource. The EC has exclusive competence to foster harmonisation and integration. Making the extent of the various Level 1–4 texts more accessible and clear, and reducing gaps and CTR between EU legislative texts as well as between EU and national legislation is not a new power or beyond the EU or the EC’s competencies. Rather this focus on eliminating gaps and errors should be a priority as smarter and clearer legislation is a pre-requisite to the actual integration of EU financial markets.

16.16 The EU Publications Office, based in Luxembourg, which also runs EUR-Lex, may be best placed, either in its current arrangement or by creating a standalone directorate “just” dedicated to financial services, to act as a (comparably) neutral coordinator and host a separate online resource for this enhanced EU Single Rulebook resource as it works with a number of EU bodies, Directorates-General of the EC and external professionals. In its role, the EU Publications Office is tasked, inter alia, with collation of documents for publication; the preparation of, graphic design, correction, page make-up and verification of the texts and other components, in whatever format and on whatever medium, as instructed by the institutions and in compliance with the typographical and linguistic presentation requirements established in cooperation with the institutions; the indexation and cataloguing of publications; the documentary analysis of texts published in the Official Journal and other official texts; the consolidation of legislative texts; quality control; the physical and electronic distribution of the Official Journal, official texts other than those published in the Official Journal and other non-mandatory publications; and storage and physical and electronic archiving. The content can be provided by the ESAs, the ECB and suitably qualified professional legal advisers with a track-record of building rulebooks that emulate the UK FS Handbook.

16.17 The EU Publications Office, if given a role as a neutral coordinator, might also be a more efficient “control body” if it were to be tasked with maintaining the EU Single Rulebook but also if it were equally granted competent powers and resources to identify and, in conjunction with the ESAs as policymakers, to eliminate the various gaps, inconsistencies and errors across the legislative instruments making up the EU financial services environment. In such a possible conceptual scenario, the ESAs, and where relevant the
ECB-SSM and SRB, along with DG-FISMA (as legislative policymaker), would retain their rule and (supervisory/regulatory) policymaking authority (i.e. the draftsman) as well as their mandated priorities. They would however benefit and be able to leverage upon an independent body to provide greater assistance in ensuring that all the individual strands of legislative and regulatory provisions tie together in an interoperable fashion as well as to advance convergence, standardisation and/or harmonisation where necessary/desirable.

16.18 In many ways the absence of such a function in the EU means that, unwarranted gaps between EU legislative instruments as well as between those and national legislation are likely to continue including in the form of conceptual gaps and CTR. As a result, this inconsistency of rules, the continued absence of a true EU Single Rulebook will allow market fragmentation to persist and will most likely do so irrespective of any political will driving the EBU, the Capital Markets Union or the range of other initiatives that seek to complete the Single Market.

16.19 Competent delivery of such a transformation from PDF to online based, assisted by appropriate legal counsel and professional advisers, by the EC, the ESAs and the ECB, would strengthen the market and build CMU, improve certainty and mobilisation of collateral. The same would be welcome to create a resource that compares security interests’ characteristics. That might serve as a first step to working to an EU-wide security interest. These are far from insurmountable technical issues. Nevertheless, whether this occurs EU-wide or between certain EU-MS, is largely a political question and requires overcoming some of the barriers flagged by Bosomworth but also in the 2015 FMLC Paper.

16.20 That said, in the interim, however, market participants need to remain cognisant that CMU, as currently proposed, does not eliminate, forestall or reduce CTR and legal uncertainty, rather if not handled correctly and prudently (equally on the transaction documentation level) will surely eliminate a number of the efficient capital allocation benefits that CMU is supposed to achieve – especially if this common regulatory language is lacking. In fact, if left unchecked the wind on the good ship convergence may lose more wind out of its sail, less oil to its engine etc., if the following issues that the 2015
FMLC Paper highlighted as continuing barriers and challenges for policymakers and regulators, namely – with comment added:

<table>
<thead>
<tr>
<th>Barriers flagged in 2015 FMLC Paper</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. “discontinuity in the G20 handover process”</td>
<td>one might term discontinuity as “mission drift” or ceasing to pursue reforms to the full level of delivery in favour of prioritising efforts on other reforms.</td>
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<tr>
<td>2. “reticence of governments to follow through on specific G20 commitments or international principles”</td>
<td>or do so in a consistent manner.</td>
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<td>3. “constraints imposed by domestic legislative processes”</td>
<td>in that certain policy objectives cannot be implemented as quickly or as easily in domestic legislation as had been anticipated at the international level. As a result this delay due to the conceptual translation barrier may aggravate an uneven regulatory environment.</td>
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<tr>
<td>4. “the effects of any tendency towards super-equivalence or “gold plating”</td>
<td>as with the above, this continued process of super-equivalence, which occurs between international levels, i.e., the USA and the EU, both Goldplating the international commitment, may if done without legitimate justification, significantly detract from the underlying regulatory policy objective of the particular commitment and thus prevent compliance in a productive or meaningful manner. Equally, Goldplating amongst relevant jurisdictions (an EU issue) or amongst differing regulators across transaction types (more a US-American issue) can create roadblocks that obfuscate the conceptual translation and thus may aggravate an uneven regulatory barrier.</td>
</tr>
<tr>
<td>5. “a lack of consensus regarding consistency and comparability assessments”</td>
<td>without regulators and policymakers having a common understanding of how to assess the degree of convergence, and would ideally hope for, the degree of CTR, further convergence of consistency and comparability may remain an aspirational goal.</td>
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<td>6. “limits on the powers of international bodies”</td>
<td>the inability of the FSB or IOSCO and the absence of EU action in respect of rectifying convergence, lacks the ability to give credence to that work.</td>
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<td>7.</td>
<td>“concerns regarding regulatory cooperation, supervision and enforcement”&lt;br&gt;in the absence of harmonised working practices, standards differ, CTR increases and supervisory arbitrage opportunities ensue with certain jurisdictions being perceived as lax versus others that are more rigorous.</td>
</tr>
<tr>
<td>8.</td>
<td>“a lack of a formal grievance procedure”&lt;br&gt;for transgressions, inconsistencies or delayed translation of the agreed policy objectives into the respective legislative and/or regulatory framework(s).</td>
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*Figure 5 – 2015 FMLC Paper Barriers*
17. Revisiting the Draft SLL and how it and a CASS Rollout could support other reforms

17.1 To date, the EU legislative response in harmonising the types of securities interests, in a similar fashion taken by the UCC or in other jurisdictions the approach taken on PPSAs, has not advanced beyond the concept stage. For reasons discussed in Parts I and II, an EU UCC would be welcome. The same lacklustre approach has been taken in slow movement to even create a table showing the conceptual similarities and differences between in the form of the Draft SLD/Draft SLL which stalled in 2010/2011, has not even come close to what might be necessary to advance financial integration in the post-trade services sector. The Draft SLL was heralded by a number of EU policymakers, including the EC in preparing CMU as one option that would assist in establishing the necessary prerequisites to a resilient foundation of CMU and give greater certainty in the post-trade environment of financial instruments. Like with the conceptual gaps around collateral and Custody, little if no action has been advanced to revitalise a Draft SLL as a binding EU-wide Regulation, akin to an “EU UCC” or even (just as) a voluntary common regime, i.e. a 29th Regime. The Draft SLL may not be, in its stalled form, perfect, but it marks an anchor upon which to advance reform.

17.2 Commitment to creating a voluntary or 29th Regime” or any other harmonising legislative framework for EU-wide financial instruments beyond areas where such approach has been mooted and delivered in actual EU legislation, such as the pan-European “personal pension product” (PEPP) or proposals for a comparable financial instrument based savings products would be welcome for the central role the Collateral Ecosystem plays for financial markets that the EU wants to harmonize using CMU (2.0) measures to make the Single Market more single.

17.3 Similar action of dusting off good proposals that both the EBU and ultimately Brexit have put on old also apply to action to increase harmonisation of investor protection levels, notably beyond those levels in Directive 1997/9 (the Investor Compensation Scheme Directive (the ICSD)). This action point not only merits a revival of the reforms to the ICSD, but makes it fit for purpose to be interoperable with the revised BU supervisory framework as well as the recovery and resolution legislation. Some of these changes were contained in the legislative amendment proposals of 201051 and of 201152 to the ICSD.
Both the ICSD and Draft SLL could potentially be quickly ready to be put back on the table, having been surprisingly shelved and withdrawn by the Juncker Presidency in December 2014. As legislative proposals, these were very much publicised as key to the post-GFC reforms that sought to strengthen investor confidence in securities markets. More generally, the harmonisation of protection levels of investor compensation schemes was also heralded as a precondition to delivery of EBU (before CMU was even a concept), yet was seen by some as politically divisive (even though the actual points were minor) as ICSD at least was perceived to undermine the reforms culminating in improvements to depositor protection and its protection levels under the now subsequently revised Deposit Guarantee Scheme Directive (DGSD).

However, both legislative proposals to improve the ICSD focussed on the scope of coverage of relevant investor compensation schemes, standardised disclosure requirements on scope of coverage and a faster payout speed. The legislative proposals were to raise the original (and still in force) staggered protection levels from €20,000 to an uniform level of €50,000 in the 2010 legislative proposal and in the 2011 proposal to a tiered level ranging between €30,000 and €100,000. In both instances, these improvements would have benefitted investors covered by the ICSD schemes. Halting reform in securities investor protection has however been repeatedly criticised by a number of EU EU-MS, especially those that have a deep, functioning capital markets and a strong consumer protection ethos. Why precisely this is not addressed in the 2015 CMU Action Plan is strange, especially since the CMU’s objectives are to improve resilience and confidence in capital markets and open up non-bank lending funding alternatives.

Turning briefly to the U.S. equivalent compensation schemes for inspiration, it should be noted that the equivalent to an ICSD scheme, the Securities Investor Protection Corporation (SIPC), was itself born out of the “paper crunch” crisis of 1968–70 and failures of broker-dealers during the birth of the Eurodollar Market. Like most sophisticated investor compensation schemes, SIPC protects investors against the loss of cash and securities held by a customer at a financially-troubled SIPC member firm. Protection levels are up to a value of U.S.$500,000 of which U.S.$250,000 is the applicable limit for cash held. Protection for multiple accounts is available depending on the type of capacity the customer acts in. These protection levels are considerably higher than any EU relevant ICSD and DGSD. It should also be noted that the US equivalent of
the DGSD is the Federal Deposit Insurance Corporation (FDIC); a creation in 1933 as part of Roosevelt’s far-reaching “New Deal” financial market and infrastructure reforms in response to the earlier crisis of the 1929 Great Depression. In terms of protection, the FDIC protects the consumer in a harmonised fashion up to the value of US $250,000 per depositor, per insured FDIC firm per each account in each type of covered category. Both SIPC and the FDIC provide considerably more protection than anything the EU has ever delivered and the EC should have considered this development in its CMU Plan’s “actions” as one that would deliver tangible benefits to consumers.

17.7 The same applies in respect of insurance sector coverage, and as shown in Annexes 1 and 2, some of what say the UK has done to level the playing field of rules to the banking and securities markets sector to extend this wider to other financial sectors like insurance, means that the EU would best be placed to assess and conclude, regardless of the EU-UK’s changing relationship, grounds to follow suit and provide financial market participants with greater coverage of protections and confidence to engage in more single Single Market. To not do anything would mean that compensation coverage in the EU’s insurance sector remains disjointed in Europe to the extent that any national schemes for insurance business exist. This failing was recognised in the FSAP and the FSWP, yet, little or anything has been done to plug this conceptual gap in consumer protection and introduce an insurance sector equivalent to ICSD or DGSD schemes. The UK does have insurance guarantee protection through the harmonised scheme, the Financial Services Compensation Scheme (FSCS), which currently provides uncapped coverage for certain eligible claims. The EU’s current detail on efforts with respect to insurance guarantee schemes is limited to a landing page.

17.8 Delivering tangible and achievable measures as a Draft SLL Rollout means advancing the revised and new principles to in the short-term a 29th Regime and over the longer-term actual legislative proposals including focusing on:

(a) **Clarifying and harmonising when/how financial instruments/collateral are acquired in legal terms (when ownership transfers):** one benefit deliverable in the revised Draft SLL would be harmonising when transfer of legal title would be deemed to take effect (e.g. at the moment of debiting or crediting of an account
holder’s Custody/Depository account on the books and records of an account provider\textsuperscript{268});

(b) **Transparency offered to market participants and choices in respect of where their collateral is held:** in particular in the holding and disposition of financial instruments held through Custody/Depository accounts regarding conflict of laws as well as the processing of rights flowing from financial instruments held in those accounts. The Draft SLL also included principles to improve the transparency offered to market participants and choices in respect of whether their collateral is held at a financial intermediary or directly with a (International) Central Securities Depository (I)CSD). In particular, the differences between account models offered by (I)CSDs’ could benefit from greater comparability so as to allow standardisation to take place but equally for users of such services to better assess their exposure and the commercial proposition. This is particularly the case where there are mismatches between the segregation as well as account holding models on the vertical exposure level as well as the horizontal exposure level; and

(c) **Aligning protection of investors’ rights in the event of the insolvency/resolution of the foreign intermediary through which book entry financial instruments are held:** In addition to the issues relating to PRIMA, one more practical issue is that EU law does not uniformly and consistently define harmonised criteria for determining the ‘location’ of an account in complex models of financial instrument holding chains involving technical infrastructures such as T2S. More specifically, as the EPTF Report assesses and asks for a review to Art. 9(1) EU-FCD “without delay” – which has yet to happen, EU law does not (currently) specify whether the location of a relevant account should be understood as:

(i) the place of the relationship office through which the client maintains its business relationship?;

\textsuperscript{268} See in particular comments above with regard to the problems on acquisition, disposition of title and fragmented concepts across borders.
(ii) the place of the actual IT platform operating and maintain the relevant account and whether this is in relation to the location of the servers or the legally registered place of business of the platform;

(iii) the place of business where the client opened its account;

(iv) the place of business where the transaction is booked;

(v) the place of business of any sub-account provider or the place of business of the (I)CSD account; and

(d) As advocated by a number of commentators, in view of the possible divergent interpretations, Principle 14 of the publically available Draft SLD proposed introducing a uniform conflict of laws rule for all account holders and account providers included the clarification that a relevant account should be deemed maintained by the “…branch which services the client in relation to the securities account”. This logic is fundamentally flawed for a number of reasons and merits reform (as set out below) to avoid hardwiring legal risk rather than solving the problem:

(i) branches do not have their own legal personality although they can be treated, under English (but not EU supervisory) law, as distinct from head offices. Equally, multiple branches/teams “…service the client in relation to the securities account”. This creates legal uncertainty as to who/where the reference point is. This uncertainty not only applies to front office to back office splits, but equally to custodian and sub-custodian relationships\(^\text{269}\);

\(^{269}\) It should be noted that sub-custodians themselves may have deposited financial instruments with local clearing systems. This introduces further tiers in the holding relationship if viewed from the perspective of an EU market participant i.e., with an EU custodian as head custodian interfacing with an EU (I) CSD, a non-EU depositary as sub-custodian and a foreign (I)CSD as sub-custodian, complemented by relationships with the respective paying agent in the foreign jurisdiction. From the point of view of the custodian and (I)CSD, it is important to note from the perspective of an EU market participant user of such services, that despite the custodian and (I)CSD possibly being under a regulatory or contractual obligation to exercise a requisite duty of care and skill in respect of selecting foreign entities (irrespective of legal opinions) the holding chain is expanded further and to legal systems where it may not be absolutely clear to the EU market participant at the top of the holding tier, how it is protected through the claims of the head custodian (I)CSD against those lower down in the tiers.
(ii) the fact that the branches/teams that service the client (front office) and those that service the account (back office) are not mutually exclusive/dependent on one another and may move across jurisdictions during the relevant lifetime of the client relationship. The point of reference that is relevant is where the account is booked;

(iii) a possible reform would be to replace the concept of where the account is deemed maintained with “…in the jurisdiction of the place of business where the relevant account (to which the financial instruments or relevant entitlements are credited and recorded) is booked by the account provider.”

17.9 The Draft SLD’s approach on conflicts of laws also comes with deficits, as noted by the ECB T2S May 2013 Letter as well as by Paech (also author of the 2011 EP Report). As further noted, a number of legal-conceptual issues are largely untouched by SFD and FCD and since their transposition (footnotes and emphasis added):

“…further harmonisation efforts, both in international fora and the EU, rapidly slowed to a trickle the 2002 Hague Securities Convention and the 2009 Geneva Securities Convention, though unanimously adopted after years of expert discussions, faced considerable opposition from inside the EU and to date have not been implemented by sufficient number of countries. The European Commission worked on its own proposal for a comprehensive harmonisation of securities law aimed at mitigating legal uncertainty in this area.”


As Paech 11/2012 summarises in footnote 5 (emphasis added): “The Settlement Finality Directive is confined to system operators and system participants. It prescribes that (national) insolvency rules cannot reverse transfer orders once entered into the settlement system. The Financial Collateral Directive prescribes that formalities in respect of securities collateral are to be abolished and is (by and large) confined to wholesale market participants. Neither of the Directives attempts to harmonise the content of the securities holder’s right, the rules on how such rights are to be transferred or encumbered, or any rules on priority or good faith acquisition. Furthermore, the two Directives, given their un-coordinated scope, contribute to creating a generally patchy framework for securities holding and disposition in the EU.”
(i.e. this stalled work from the Commission is the Draft SLD described in further detail below). Paech 11/2012 also goes on to state (emphasis in bold and clarifications in square brackets):

“The fate of both the Hague Convention and the Geneva Convention, as well as that of the [proposed Draft SLD/SLL] European legislation show a common pattern: the instruments (or the project in case of the EU) became bogged down as they passed from the stage of expert discussions into the political sphere. The proposed solutions were rejected, and even the case for harmonisation was re-opened and questioned. In all three cases, the furore centred mainly on concerns that account holders’ securities would be less protected if existing legal concepts governing securities holding, notably the concept of property, were undermined.

This controversy exposed conflicts and tensions of different kinds. Some commentators were genuinely convinced that rights in securities can best be expressed in the form of proprietary positions for conceptual reasons, notably in view of the general approach which classifies securities as tangibles. Others feared that harmonisation of the legal approaches in respect of securities law would inevitably lead to a proliferation of the ‘Anglo-American’ approach which purportedly leads to less protection of client securities in the event of a bank’s or broker’s insolvency. Small wonder that this argument proved very effective in political terms in the wake of the financial crisis. A third type of criticism skimmed the surface of the legal debate—centring in particular on property concepts—but in substance aimed at preserving current business models in the securities markets against legal reform, as legal or regulatory changes regularly cause costs and might, in this particular case, open up certain business domains to international competitors.

It was impossible to sort the partisans into clear factions. Governments, regulators, issuers, brokers, merchant banks, service providers and private and institutional investors across national boundaries could be found on both sides of the discussion. There were even divides within organisations acting globally, where the merchant bank arm argued in favour of market-focussed
harmonisation while the securities service arm held out for conceptual purity.\(^{272}\)

Justice ministries and central banks in one and the same country might likewise be at odds over that question – and even different divisions within the ECB did not agree as to which concept was the correct basis for harmonisation.”

17.10 The nature of the European project and in particular this workstream is that it is precisely the “Anglo-American approach” in particular in relation to the UK’s CASS Sourcebook for MiFID retail and professional clients and the United States’ U.C.C. as well as the more consumer focussed protections that offers a greater deal of protection than the regime both in 2010-2013 (when the debate on the Draft SLD/SLL was more pronounced and Paech 11/2012 was being concluded) was offered and this remains fact as of the date of this publication in particular, in the absence of a level playing field and application of UK CASS style protections across the rest of the EU.

17.11 Such an application might be realisable in bringing harmonised benefits and more resilient measures in a functional manner without the need to detract from delivery of CMU and reopen stalled workstreams focussed on harmonising national laws on security interests, legal schools of thought and exerting resources in debating the pros and cons of Factual PRIMA \(v\) Contractual PRIMA or \(v\) lex rei sitae \(v\) lex contractus.

17.12 Other areas where reforms are likely to be needed include clarifying and harmonising an EU definition of contractual and statutory netting and set-off for consistent use in EU legislation but equally as a point of reference for national EU-MS to benchmark their national security interests against. The following might serve as a starting-block for a jurisdiction-agnostic definition (one that stands alongside the definition in the EU-SFD as used in the context of safeguarding transfer orders in settlement systems) – which can be further annotated as required with either “contractual” or “statutory”, as may be relevant\(^{273}\):

\(^{272}\) As proffered by Paech 11/2012 in footnote 15: “This phenomenon can be explained by the fact that the aim of a merchant bank is to secure more and easier cross-border business, whereas the securities service arm of the same banking group will consider the protection of the status quo, i.e., market fragmentation, which is more advantageous for its business model.”

\(^{273}\) For further background reading, please also refer to Wood, Philip, “Set-off and Netting, Derivatives, Clearing Systems”, 2007, Sweet & Maxwell.
(a) **Netting:** means the legally enforceable reconciliation and payment under which amounts between contracting parties are consolidated into a single payment from one party to another;

(b) **Set-off:** means the legally enforceable offset or discharge of competing eligible claims, whether as a product of netting or not, to extinguish the competing claims and produce a single, smaller amount from one party to another.

17.13 The words “legally enforceable” aim to cover bilateral as well as multilateral netting arrangements and equally to facilitate the benchmarking between national laws of EU-MS and this EU jurisdiction neutral definition which may be relevant in particular for those civil/Napoleonic law based legal systems that do not recognise set-off at insolvency or where there are special jurisdiction-specific rules on the mutuality or reciprocity of obligations that are to be netted and set-off. The key legal principle to note is that netting is usually a pre-requisite to the application of set-off by parties and whilst the distinction between the two concepts may be established at EU law, further harmonisation is desirable.

17.14 Cross-border financial transactions, including collateralisation arrangements, whether based on English law master agreements (such as ISDA or GMRA documentation) have in part rolled-out the English law approach to netting and set-off. Nevertheless, as highlighted above, various different (governing) laws or legal systems may have application in such situations as well as in relation to insolvency or analogous proceedings including BRRD style recovery/resolution application and what that means to identifying

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274 This should be contrasted further, with those jurisdictions, which however would permit that all contracts between the parties are automatically deemed to be cancelled and losses and gains set-off at the point immediately preceding the commencement of insolvency proceedings. This contractual fiction, is typically included by parties in their English law governed master agreements including collateralisation arrangements. One such example would be the parties’ choice to apply Automatic Early Termination in the context of an ISDA Master Agreement as a contractual work-around in respect of say a German domiciled counterparty so as to conform to the German insolvency law principles in the context of mandatory applicable and overriding insolvency law principles applicable in respect of the German domiciled counterparty. The legal effectiveness of Automatic Early Termination mechanics in different jurisdiction is periodically confirmed in ISDA’s commissioned legal opinions. As Wood (2007) notes in 1-046 in the above mentioned title: “The key question is whether a private contract—whether automatic termination on contractual connexity or novation—can defeat a bankruptcy statute which expressly nullifies set-off or rescission or both. If the contracting-out defies a statutory prohibition, it must be capable of strong and convincing legal justification if the requirement of predictability is to be satisfied.” And should be borne in mind when assessing the contractual solutions offered by a number of trading and collateral documentation as well as the application of EU-FCD or the EU-SFD.
certain transactions as well as applying netting/set-off in those transactions. This confusion, even with a more pronounced conflict of laws regime as advocated above, merits closing as the conceptual gaps between legal systems ought to be closed, through a common point of reference so as to build a common understanding of these key terms in building CMU.

17.15 As evidenced in Annex 2, given some of the questions in the EU-FCD’s drafting, some EU counterparties employ contractual/tri-party arrangements to protect return of excess collateral in the event such excess is not protected by EU-FCD, or appropriately segregated. This is costly but avoids the excess from being “trapped” within the counterparty’s insolvency/resolution proceedings. Under the UK CASS rules, there is a principle²⁷⁵, which requires that any excess after the solvent netting and set-off is promptly paid to the collateral giver or held in accordance with the UK’s Client Money Rules i.e., on a segregated basis or a statutory trust basis so as to remove it from the insolvency/resolution proceedings in respect of the estate of the account provider.²⁷⁶

17.16 A CASS Rollout i.e., taking the British and Irish rules, adopting them on a Jurisdiction-Agnostic manner to benefit the EU-27 would spearhead such convergence and harmonisation in a truly transformational manner. Coupled with a Draft SLL Rollout, whether as a 29th Regime plus legislative instrument or just as a 29th Regime, real action to close fragmentation could be achieved in ways that Bosomworth also proposes i.e., without EU-treaty or other invasive changes – such as on-going work on insolvency laws.

²⁷⁵ In particular CASS 7.2.11.
²⁷⁶ See also Yeowart and Parsons Chapter 18 but specifically issues discussed at 18.90.
Nevertheless, in the EC’s own words in the CMU GP this harmonisation of national laws is “no easy task”, so it is questionable why harmonisation of insolvency laws and security interests, through more legislation at EU level, in particular building on stalled workstreams would solve a problem that the EU has noted for the past 30 years. These (perhaps aspirational) ambitions of harmonising national laws on insolvency or security interests in a comprehensive manner are longer term goals, however, ones that should not impede a new EU legislation focussing on functional matters in advancing comparability, harmonisation and standardisation as methods of delivering greater integration. The U.S. legislative evolution over a number of years, delivered harmonisation by adopting an approach concentrated on functional harmonisation as opposed to a focus on conceptual harmonisation. The latter has been the Commission’s historical focus. As the CMU GP notes, focus for change will determine between short(er) and long(er) term measures.

It although perhaps worth noting that the U.S. U.C.C., is a model code that individual state legislatures transposed. The general U.S. Federal and State legislative evolution meant that the U.C.C. as adopted by most American legislatures had a lesser task of harmonising State law as legal systems had comparatively more commonalities amongst

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277 See page 24 of CMU GP (footnotes in square brackets):

While the discussion around harmonising substantive insolvency legislation has been slow over the past 30 or so years due to its complexity, there has been considerable progress in the area of conflict-of-laws rules for cross-border insolvency proceedings [Footnote Text: clarifying that Regulation 1346/2000 on insolvency proceedings will be replaced by an improved legal instrument in 2015]. However, underlying national insolvency frameworks are still divergent in their basic features and in their effectiveness [Commission Staff Working Document 2014 (61) final]. Reducing these divergences could contribute to the emergence of pan-European equity and debt markets, by reducing uncertainty for investors needing to assess the risks in several Member States. Furthermore, the lack or inadequacy of rules enabling early debt restructuring in many Member States, the absence of “second chance” provisions, and the excessive length and costs of formal insolvency proceedings can lead to low recovery rates for creditors and discourage investors. With a view to achieving progress on insolvency, the Commission adopted a Recommendation on a new approach to business failure and insolvency [Commission Recommendation C(2014) 1500] in which it urges Member States to put in place early restructuring procedures and ‘second chance’ provisions. The recommendation also invites Member States to consider applying the principles to consumer over-indebtedness and bankruptcy. An evaluation of the Recommendation is planned for 2015.

278 It is important to of course recall that EU national legal systems also differ not only in schools of thought but legal culture in particular with relation to protection for debtors and sympathy to ease of creation of security interests. The latter point is discussed in Wood, Philip “Comparative Law of Security and Guarantees” in detail at 1-7 (although possibly superseded) in terms of certain legal cultural approaches across key jurisdictions and at 1-10 and 1-11 the main issues that Wood in this leading text and unique analytical categorisation considered as main issues relating to security interests and how these impact the ranking.
U.S. states than perhaps amongst EU-MS and their respective legal schools of thought. It should be noted that the U.C.C was transposed only in part by Louisiana (civil law jurisdiction) that were deemed by that state as compatible and that a small number of other state legislatures have exercised their legislative independence and made a few substantial deviations to that of the model code. Furthermore, in contrast to the EU principles of subsidiarity, cases under the U.C.C. may be decided by either state or federal courts however, interpretation by state courts of U.C.C. provisions binds the federal courts. The U.C.C. is regularly reviewed and legislative commentary issued by the National Conference of Commissioners on Uniform State Laws and the American Law Institute to meet new needs, as such it is an evolutionary guiding piece of model legislation.

17.19 In Europe, these differing schools of thought in EEA jurisdictions have impacts on laws of property, security and proprietary interests and concepts of ownership, entitlement, acquisition and disposition of title as well as bona fide acquisition. It is notably in relation to the latter that a functional approach might be helpful in ensuring that the fragmentation across national EU legal systems might be set aside and a consistent and legally certain regime applied. Historically rules on good faith acquisition were meant to alleviate the need for the acquirer that the disposer had not committed fraud and indeed had good title and thus remove an impediment of relevant laws to the rapid transferability of financial instruments and assets. And part of the problem is that in providing a solution that evolved prior to dematerialised financial instruments and true cross-border transactions a number of jurisdictions, had in uncoordinated fashion, applied principles of property law – thereby hardwiring conceptual barriers between negotiability and protection against fraud and in more recent times, against insolvency risk of the intermediary.

17.20 Those rules, possibly along with traditional legal concepts applicable to financial instruments may be superseded yet, as Paech 11/2012 notes, that market participants and markets operate implicitly on the assumption that financial instruments that are in flux are transferred with good title and thus without the need to verify this in any great detail. As further noted this concept needs to be updated, not least to have a uniform playing field, but equally to interoperate with the updated principles of insolvency as well as those as amended with respect to resolution of regulated financial institutions and financial market infrastructure providers. Equally, a point that can be agreed on with Paech (in
particular p. 32) is that any revised Draft SLD/SLL, including an EU UCC in the mould of the U.S., should not fully displace the remainder of domestic securities laws and on security interests that EU-MS (or indeed market participants) might need to remain. Any legislative approach ought to seek to be one of co-existence and overlay as opposed to displacement. This may also reduce resistance from certain EU-MS.

17.21 Delivering change might also benefit from legislation assisting in the harmonisation process and building common items. As noted above, a lot of change has already been delivered through multiple strands of legislation. Further change can be delivered through EU delegated regulation, notably MiFID II/MiFIR and could focus on harmonising some of the items relevant for collateral below. Other change should be delivered in a standalone legislative initiative, preferably one that focusses on a functional approach but also ties existing legislative strands together in a comprehensive manner i.e., including definitions, terms, concepts. In tying these strands together this means *inter alia*:

(a) **Aligning collateral ownership reforms with client money and/or client asset protections:** Further action is needed to take into account recent national and EU regulatory developments affecting collateral generally, as well as those specifically relating to the handling and protection of client money and/or client assets. Developments in collateral markets also have to be taken into account, both in terms of asset classes, transmission channels, Custody and safekeeping arrangements and improvements to resilience of securities settlements systems as well as revisions that seek greater convergence of the application of relevant conflict of laws rules. Some of this includes assessing how EU-MS addressed this, notably the UK and Ireland, which were translated into clear, workable rules (i.e. the CASS Sourcebook in particular CASS 5, 6 and 9), that the market has implemented (including in a manner that works with the BRRD) without the need for ‘over legislation’ and a track-record of active supervisory engagement. As a result these future CMU reforms could, by way of a legislative overlay, concentrate on functional questions as opposed to harmonising 28 EU-MS laws. This means focussing both on “who owns what” but more importantly “who can do what, how and when” with collateral, client assets and client money and

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specifically segregation and rights of re-use. Such a legislative overlay could serve to harmonise these issues more efficiently than stalled workstreams have progressed and not only across borders (i.e., differences between protections/rules in say Ireland versus Italy) but equally through the different tiers of holding chains (i.e., from (I)CSD level to end user) but more importantly across the various chains of financial transactions, collateral arrangements and holding chains. Concretely this means a uniform set of rules with regard to:

(i) on-going transparency obligations for dealer entities to provide information in a simple, transparent and standardised format to their counterparties on how these counterparties’ collateral is held and/or segregated, how and when it may be used and which events require notifications as to the usage of collateral;

(ii) periodic regulatory reporting by dealer entities on Client Money and Client Asset positions and holdings allowing competent authorities to take timely, firm or specific supervisory action thereby assisting in the identification, mitigation and management of risk and its propagation; and

(iii) the timely identification, protection and separation (including Segregation in a consistent fashion) of Client Assets and Client Money from the estate of the provider of the safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management when such provider becomes subject to insolvency proceedings (or such analogous proceedings) or the administration of a regulatory led resolution plan.

(b) harmonising consistency of rules and interpretation of the EU-FCD and EU-SFD: as applied throughout the EU in particular in the context of greater uniformity of legal outcomes particularly in a default/insolvency (or analogous) situation, particularly in certain jurisdictions with less developed legislation, the principles of applicable insolvency laws in particular due to potential inefficiencies for certain jurisdictions that exist as a result of fragmented technical standards and differing business practices. Put otherwise, closing this gap means
closing the risk of CTR propagating further in how FCD and SFD are applied across the EU; and

(c) introducing harmonising legislation to create a uniform and comprehensive solution to conflict of laws as they apply to securities and in certain circumstances ownership rights: The fact that differing approaches are included in various EU legislation presents an unnecessary and unwarranted confusion, which may still arise even where parties have still chosen a governing law to apply to their arrangements. This merits not only having harmonised defined terms, points of identification such as attributing accounts as being maintained as to where they are booked as opposed to the nebulous concept of a relationship being serviced etc. and making these rules operable in a manner that does not upset or obstruct the privity of contract between counterparties wishing a governing law to apply as well as defined fallbacks as to when inactions trigger action. The CSDR took a first step in imposing principles on (I)CSDs operating cross-border to address their legal risks and take mitigating action. A further welcome step for delivery of CMU, as well as increasing resilience of financial market infrastructure providers more broadly, would be to expand that identification and mitigation requirement and complement it by imposing a periodic public disclosure obligation of such legal risks, CTR, general business risk, operational risk and scope as well as resilience of mitigating actions. Currently any such detailed is largely split between regulatory public disclosure requirements of governance arrangements (mostly satisfied through a high-level version of the actual governance arrangements) as well as largely voluntary, unharmonised and non-comparable to users of financial market infrastructure

See Art. 43 of CSDR which sets out:

“1. For the purpose of its authorisation and supervision, as well as for the information of its clients, a CSD shall have rules, procedures, and contracts that are clear and understandable for all the securities settlement systems that it operates and all other services that it provides.

2. A CSD shall design its rules, procedures and contracts so that they are enforceable in all relevant jurisdictions, including in the case of the default of a participant.

3. A CSD conducting business in different jurisdictions shall take all reasonable steps to identify and mitigate the risks arising from potential conflicts of law across jurisdictions.”
providers. Such a change would most likely be able to be delivered through delegated legislation of the CSDR and more broadly in respect of MiFID II/MiFIR reforms. If as proposed herein financial market infrastructure providers were to become users of the Coll-RR, Cust-RR as well as CTR, they could measure their own systems, controls and governance arrangements and their susceptibility to these new risk methodology measures as well as more established risk metrics and periodically make these publically available, thereby reinforcing ease of comparability for users.

17.22 From a settlement perspective, the CSDR recognised and sought to address that settlement markets in the EU remain fragmented across national borders and cross-border settlement remains costly. This cost arises due to differing rules (in part with staggered application) applicable to settlement and a CSD’s activity. What the CSDR did deliver was a shortening of settlement cycles to T+2 as well as improving settlement discipline i.e., requiring CSDs to establish systems to monitor settlement fails, publish the ten participants with the highest fail rate, provide the prevention of settlement failures through imposing mandatory buy-ins and penalties. Such harmonising measures would be beneficial for arrangements along the “levels” between CSDR and end-user investor. Improving those arrangements will require looking at national, notably insolvency laws and seeing how EU law can close gaps in much the same way as analysis conducted in Annexes 1 and 2.

17.23 Harmonisation and subsequent standardisation of legislative and regulatory obligations touches across the entire spectrum of the component legislative and regulatory provisions. Aside from the technical barrier above, there are also more fundamental barriers that are beginning to erode, but CMU may be a platform to bring a sledgehammer to break down the rest. One key area in which policymakers have begun to (welcomingly) focus their attention is convergence of both the consistent use and standardised use of definitions i.e., defining the who and the what as well as harmonising and standardising the terms of the obligations imposed in respect of the market participants, the subject matter and the relevant definitions i.e., ensuring convergence across the how, when, where, what and why. This remains a long work in progress, complicated not only by the fact that multiple work-streams are working around the same set of regulatory policy objectives (the silo
mentality factor expanded into multiple silos with little communication between one another).

17.24 This is further complicated by the fact that CTR may have already be hardwired in to these work-streams through (A) the differing often opposed objectives of stakeholders in each silo, (B) lack of genuine convergence across different silos (between multiple stakeholders or within individual stakeholders), (C) sheer volume of workload, (D) the correlation of the impact that the workstreams have on one another and the fact that the silos are not isolated whereas working groups may treat them as such, (E) the speed at which such reforms need to take place and (F) lack of single project management bringing the strands from the silos together at EU level i.e., a degree of legal dirigisme is lacking that is perhaps necessary in overcoming the existing fragmentation pre-CMU and the emerging fragmentation and hardwiring of CTR as CMU develops. The building of the EBU, an on-going project, is no different.

17.25 From a lawyer’s perspective or that of a legal academic, the attractive solution might be, as proposed in subsequent sections to suggest an EU institution that takes lead on this project management to make the Single Rulebook more single and steer (dirige) the components of the ESFS that are all committed to delivering convergence but have different track records. The nuts and bolts remain the issue in removing the inconsistency and improving convergence. As the 2015 FMLC Paper, summarised:

“Considerable progress has been made by the FSB, other international standard-setters, national regulators and supervisors towards the ideal of regulatory consistency and systematic cooperation, but challenges remain. For example, deadlines and timetables have proved difficult to meet and/or subject to a failure of coordination. Countries have legislated unilaterally in advance of international principles or standards. Approaches to important issues such as “equivalence” or “substituted compliance” differ across countries. Gaps and overlaps have emerged between jurisdictional requirements. In his letter of November 2014 to G20 Leaders, the Chair of the FSB, Mark Carney, accepted the need for further work by the FSB on aligning the national implementation of G20 commitments, announcing that, from next year, the FSB will begin “an annual reporting process on implementation”. 

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Taking a step back, in financial market transactions, defined terms are key and working across documents means often having dedicated Common Terms Agreements or equivalent documents. Certain national competent authorities notably those of the UK and Ireland have very detailed glossaries (the UK is a prime example in its Financial Services Handbook) that do a very robust job in making sure regulators, the regulated and end users and the respective professional advisers all have access to the same language and can use it competently. A common regulatory language improves comparability, formation of sensible policy with common, harmonised elements and assists differentiating and benchmarking. Why should this be any different for CMU and notably collateral?

A new cross-sectorial study is long overdue and now more so than ever before paramount as demonstrated by the assessment in the Annexes 1 and 2. The sections above, have set out that whilst CMU, it comes with a number of issues and challenges for the future strength and degree of integration in an EU single market for collateral. Proposals voiced herein, may assist stakeholders in shaping and operating in a Collateral Ecosystem, however comes with warnings not to overlook the importance of identification, mitigation and management of one’s risk exposure and risk contribution in that ecosystem.

Whatever the future holds on the delivery of CMU 2.0 as well as new or improved rules on collateral, client assets and client money, the main threat to destabilising the catalyst that CMU overall is intended to be remains the will of policymakers, supervisors and market participants to push financial integration forward. Fatigue in that process will be inevitable if one does not focus on a functional approach and comparability rather than trying to hammer square pegs through round holes.

Thus, as mentioned above, irrespective of CMU’s revised delivery strategy being based on a sensible and manageable staged approach, it is crucial that policymakers and stakeholders have consensus on a rough blueprint of how the supervisory and market environment of CMU 2.0 (possibly 5.0?) will look like in five, ten and fifteen years. This roadmap was anticipated to be delivered before end of 2015 and now is scheduled for before 2024. One can only hope that it will serve as a valuable provides a roadmap against which delivery and reform can be benchmarked as well as managed and that it is flexible enough to account for innovation or for mitigating action to be taken in relation to risks in its design or risk affecting stakeholders.
18. **Outlook ahead**

18.1 In conclusion, this thesis’ three parts, and evidence set out in the Annexes 1 and 2, have each provided a detailed insight into some of the known and newly proposed challenges, risks and levels of fragmentation that are causing barriers to making the Single Market for financial services and notably the Collateral Ecosystem that underpins it more single.

18.2 Whilst the reforms of CMU 1.0 were welcome, CMU 2.0 and Brexit present an opportunity for the EU-27 to improve the harmonisation of existing rules and to think of new pragmatic ones that improve the resilience of mobilisation channels in the Collateral Ecosystem and reduce Coll-RR, Cust-RR and eliminate CTR by equally focusing on standardisation and improving comparability.

18.3 This is an opportunity that ought not to be missed and a failure to act would be shortsighted and counterproductive. Fatigue in that process will be inevitable if one does not focus on a functional approach and comparability rather than trying to hammer square pegs through round holes.

18.4 However, many of the proposed measures tack on to legislative workstreams that are already underway. Some are possibly even “low hanging fruit” in terms of political will and drafting. The drafting required ideally needs to take a Jurisdiction-Agnostic approach that is holistic and CMU 2.0 is the right channel. Changes ought to be advanced now ahead of the next-GFC like event providing an excuse to call that occurrence a catalyst for action. Financial crisis have a habit of coming back to haunt markets and with post-GFC changes and their failsafes still being implemented there are some known risks that have been identified, are ready to be mitigated so that if issues do arise they can be managed.

18.5 Whatever the future holds on the delivery of CMU 2.0 as well as new or improved rules on Collateral Assets, Client Assets, Client Money and Custody, the main threat to destabilising the catalyst that CMU overall is intended to be remains the will of policymakers, supervisors and market participants to push financial integration forward. It is also crucial for policymakers and stakeholders that shape the collateral ecosystem and financial markets more generally to have consensus on some of the national-perceptions and how that might hinder getting to the rough blueprint of how the
supervisory and market environment of CMU 2.0 (possibly 5.0?) will look like in five, ten and fifteen years. Not tackling this very crucial area underpinning the functioning of European but also globally linked financial markets may require political will to breakthrough perceptions.

18.6 Not tackling this fundamental area underpinning the functioning of European but also globally linked financial markets may require political will to breakthrough perceptions of “too rigid to reform” but crucially it is an area that is “too important to miss”.

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The 2017 EPTF Report summarises these as follows:

### Comparative listing of “Giovannini Barriers” vs “EPTF Barriers”

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<tr>
<th>GB Barrier nr.</th>
<th>GB Barrier Title</th>
<th>Responsible entity (1)</th>
<th>EPTF Barrier nr.</th>
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<td>GB 1</td>
<td>National differences in information technology and interfaces</td>
<td>Private Sector (SWIFT)</td>
<td>EPTF 2</td>
<td>Lack of convergence and harmonisation in information messaging standards</td>
<td></td>
</tr>
<tr>
<td>GB 2</td>
<td>National clearing and settlement restrictions that require the use of multiple systems.</td>
<td>National governments</td>
<td>XX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>GB 3</td>
<td>Differences in national rules relating to corporate actions, beneficial ownership and custody</td>
<td>Private Sector (ECSDA)</td>
<td>EPTF 1</td>
<td>Fragmented corporate actions and general meeting processes</td>
<td></td>
</tr>
<tr>
<td>GB 4</td>
<td>Absence of intra-day settlement finality</td>
<td>Private Sector (ECSDA)</td>
<td>XX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>GB 5</td>
<td>Practical impediments to remote access to national clearing and settlement systems</td>
<td>National governments</td>
<td>XX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>GB 6</td>
<td>National differences in settlement periods</td>
<td>Private Sector</td>
<td>XX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>GB 7</td>
<td>National differences in operating hours/settlement deadlines</td>
<td>Private Sector (ECSDA)</td>
<td>XX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>GB 8</td>
<td>National differences in securities issuance practice</td>
<td>Private Sector (IFMA, ANNA)</td>
<td>EPTF 7</td>
<td>Unresolved issues regarding reference data and standardised identifiers</td>
<td>Merged with GB 9</td>
</tr>
<tr>
<td>GB 9</td>
<td>National restrictions on the location of securities</td>
<td>National governments</td>
<td></td>
<td></td>
<td>Merged with GB 8</td>
</tr>
<tr>
<td>GB 10</td>
<td>National restrictions on the activity of primary dealers and market makers</td>
<td>National governments</td>
<td>EPTF W1</td>
<td>National restrictions on the activity of primary dealers and market makers</td>
<td></td>
</tr>
</tbody>
</table>

II. Barriers related to taxation

GB 11 Domestic withholding tax regulations serving to disadvantage foreign intermediaries | National governments | EPTF 12 | Inefficient withholding tax collection procedures |

<table>
<thead>
<tr>
<th>GB Barrier nr.</th>
<th>GB Barrier Title</th>
<th>Responsible entity (1)</th>
<th>EPTF Barrier nr.</th>
<th>EPTF Barrier Title</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>GB 12</td>
<td>Transaction taxes collected through a functionality integrated into a local settlement system</td>
<td>National governments</td>
<td>EPTF W15</td>
<td>Non-harmonised procedures to collect transaction taxes</td>
<td></td>
</tr>
</tbody>
</table>

III. Barriers relating to legal certainty

GB 13 The absence of an EU-wide framework for the treatment of interests in securities | National governments | EPTF 9 | Deficiencies in the protection of client assets as a result of the fragmented EU legal framework for book entry securities |
| GB 14         | National differences in the legal treatment of bilateral netting for financial transactions | National governments | EPTF 8 | Uncertainty as to the legal soundness of risk mitigation techniques used by intermediaries and of CSD’s default management procedures |
| GB 15         | Uneven application of national conflict of law rules | National governments | EPTF 11 | Legal uncertainty as to ownership rights in book entry securities and third party effects of assignment of claims |

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1 “Responsibility”, as indicated in the 2nd Giovannini Report 2003

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*Figure 6 – Giovannini Barriers vs EPTF Barriers*
### List of "EPTF Barriers"

<table>
<thead>
<tr>
<th>EPTF Barrier nr.</th>
<th>EPTF Barrier Title</th>
<th>Priority (2)</th>
<th>Responsible entity (2)</th>
<th>Chapter</th>
<th>Synergies and dependencies</th>
<th>GB Barrier nr.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>I. Operational Barriers</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EPTF 1</td>
<td>Fragmented corporate actions and general meeting processes</td>
<td>High</td>
<td>Private sector (all relevant parties), EI and national policy makers</td>
<td>Operational Barriers</td>
<td>EPTF 2 (management standards), EPTF 5 (shareholder registration), EPTF 9 (client asset protection), EPTF 11 (ownership rights)</td>
<td>GB 3</td>
</tr>
<tr>
<td>EPTF 2</td>
<td>Lack of convergence and harmonisation in information messaging standards</td>
<td>High</td>
<td>Market participants and regulators</td>
<td>Operational Barriers</td>
<td></td>
<td>GB 1</td>
</tr>
<tr>
<td>EPTF 3</td>
<td>Lack of harmonisation and standardisation of ETF processes</td>
<td>Medium</td>
<td>Private sector, EI Commission</td>
<td>Operational Barriers</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>II. Structural Barriers</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EPTF 4</td>
<td>Inconsistent application of asset segregation rules for securities accounts</td>
<td>High</td>
<td>EI Commission and Member States</td>
<td>Structural Barriers</td>
<td>EPTF 9 (asset segregation) and EPTF 11 (ownership rights)</td>
<td>New</td>
</tr>
<tr>
<td>EPTF 5</td>
<td>Lack of harmonisation of registration and investor identification rules and processes</td>
<td>High</td>
<td>Private sector, EI Commission and Member States</td>
<td>Structural Barriers</td>
<td></td>
<td>New</td>
</tr>
<tr>
<td>EPTF 6</td>
<td>Complexity of post-trade reporting structure</td>
<td>High</td>
<td>EI Commission</td>
<td>Structural Barriers</td>
<td></td>
<td>New</td>
</tr>
<tr>
<td>EPTF 7</td>
<td>Unresolved issues regarding reference data and standardised identifiers</td>
<td>Medium</td>
<td>EI Commission</td>
<td>Structural Barriers</td>
<td></td>
<td>GB 8 &amp; 9 redefined and combined</td>
</tr>
<tr>
<td></td>
<td><strong>III. Legal Barriers</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EPTF 8</td>
<td>Uncertainty as to the legal soundness of risk mitigation techniques used by intermediaries and of CCPs and default management procedures</td>
<td>High</td>
<td>EI Commission</td>
<td>Legal Barriers</td>
<td>EPTF 11 (ownership rights)</td>
<td>GB 14</td>
</tr>
<tr>
<td></td>
<td><strong>IV. Tax Barriers</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EPTF 9</td>
<td>Inefficiencies in the protection of client assets as a result of the fragmented EU legal framework for book entry securities</td>
<td>High</td>
<td>EI Commission</td>
<td>Legal Barriers</td>
<td>EPTF 4 (asset segregation) and EPTF 11 (ownership rights)</td>
<td>GB 13</td>
</tr>
<tr>
<td>EPTF 10</td>
<td>Shortcomings of EU rules on finality</td>
<td>High</td>
<td>EI Commission</td>
<td>Legal Barriers</td>
<td>EPTF 8 (risk mitigation)</td>
<td>New</td>
</tr>
<tr>
<td>EPTF 11</td>
<td>Legal uncertainty as to ownership rights in book entry securities and third party effects of assignment of claims</td>
<td>High</td>
<td>EI Commission</td>
<td>Legal Barriers</td>
<td>EPTF 9 (client asset protection)</td>
<td>GB 15</td>
</tr>
<tr>
<td></td>
<td><strong>V. Barriers on Watchlist</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EPTF WL1</td>
<td>National restrictions on the activity of primary dealers and market makers</td>
<td>Watchlist</td>
<td>Watchlist</td>
<td>Tax Barriers</td>
<td>EPTF 4 (asset segregation) and EPTF 5 (shareholder registration)</td>
<td>GB 11</td>
</tr>
<tr>
<td>EPTF WL2</td>
<td>Obstacles to DVP settlement in foreign currencies at CSDs</td>
<td>Watchlist</td>
<td>Watchlist</td>
<td></td>
<td></td>
<td>New</td>
</tr>
<tr>
<td>EPTF WL3</td>
<td>Issues regarding intraday credit to support settlement</td>
<td>Watchlist</td>
<td>Watchlist</td>
<td></td>
<td></td>
<td>New</td>
</tr>
<tr>
<td>EPTF WL4</td>
<td>Insufficient collateral mobility</td>
<td>Watchlist</td>
<td>Watchlist</td>
<td></td>
<td></td>
<td>New</td>
</tr>
<tr>
<td>EPTF WL5</td>
<td>Non-harmonised procedures to collect transaction taxes</td>
<td>Watchlist</td>
<td>Watchlist</td>
<td></td>
<td></td>
<td>GB 12</td>
</tr>
</tbody>
</table>

(2) “Priority” and “Responsibility”, as indicated in the EPTF Report.

Figure 7 – EPTF Barriers
See page 3 of the ECB HTF Report ([link](https://www.ecb.europa.eu/paym/initiatives/shared/docs/ea6aee-ami-seco-2017-12-07-item-1-3-collateral-management-harmonisation-report.pdf)) which in summary relate to the following areas, not all of which have (currently at the time of writing) an actual or proposed EU legal/regulatory equivalent that governs what the business processes aim to cover and/or where harmonisation is proposed to be advanced:

<table>
<thead>
<tr>
<th>Collateral Management Harmonisation Activities and their prioritisation</th>
<th>EU legal/regulatory regime exists to cover this activity?</th>
</tr>
</thead>
</table>
- 11 priority 1 business processes  
- 7 priority 2 business processes  
Interoperable processes allowing collateral mobility across triparty agents. | Not explicitly provided for in current EU legislation/regulatory requirements. |
| 2. Corporate Actions (relevant for collateral management) | Harmonisation of Corporate Actions processes, workflows and messaging by reinforcing existing harmonisation standards/efforts or adding new harmonisation standards (taking into account specific considerations from a collateral management perspective).  
- 16 priority 1 business processes  
- 5 priority 2 business processes | Not explicitly provided for in current EU legislation/regulatory requirements. |
| 3. Taxation processes (relevant for collateral management) | Harmonisation of tax processing in the context of collateral management (taking into account identification of parties in collateralised transactions). Creation of map of different national withholding tax requirements.  
- 8 priority 1 business processes | Not explicitly provided for in current EU legislation/regulatory requirements. |
- 2 priority 1 business processes  
- 2 priority 2 business processes  
Market practices needed for cleared OTC derivatives. | Not explicitly provided for in current EU legislation/regulatory requirements other than in SFTR, EMIR, CSDR and delegated legislation. |
| 5. Margin Calls | Interoperability and leverage of existing infrastructures and market platforms for margin processes.  
- 1 priority 1 business process | Not explicitly provided for in current EU legislation/regulatory requirements other than in Margin RTS. |
- 3 priority 1 business process  
- 2 priority 2 business process | Not explicitly provided for in current EU legislation/regulatory requirements other than in SFTR, EMIR, CSDR and delegated legislation. |
| 7. Cut-Off Times | Analysis is currently ongoing on minimum requirements for end-of-day cut off times (to avoid possible different value dates in cross-infrastructure transactions in different markets, which may create frictions for market participants active in different markets). | Not explicitly provided for in current EU legislation/regulatory requirements. |
| 8. Collateral Data | Harmonisation of data exchanges to ensure that information / data is available where necessary. Market practises needed for use of data.  
- 6 priority 1 business processes  
- 1 priority 2 business process | Not explicitly provided for in current EU legislation/regulatory requirements other than in SFTR, EMIR, CSDR and delegated legislation. |
| 9. Sourcing of Collateral processes | 10 Minimum requirements for sourcing/movement of collateral across Europe (priority 1). | Not explicitly provided for in current EU legislation/regulatory requirements other than CSDR. |
| 10. Non-Euro Collateral processes | Market practices for the handling of non-euro denominated collateral (including related corporate action processes).  
- 2 priority 1 business processes. | Not explicitly provided for in current EU legislation/regulatory requirements. |
Annex 1: Comparison on Financial Collateral Arrangement Rules

The following table sets out relevant rules and the assessment of their conceptual divergence or CTR (excluding rules on regulatory notifications to EU-level and national competent authorities).

|--------------------------|---------------------------------------------------------------|----------------------------------------------------------------------------------|-------------|-----------------------------------------------|
| Definition of SFCA       | Art. 2(3)(a) 

“security financial collateral arrangement” means an arrangement under which a collateral provider provides financial collateral by way of security to or in favour of a collateral taker, and where the full or qualified ownership of, or full entitlement to, the financial collateral remains with the collateral provider when the security right is established. | Regulation 3 

“security financial collateral arrangement” means an arrangement or security financial collateral arrangement, whether or not these are covered by a master agreement or general terms and conditions; | Regulation 2(1) 

“security financial collateral arrangement” means an arrangement under which a collateral provider provides financial collateral by way of security to or in favour of a collateral taker, and where the full or qualified ownership of, or full entitlement to, the financial collateral remains with the collateral provider when the security right is established. | • The UK limits introduced in Regulation 3 (a) to and including (c) reflect the concepts introduced in Art. 1 of the EU-FCAR.  
• The UK-FCAR’s scope is wider and super-equivalent to that of the EU SFTR and Irish-FCARs in that it extends to all non-natural persons. This in some ways is quite welcome.  
• As these laws pre-date the EU’s SFTR, the reference to “repurchase agreement” is not to be read in accordance with the definition in the EU SFTR of “repurchase transaction”, but rather is defined here: EU policymakers would be assisting the market in creating greater certainty by replacing “repurchase agreement” within the definition with a cross-referenced definition to “securities financing transaction” as defined in SFTR.  
• It should be noted that Art. 3(13) and (14) SFTR cross-refer to TTCA and SFCA respectively as defined in the EU FCD and Art. 3(4) to “financial instrument” as defined in MiFID II.  
• The UK-FCAR’s scope is wider and super-equivalent to that of the EU FCD and Irish-FCARs in that extends to all non-natural persons. This in some ways is quite welcome.  
• The UK-FCARs do not have reference to the concept of “qualified ownership” as in the EU FCD and Irish-FCARs. |
| Definition of TTCA       | Art. 2(3)(b) 

“title transfer financial collateral arrangement” means an arrangement, including repurchase agreements, under which a collateral provider transfers full ownership of, or full entitlement to, financial collateral to a collateral taker for the purpose of securing or otherwise covering the performance of relevant financial obligations;  | Regulation 3 

“title transfer financial collateral arrangement” means an agreement or arrangement, including a repurchase agreement, evidenced in writing, where—  
(a) the purpose of the agreement or arrangement is to secure or otherwise cover the relevant financial obligations owed to the collateral taker;  
(b) the collateral provider transfers legal and beneficial ownership in financial collateral to a collateral taker on terms that when the relevant financial obligations are discharged the collateral taker must transfer legal and beneficial ownership of equivalent financial collateral to the collateral provider; and  
(c) the collateral-provider and the collateral-taker are both non-natural persons; | Regulation 2(1) 

“title transfer financial collateral arrangement” means an arrangement under which a collateral provider transfers full ownership of, or full entitlement to, financial collateral to a collateral taker for the purpose of securing or otherwise covering the performance of relevant financial obligations, and includes a repurchase agreement;  | • All definitions are identical.  
• The UK limits introduced in Regulation 3 (a) to and including (c) reflect the concepts introduced in Art. 1 of the EU-FCAR.  
• The UK-FCAR’s scope is wider and super-equivalent to that of the EU SFTR and Irish-FCARs in that it extends to all non-natural persons. This in some ways is quite welcome.  
• As these laws pre-date the EU’s SFTR, the reference to “repurchase agreement” is not to be read in accordance with the definition in the EU SFTR of “repurchase transaction”, but rather is undefined here: EU policymakers would be assisting the market in creating greater certainty by replacing “repurchase agreement” within the definition with a cross-referenced definition to “securities financing transaction” as defined in SFTR.  
• It should be noted that Art. 3(13) and (14) SFTR cross-refer to TTCA and SFCA respectively as defined in the EU FCD and Art. 3(4) to “financial instrument” as defined in MiFID II.  
• The UK-FCAR’s scope is wider and super-equivalent to that of the EU FCD and Irish-FCARs in that extends to all non-natural persons. This in some ways is quite welcome.  
• The UK-FCARs do not have reference to the concept of “qualified ownership” as in the EU FCD and Irish-FCARs. |
| Definition of SFCA       | Art. 2(3)(c) | “security financial collateral arrangement” means an arrangement under which a collateral provider provides financial collateral by way of security to or in favour of a collateral taker, and where the full or qualified ownership of, or full entitlement to, the financial collateral remains with the collateral provider when the security right is established. | Regulation 3 | “security financial collateral arrangement” means an arrangement or security financial collateral arrangement, whether or not these are covered by a master agreement or general terms and conditions; | Regulation 2(1) | “security financial collateral arrangement” means an arrangement under which a collateral provider provides financial collateral by way of security to or in favour of a collateral taker, and where the full or qualified ownership of, or full entitlement to, the financial collateral remains with the collateral provider when the security right is established. | • All definitions are identical.  
• The UK limits introduced in Regulation 3 (a) to and including (c) reflect the concepts introduced in Art. 1 of the EU-FCAR.  
• The UK-FCAR’s scope is wider and super-equivalent to that of the EU SFTR and Irish-FCARs in that it extends to all non-natural persons. This in some ways is quite welcome.  
• As these laws pre-date the EU’s SFTR, the reference to “repurchase agreement” is not to be read in accordance with the definition in the EU SFTR of “repurchase transaction”, but rather is undefined here: EU policymakers would be assisting the market in creating greater certainty by replacing “repurchase agreement” within the definition with a cross-referenced definition to “securities financing transaction” as defined in SFTR.  
• It should be noted that Art. 3(13) and (14) SFTR cross-refer to TTCA and SFCA respectively as defined in the EU FCD and Art. 3(4) to “financial instrument” as defined in MiFID II.  
• The UK-FCAR’s scope is wider and super-equivalent to that of the EU FCD and Irish-FCARs in that extends to all non-natural persons. This in some ways is quite welcome.  
• The UK-FCARs do not have reference to the concept of “qualified ownership” as in the EU FCD and Irish-FCARs. |
(b) the collateral-provider creates or there arises a security interest in financial collateral to secure those obligations;

c) the financial collateral is delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral-taker or a person acting on its behalf; any right of the collateral-provider to substitute financial collateral of the same or greater value or withdraw excess financial collateral or to collect the proceeds of credit claims until further notice shall not prevent the financial collateral being in the possession or under the control of the collateral-taker; and

d) the collateral-provider and the collateral-taker are both non-natural persons; remains with the collateral provider when the security right is established;

- In the UK, in addition to limb (c) being considerably wider and there being issues on the understanding of “control” as in Gray v G-T-P (see below) there are also issues resulting from the case of Re Lehman Brothers International (Europe) (In Administration) [2012] EWHC 2997 (Ch), which established that there is no requirement that the arrangement must be strictly bilateral as this would exclude from the scope of the FCAR arrangements that grant security to a trustee for a group of beneficiaries. The UK 2010 FCAR Amendment in Regulation 4(c) inserts the following:

“(2) For the purposes of these Regulations “possession” of financial collateral in the form of cash or financial instruments includes the case where financial collateral has been credited to an account in the name of the collateral-taker or a person acting on his behalf (whether or not the collateral-taker, or person acting on his behalf, has credited the financial collateral to an account in the name of the collateral-provider or that person’s, books) provided that any rights the collateral-provider may have in relation to that financial collateral are limited to the right to substitute financial collateral of the same or greater value or to withdraw excess financial collateral.”

Definition of Cash

<table>
<thead>
<tr>
<th>Art 2(d)</th>
</tr>
</thead>
<tbody>
<tr>
<td>“cash” means money credited to an account in any currency, or similar claims for the repayment of money, such as money market deposits.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Regulation 3(1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>“cash” means money in any currency, credited to an account, or a similar claim for repayment of money and includes money market deposits;</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Regulation 2(1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>“cash” means money credited to an account, or a claim for the repayment of money (for example, money market deposits).</td>
</tr>
</tbody>
</table>

- The UK-FCAR definition of “cash” is somewhat wider and super-equivalent in its scope even if it covers items explicitly that are otherwise implied.

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301 It should be noted that in the UK, in Gray v G-T-P the financial collateral consisted of the balance from time to time standing to the credit of a bank account in the name of G-T-P Group Limited. Following the ratio of this English case, Yeovart and Parsons suggest at 3.06 that “It appears to have been accepted as common ground that the customer’s interest in the credit balance was ‘cash’ for the purposes of the [UK] FCARs."
suns due or payable to, or received between the parties in connection with the operation of a financial collateral arrangement or a close-out netting provision.

(such as realised proceeds of financial collateral arrangement or funds from close-out netting) in the EU-FCD and Irish-FCARs.

- Recital 18 of the EU-FCD indicates that money market deposits are an example of “similar claims to the repayment of money”, whereas, as noted in Yeowart and Parsons at 3.08 in relation to the UK’s definition of cash (but by extension the EU-FCD), “Although certificates of deposit might have been included, they are perhaps more naturally classified as ‘money market instruments’ expressly included in the definition of EU-FCD and thus UK-FCARs and Irish-FCARs of ‘financial instruments’.”

- None of the legislative instruments reviewed make any definitive statement on the treatment of virtual currencies as money.

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**Definition of financial instruments**

**Art. 2(1)**

“financial instruments” means shares in companies and other securities equivalent to shares in companies and bonds and other forms of debt instruments if these are negotiable on the capital market, and any other securities which are normally dealt in and which give the right to acquire any such shares, bonds or other securities by subscription, purchase or exchange or which give rise to a cash settlement (excluding instruments of payment), including units in collective investment undertakings, money market instruments and claims relating to or rights in or in respect of any of the foregoing.

**Regulation 2(1)**

“financial instruments” means any of the following:

(a) shares in companies;

(b) securities equivalent to shares in companies;

---

**Regulation 3**

- “financial collateral” means either cash, financial instruments or credit claims.

- “financial instruments” means:
  
  (a) shares in companies and other securities equivalent to shares in companies;
  
  (b) bonds and other forms of instruments giving rise to or acknowledging indebtedness if these are tradeable on the capital market; and
  
  (c) any other securities which are normally dealt in and which give the right to acquire any such shares, bonds, instruments or other securities by subscription, purchase or exchange or which give rise to a cash settlement (excluding instruments of payment); and

---

For a further discussion on the nature of this drafting, which Yeowart and Parsons state at 3.11 that it “...leaves something to be desired” see their discussion in paras. 3.12 and 3.13 as to the “felicitous drafting” in the UK-FCARs. The issue that this UK-driven conceptual divergence is one that goes beyond the scope of the EU-FCD, and the risks that poses, is not discussed therein.
<table>
<thead>
<tr>
<th>Definition of book entry securities collateral</th>
<th>Art. 2(g)</th>
</tr>
</thead>
<tbody>
<tr>
<td>“book entry securities collateral” means financial collateral provided under a financial collateral arrangement which consists of financial instruments, title to which is evidenced by entries in a register or account maintained by or on behalf of an intermediary.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Definition of relevant financial obligations</th>
<th>Art. 2(f)</th>
</tr>
</thead>
<tbody>
<tr>
<td>“relevant financial obligations” means the obligations which are secured by a financial collateral arrangement and which give a right to cash settlement and/or delivery of financial instruments. Relevant financial obligations may consist of or include:</td>
<td></td>
</tr>
<tr>
<td>(i) present or future, actual or contingent or prospective obligations (including such obligations arising under a master agreement or similar arrangement);</td>
<td></td>
</tr>
<tr>
<td>(ii) obligations owed to the collateral taker by a person other than the collateral provider; or</td>
<td></td>
</tr>
<tr>
<td>(iii) obligations of a specified class or kind arising from time to time;</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Regulation 3.</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>“relevant financial obligations” means the obligations which are secured or otherwise covered by a financial collateral arrangement, and such obligations may consist of or include—</td>
<td></td>
</tr>
<tr>
<td>(a) present or future, actual or contingent or prospective obligations (including such obligations arising under a master agreement or similar arrangement);</td>
<td></td>
</tr>
<tr>
<td>(b) obligations owed to the collateral taker by a person other than the collateral provider;</td>
<td></td>
</tr>
<tr>
<td>(c) obligations of a specified class or kind arising from time to time;</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Regulation 2(1)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>“relevant financial obligation” means an obligation (whether present or future, and whether actual, contingent or prospective) secured by a financial collateral arrangement that gives a right to a cash settlement or the delivery of financial instruments, or both, and includes—</td>
<td></td>
</tr>
<tr>
<td>(a) an obligation arising under a master agreement or similar arrangement,</td>
<td></td>
</tr>
<tr>
<td>(b) an obligation owed to a collateral taker by a person other than the collateral provider, and</td>
<td></td>
</tr>
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<td>(c) an obligation of any class or kind arising from time to time specified in the arrangement or, if the arrangement is varied, the arrangement as varied;</td>
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<td>“relevant financial obligation” means an obligation (whether present or future, and whether actual, contingent or prospective) secured by a financial collateral arrangement that gives a right to a cash settlement or the delivery of financial instruments, or both, and includes—</td>
<td></td>
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<td>(a) an obligation arising under a master agreement or similar arrangement,</td>
<td></td>
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<td>(b) an obligation owed to a collateral taker by a person other than the collateral provider, and</td>
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<td>(c) an obligation of any class or kind arising from time to time specified in the arrangement or, if the arrangement is varied, the arrangement as varied;</td>
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- Footnote: Yeomans and Paterson note in 3.30 that the difference in the construction of the definition of “financial instrument” in Art. 2(e) when compared to Regulation 3 of the UK-FCARs and the phrase “...and any other securities which are normally dealt in...” could be construed in reading that all securities previously set out in Art. 2(e) must be “normally dealt in.” If that statement is true, then this would exclude private limited companies from EU FCD protections, and by definition mean that the UK-FCAR’s protections afforded inter alia to private limited companies etc., would go beyond the principles of EU law in the form of a conceptual divergence. A similar situation would thus perhaps apply in relation to Regulation 2.1(d) of the Irish-FCARs, which follow the UK-FCAR’s logic and thus could itself be incompatible with how some might read that provision.

- The UK-FCARs omit the reference in EU FCD, which the Irish-FCARs stick with, regarding “a right to cash settlement and/or delivery of financial instruments”.

- The Irish-FCARs make the useful point that an obligation is owed as varied if it is varied.
and for its own account but does not include—

(a) a person who acts as a registrar or transfer agent for the issuer of financial instruments; or

(b) a person who maintains registers or accounts in the capacity of operator of a system for the holding and transfer of financial instruments on records of the issuer or other records which constitute the primary record of entitlement to financial instruments as against the issuer.

<table>
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<tr>
<td>'relevant account' means in relation to book entry securities collateral which is subject to a financial collateral arrangement, the register or account — which may be maintained by the collateral taker — in which the entries are made by which that book entry securities collateral is provided to the collateral taker;</td>
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'relevant account' means, in relation to book entry securities collateral which is subject to a financial collateral arrangement, the register or account, which may be maintained by the collateral-taker, in which entries are made, by which that book entry securities collateral is transferred or designated so as to be in the possession or under the control of the collateral-taker or a person acting on its behalf;

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<th>Definition of equivalent collateral</th>
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Regulation 3

'equivalent financial collateral' means—

(a) in relation to cash, a payment of the same amount and in the same currency;

(b) in relation to financial instruments, financial instruments of the same issuer or debtor, forming part of the same issue or class and of the same nominal amount, currency and description or, where a financial collateral arrangement provides for the transfer of other assets following the occurrence of any event relating to or affecting any financial instruments provided as financial collateral, those other assets;

and includes the original financial collateral provided under the arrangement;

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'equivalent collateral' means—

(a) in relation to collateral that is cash, a payment of the same amount and in the same currency, and

(b) in relation to collateral that is a financial instrument—

(1) another financial instrument of the same issuer or debtor that is part of the same issue or class, and is of the same nominal amount, currency and description, as the first-mentioned instrument, or

(ii) if the relevant financial collateral arrangement provides for the transfer of other assets following the occurrence of an event relating to or affecting a financial instrument provided as financial collateral, those other assets;

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<td>‘right of use’ means the right of the collateral taker to use and dispose of financial collateral provided under a security financial collateral arrangement as the owner of it in accordance with the terms of the security financial collateral arrangement.</td>
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<td>‘close-out netting provision’ means a provision of a financial collateral arrangement, or of an arrangement of which a financial collateral arrangement forms part, or, in the absence of any such provision, any statutory rule by which, on the occurrence of an enforcement event, whether through the operation of netting or set-off or otherwise:</td>
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<td>(i) the obligations of the parties are accelerated so as to be immediately due and expressed as an obligation to pay an amount representing their estimated current value, or are terminated and replaced by an obligation to pay such an amount; and/or</td>
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<td>(ii) an account is taken of what is due from each party to the other in respect of such obligations, and a net sum equal to the balance of the account is payable by the party from whom the larger amount is due to the other party;</td>
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**Regulation 3**

“close-out netting provision” means a term of a financial collateral arrangement, or of an arrangement of which a financial collateral arrangement forms part, or any legislative provision under which on the occurrence of an enforcement event, whether through the operation of netting or set-off or otherwise—

(a) the obligations of the parties are accelerated to become immediately due and expressed as an obligation to pay an amount representing the original obligation’s estimated current value or replacement cost, or are terminated and replaced by an obligation to pay such an amount; or

(b) an account is taken of what is due from each party to the other in respect of such obligations and a net sum equal to the balance of the account is payable by the party from whom the larger amount is due to the other party; as a result of which, on the occurrence (whether through the operation of netting or set-off or otherwise) of an enforcement event—

(i) either or both of the following apply:

(A) the obligations of the parties—

(1) are accelerated so as to be immediately due and are expressed as an obligation to pay an amount representing the estimated current value of the obligations, or

(2) are terminated and replaced by an obligation to pay such an amount;

(B) an account is taken of what is due from each party to the other in respect of those obligations and the party from which the larger amount is due is required to pay to the other party a net amount equal to the balance of the account;|

**Regulation 2(1)**

“close-out netting provision” means—

(a) a provision of a financial collateral arrangement, or an arrangement of which a financial collateral arrangement forms part, or

(b) a rule of law, |

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<td>‘credit claims’ means pecuniary claims arising out of an agreement whereby a credit institution, as defined in Article 4(1) of Directive 2006/48/EC, including the institutions listed in Article 2 of that Directive, grants credit in the form of a loan.</td>
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**Regulation 4 of 2010 UK-FCAR Amendment**

“‘credit claims’ means pecuniary claims which arise out of an agreement whereby a credit institution, as defined in Article 4(1) of Directive 2006/48/EC of the European Parliament and of the Council relating to the taking up and pursuit of the business of credit institutions (recast), including the institutions listed in Article 2 of that Directive, grants credit in the form of a loan” |
Concept of collateral asset mobilisation “provision”

Art. 2(2)

References in this Directive to financial collateral being “provided”, or to the “provision” of financial collateral, are to the financial collateral being delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral taker or of a person acting on the collateral taker’s behalf. Any right of substitution, right to withdraw excess financial collateral in favour of the collateral provider or, in the case of credit claims, right to collect the proceeds thereof until further notice, shall not prejudice the financial collateral having been provided to the collateral taker as mentioned in this Directive.

Regulation 2(1)

“provision of financial collateral” is to be construed in accordance with paragraph (2).

Regulation 2(2)

For the purposes of these Regulations, financial collateral is provided when financial collateral that is or is to be delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of a collateral taker or a person acting on a collateral taker’s behalf is so delivered, transferred, held, registered or otherwise designated.

Regulation 2(3)

Financial collateral has been provided to a collateral taker for the purposes of these Regulations if paragraph (2) has been complied with in relation to that collateral even if there exists a right of substitution of the financial collateral, a right to withdraw excess financial collateral in favour of the collateral provider or, in the case of a credit claim that is financial collateral, a right to collect the proceeds of the claim until further notice.

Who can benefit from the protections?

Art. 1 (2)

The collateral taker and the collateral provider must each belong to one of the following categories:

(a) a public authority (excluding publicly guaranteed undertakings unless they fall under points (b) to (e) including):
   (i) public sector bodies of Member States charged with or intervening in the management of public debt, and
   (ii) public sector bodies of Member States authorized to hold accounts for customers;

(b) a central bank, the European Central Bank, the Bank for International Settlements, a multilateral development bank as referred to in Annex VI, Part 1, Section 4 of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) (1), the International Monetary Fund and the European Investment Bank;

(c) a financial institution subject to prudential supervision including:

UK-FCARs apply, by virtue of relevant definitions in Regulation 3 (in particular TTCA and SFCA as well as the following items) to when both the collateral-provider and collateral-taker are both “non-natural persons”.

Regulation 3

“non-natural person” means any corporate body, unincorporated firm, partnership or body with legal personality except an individual, including any such entity constituted under the law of a country or territory outside the United Kingdom or any such entity constituted under international law;

“relevant account” means, in relation to book entry securities collateral which is subject to a financial collateral arrangement, the register or account, which may be maintained by the collateral-taker, in which entries are made, by which that book entry securities collateral is transferred or designated so as to be in the possession or under the control of the collateral-taker or a person acting on its behalf;

Regulation 3(2)

The collateral taker and the collateral provider who are the parties to the financial collateral arrangement must each be one of the following:

(a) a public authority (excluding a publicly guaranteed undertaking unless it is covered by one or more of paragraphs (b) to (o));

(b) a central bank, the European Central Bank, the Bank for International Settlements, a multilateral development bank, the International Monetary Fund or the European Investment Bank;

(c) a credit institution (as defined in Article 4(1) of the Recast Credit Institutions Directive, but including the institutions listed in Article 2 of that Directive);


• The UK-FCAR’s coverage of this concept is implied in the TTCA and SFCA definition.

• Irish-FCARs have definition of “public authority” that extends to:

(a) a local government body,

(b) a public sector body of an EU-MS that is charged with responsibility for, or is involved in, the management of public debt, and

(c) a public sector body of an EU-MS that is authorised to hold accounts for customers;

• The UK-FCARs are considerably broader in who can benefit from the protections as unlike the EU FCD and
(i) a credit institution as defined in Article 4(1) of Directive 2006/48/EC, including the institutions listed in Article 2 of that Directive;


(iii) a financial institution as defined in Article 4(5) of Directive 2006/48/EC;


(v) an undertaking for collective investment in transferable securities (UCITS) as defined in Article 1(2) of Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (2);

(vi) a management company as defined in Article 1a(2) of Directive 85/611/EEC;

(d) a central counterparty, settlement agent or clearing house, as defined respectively in Article 2(c), (d) and (e) of Directive 98/26/EC, including similar institutions regulated under national law acting in the futures, options and derivatives markets to the extent not covered by that Directive, and a person, other than a natural person, who acts in a trust or representative capacity on behalf of any one or more persons that includes any bondholders or holders of other forms of securitised debt or any institution as defined in points (a) to (d);

(e) a person other than a natural person, including unincorporated firms and partnerships, provided that the other party is an institution as defined in points (a) to (d);

(f) an insurance undertaking (as defined in Article 1(a) of Council Directive 92/49/EC7);

(g) an assurance undertaking (as defined in Article 1(1)(a) of Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002);

(h) a management company (as defined in Article 1a(2) of Council Directive 85/611/EEC);

(i) an undertaking for collective investment in transferable securities (UCITS) as defined in Article 1(2) of Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS);

(j) a central counterparty, settlement agent or clearing house, or any similar entity that is operating in the futures, options or derivatives markets in a way not covered by the Settlement Finality Directive, provided the entity is regulated under the law of the State or of another country;

(k) a person (other than a natural person) who acts as a trustee, or in a representative capacity, on behalf of—

(i) any one or more persons of whom at least one is a bondholder or the holder of any other form of securitised debt, or

(ii) an authority, bank, institution or other entity referred to in any of paragraphs (a) to (d);

(l) any other person or group (other than a natural person), but only if the other party to the arrangement is an authority, bank, institution or other entity of a kind specified in any of paragraphs (a) to (k);

(3) In paragraph (2)(j) “central counterparty”, “clearing house” and “settlement agent” have the respective meanings given by Article 2 of the Settlement Finality Directive.

Optional exclusion of scope

Article 1(3)

The UK made use of this exemption whereas Ireland did not.
<table>
<thead>
<tr>
<th><strong>To what do the protections apply?</strong></th>
<th><strong>In definition of SFCA and TTCA.</strong></th>
<th><strong>Regulation 3(1)</strong></th>
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<tr>
<td>Recital 13</td>
<td>This Directive seeks to protect the validity of financial collateral arrangements which are based upon the transfer of the full ownership of the financial collateral, such as by eliminating the so-called re-characterisation of such financial collateral arrangements (including repurchase agreements) as security interests.</td>
<td>These Regulations apply to a financial collateral arrangement and to financial collateral only if the arrangement and collateral comply with this Regulation.</td>
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<td>Recital 14</td>
<td>The enforceability of bilateral close-out netting should be protected, not only as an enforcement mechanism for title transfer financial collateral arrangements including repurchase agreements but more widely, where close-out netting forms part of a financial collateral arrangement. Sound risk management practices commonly used in the financial market should be protected by enabling participants to manage and reduce their credit exposures arising from all kinds of financial transactions on a net basis, where the credit exposure is calculated by combining the estimated current exposures under all outstanding transactions with a counterparty, setting off reciprocal items to produce a single aggregated amount that is compared with the current value of the collateral.</td>
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<td>Art. 1(4)(a)</td>
<td>The financial collateral to be provided shall consist of cash, financial instruments or credit claims</td>
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</tr>
<tr>
<td><strong>Exclusions of eligible financial collateral?</strong></td>
<td><strong>Regulation 10</strong></td>
<td><strong>Regulation 12</strong></td>
</tr>
<tr>
<td>Art. 1(4)(b)</td>
<td>Non-compliance with certain obligations can be subject of close-out netting provision</td>
<td>Recognition of close-out netting provisions</td>
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<td></td>
<td>If an enforcement event occurs when an obligation referred to in Regulation 8(2) has not been complied with, the obligation can be the subject of a close-out netting provision.</td>
<td>(1) A close-out netting provision has effect in accordance with its terms irrespective of whether—</td>
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<td>Regulation 12</td>
<td>(2) The operation of a close-out netting provision is subject to a requirement to do any of the things referred to in paragraphs (a) to (c) of Regulation 6(3), or to realise any collateral in any particular way, only if the relevant financial collateral arrangement so provides.</td>
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- **The Irish FCARs** set a two stage test on what needs to be complied with in order for the protections to apply. Whilst similar concepts are included in the EU FCID does not have a rigid test in the same way as the Irish FCARs.
- **UK FCARs** defines “security interest” as “… means any legal or equitable interest or any right in security, other than a title transfer financial collateral arrangement, created or otherwise arising by way of security including— (a) a pledge; (b) a mortgage; (c) a fixed charge; (d) a charge created as a floating charge where the financial collateral charged is delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral-taker or a person acting on its behalf; any right of the collateral-provider to substitute financial collateral of the same or greater value or to collect the proceeds of credit claims until further notice or withdraw excess financial collateral shall not prevent the financial collateral being in the possession or under the control of the collateral-taker; or (e) a lien;”.

It is not clear whether the UK FCARs’ draftsman indicated this to be any security interest governed by the laws of the jurisdictions of the UK and/or that applies to all comparable types of security interest regardless of which law they’re subject to.
Member States may exclude from the scope of this Directive financial collateral consisting of the collateral provider's own shares, shares in affiliated undertakings within the meaning of seventh Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts (3), and shares in undertakings whose exclusive purpose is to own means of production that are essential for the collateral provider's business or to own real property.

Art. 1(4)(c)

Member States may exclude from the scope of this Directive credit claims where the debtor is a consumer as defined in Article 3(a) of Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers (1) or a micro or small enterprise as defined in Article 1 and Article 2(2) and (3) of the Annex to Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (2), save where the collateral taker or the collateral provider of such credit claims is one of the institutions referred under Article 1(2)(b) of this Directive.

Arrangements evidenced in writing

Recital 11

Moreover, this Directive should protect only financial collateral arrangements which can be evidenced. Such evidence can be given in writing or in any other legally enforceable manner provided by the law which is applicable to the financial collateral arrangement.

Article 1 (5)

This Directive applies to financial collateral once it has been provided and if that provision can be evidenced in writing. The evidencing of the provision of financial collateral must allow for the identification of the financial collateral to which it applies. For this purpose, it is sufficient to prove that the book entry securities collateral has been credited to, or forms a credit in, the relevant account and that the cash collateral has been credited to, or forms a credit in, a designated account. For credit claims, the inclusion in a list of claims submitted in writing, or in a legally equivalent manner, to the collateral taker is sufficient to identify the credit claim and to evidence the provision of the claim provided as financial collateral between the parties.

Without prejudice to the second subparagraph, Member States may provide that the inclusion in a list of claims submitted in writing, or in a legally equivalent manner, to the collateral taker is also sufficient to identify the credit claim and to evidence the provision of the claim provided as financial collateral against the debtor or third parties.

This Directive applies to financial collateral arrangements if that arrangement can be evidenced in writing or in a legally equivalent manner.

Art. 2(3)

Concept included in definition of SFCA and TFCA.

Regulation 2(4)

A reference in these Regulations to writing includes a reference to any other method of recording information that is legally equivalent to writing, and in particular includes recording by electronic means (such as a computer) or in or by any other durable medium.

Regulation 3(4)

For these Regulations to apply to a financial collateral arrangement, there must be evidence in writing of the arrangement.

Regulation 3(5)

For these Regulations to apply to financial collateral, there must be evidence in writing of the provision of that collateral. The evidence must identify the financial collateral concerned. For that purpose, it is sufficient to prove—

(a) in the case of book entry securities collateral, that that collateral has been credited to, or forms a credit in, the relevant account, and

(b) in the case of cash collateral, that that collateral has been credited to, or forms part of, a designated account.

Regulation 3(6)
**Lex rei sitae rule applicable?**

**Recital 8**

The lex rei sitae rule, according to which the applicable law for determining whether a financial collateral arrangement is properly perfected and therefore good against third parties is the law of the country where the financial collateral is located, is currently recognised by all Member States. Without affecting the application of this Directive to directly-held securities, the location of book entry securities provided as financial collateral and held through one or more intermediaries should be determined. If the collateral taker has a valid and effective collateral arrangement according to the governing law of the country in which the relevant account is maintained, then the validity against any competing title or interest and the enforceability of the collateral should be governed solely by the law of that country, thus preventing legal uncertainty as a result of other unforeseen legislation.

**Regulation 19**

19.—(1) This regulation applies to financial collateral arrangements where book entry securities collateral is used as collateral under the arrangement and are held through one or more intermediaries.

   (2) Any question relating to the matters specified in paragraph (4) of this regulation which arises in relation to book entry securities collateral which is provided under a financial collateral arrangement shall be governed by the domestic law of the country in which the relevant account is maintained.

   (3) For the purposes of paragraph (2): “domestic law” excludes any rule under which, in deciding the relevant question, reference should be made to the law of another country.

   (4) The matters referred to in paragraph (2) are:

   (a) the legal nature and proprietary effects of book entry securities collateral;

   (b) the requirements for perfecting a financial collateral arrangement relating to book entry securities collateral and the transfer or passing of control or possession of book entry securities collateral under such an arrangement;

   (c) the requirements for rendering a financial collateral arrangement which relates to book entry securities collateral effective against third parties;

   (d) whether a person’s title to or interest in such book entry securities collateral is overridden by or subordinated to a competing title or interest; and

   (e) the steps required for the realisation of that collateral following the occurrence of an enforcement event.

**Regulation 18**

(1) Any question with respect to any of the matters specified in paragraph (2) arising in relation to book entry securities collateral is to be governed by the domestic law of the country in which the relevant account is maintained, irrespective of any law of that country that provides for the law of another country to be referred to in deciding the question.

(2) The matters referred to in paragraph (1) are the following:

   (a) the legal nature and proprietary effects of the book entry securities collateral concerned;

   (b) the requirements for perfecting a financial collateral arrangement relating to that collateral and the provision of that collateral under such an arrangement and, more generally, the completion of steps necessary to render such an arrangement and provision effective against third parties;

   (c) whether a person’s title to, or interest in, that collateral is overridden by, or subordinated to, a competing title or interest;

   (d) whether a person has in good faith acquired title to, or an interest in, that collateral;

   (e) the steps required for the realisation of that collateral following the occurrence of an enforcement event.

---

All definitions follow the PRIMA approach.

Interestingly the Irish-FCARs follow conceptually the items set out in Regulation 18(4) of the UK-FCARs.
<table>
<thead>
<tr>
<th>Perfection and formal requirements under national law</th>
<th>Parts 2 and 3</th>
<th>Regulations 4 to and including 6 as well as Part 5</th>
<th>No divergences</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recital 9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>In order to limit the administrative burdens for parties using financial collateral under the scope of this Directive, the only perfection requirement regarding parties which national law may impose in respect of financial collateral should be that the financial collateral is under the control of the collateral taker or of a person acting on the collateral taker's behalf while not excluding collateral techniques where the collateral provider is allowed to substitute collateral or to withdraw excess collateral. This Directive should not prohibit Member States from requiring that a claim be delivered by means of inclusion in a list of claims.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Recital 10</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>For the same reasons, the creation, validity, perfection, enforceability or admissibility in evidence of a financial collateral arrangement, or the provision of financial collateral under a financial collateral arrangement, should not be made dependent on the performance of any formal act such as the execution of any document in a specific form or in a particular manner, the making of any filing with an official or public body or registration in a public register, advertisement in a newspaper or journal, in an official register or publication or in any other matter, notification to a public officer or the provision of evidence in a particular form as to the date of execution of a document or instrument, the amount of the relevant financial obligations or any other matter. This Directive must however provide a balance between market efficiency and the safety of the parties to the arrangement and third parties, thereby avoiding inter alia the risk of fraud. This balance should be achieved through the scope of this Directive covering only those financial collateral arrangements which provide for some form of dispossessions, i.e. the provision of the financial collateral, and where the provision of the financial collateral can be evidenced in writing or in a durable medium, ensuring thereby the traceability of that collateral. For the purpose of this Directive, acts required under the law of a Member State as conditions for transferring or creating a security interest on financial instruments, other than book entry securities, such as endorsement in the case of instruments to order, or recording on the issuer's register in the case of registered instruments, should not be considered as formal acts.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Art. 3 and 4 [not set out here in the interests of space]</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Right of use?</th>
<th>Regulation 16</th>
<th>Regulation 8</th>
<th>No major conceptual divergences other than the fact that the very pragmatic (and welcome) drafting in UK-FCAR’s Regulation 18 and the duty to value the financial collateral is not reflected in the EU FCD or the Irish-FCARs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recital 19</td>
<td>Right of use under a security financial collateral arrangement</td>
<td>Right of collateral taker to use financial collateral if arrangement so provides</td>
<td></td>
</tr>
<tr>
<td>This Directive provides for a right of use in case of security financial collateral arrangements, which increases liquidity in the financial market stemming from such reuse of “pledged” securities. This reuse however should be without prejudice to national legislation about separation of assets and unfair treatment of creditors.</td>
<td>16. (1) If a security financial collateral arrangement provides for the collateral taker to use and dispose of any financial collateral provided under this Directive, the collateral taker has the right to use the financial collateral as provided in this Regulation.</td>
<td>8. (1) If and to the extent that the terms of a security financial collateral arrangement so provide, the collateral taker under the arrangement has</td>
<td></td>
</tr>
<tr>
<td>Art. 6</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Right of use of financial collateral under security financial collateral arrangements

1. If and to the extent that the terms of a security financial collateral arrangement so provide, Member States shall ensure that the collateral taker is entitled to exercise a right of use in relation to financial collateral provided under the security financial collateral arrangement.

2. Where a collateral taker exercises a right of use, he thereby incurs an obligation to transfer equivalent collateral to replace the original financial collateral at the latest on the due date for the performance of the relevant financial obligations covered by the security financial collateral arrangement. Alternatively, the collateral taker shall, on the due date for the performance of the relevant financial obligations, either transfer equivalent collateral, or, if and to the extent that the terms of a security financial collateral arrangement so provide, set off the value of the equivalent collateral against or apply it in discharge of the relevant financial obligations.

3. The equivalent collateral transferred in discharge of an obligation as described in paragraph 2, first subparagraph, shall be subject to the same security financial collateral agreement to which the original financial collateral was subject and shall be treated as having been provided under the security financial collateral arrangement at the same time as the original financial collateral was first provided.

4. Member States shall ensure that the use of financial collateral by the collateral taker according to this Article does not render invalid or unenforceable the rights of the collateral taker under the security financial collateral arrangement in relation to the financial collateral transferred by the collateral taker in discharge of an obligation as described in paragraph 2, first subparagraph.

5. If an enforcement event occurs while an obligation as described in paragraph 2 first subparagraph remains outstanding, the obligation may be the subject of a close-out netting provision.

6. This Article shall not apply to credit claims.

the arrangement, as if it were the owner of it, the collateral-taker may do so in accordance with the terms of the arrangement.

(2) If a collateral-taker exercises such a right of use, it is obliged to replace the original financial collateral by transferring equivalent financial collateral on or before the due date for the performance of the relevant financial obligations covered by the arrangement or, if the arrangement so provides, it may set off the value of the equivalent financial collateral against or apply it in discharge of the relevant financial obligations in accordance with the terms of the arrangement.

(3) The equivalent financial collateral which is transferred in discharge of an obligation as described in paragraph (2), shall be subject to the same terms of the security financial collateral arrangement as the original financial collateral was subject to and shall be treated as having been provided under the security financial collateral arrangement at the same time as the original financial collateral was first provided.

(4) If a collateral-taker has an outstanding obligation to replace the original financial collateral with equivalent financial collateral when an enforcement event occurs, that obligation may be the subject of a close-out netting provision.

Regulation 17

Appropriation of financial collateral under a security financial collateral arrangement

17. (1) Where a security interest is created or arises under a security financial collateral arrangement on terms that include a power for the collateral-taker to appropriate the financial collateral, the collateral-taker may exercise that power in accordance with the terms of the security financial collateral arrangement, without any order for foreclosure from the courts (and whether or not the remedy of foreclosure would be available).

(2) Upon the exercise by the collateral-taker of the power to appropriate the financial collateral, the equity of redemption of the collateral-provider shall be extinguished and all legal and beneficial interest of the collateral-provider in the financial collateral shall vest in the collateral-taker.

(3) Instead of complying with paragraph (2), the collateral-taker may, on the due date for the performance of the relevant financial obligations, either—

(a) transfer equivalent collateral, or

(b) if and to the extent that the terms of the arrangement so provide, set off the value of the equivalent collateral against, or apply it in discharge of, the relevant financial obligations.

(4) Equivalent collateral transferred in accordance with paragraph (2) or (3) is subject to the same security financial collateral agreement as that to which the original financial collateral was subject and is to be taken to have been provided under the security financial collateral arrangement at the same time as the original financial collateral was first provided.

(5) This Regulation does not apply to credit claims.

Regulation 9

Use of financial collateral by collateral taker not to render rights of collateral taker invalid or unenforceable

The use of financial collateral by a collateral taker in accordance with Regulation 8 does not render invalid or unenforceable the rights of the collateral taker under the security financial collateral arrangement concerned in relation to financial collateral transferred in discharge of an obligation referred to in paragraph (2) of that Regulation.
Regulation 18

Duty to value collateral and account for any difference in value on appropriation

18. (1) Where a collateral-taker exercises a power contained in a security financial collateral arrangement to appropriate the financial collateral the collateral-taker must value the financial collateral in accordance with the terms of the arrangement and in any event in a commercially reasonable manner.

(2) Where a collateral-taker exercises such a power and the value of the financial collateral appropriated differs from the amount of the relevant financial obligations, then as the case may be, either—

(a) the collateral-taker must account to the collateral-provider for the amount by which the value of the financial collateral exceeds the relevant financial obligations; or

(b) the collateral-provider will remain liable to the collateral-taker for any amount whereby the value of the financial collateral is less than the relevant financial obligations.
Annex 2: Rules on Client Assets, Client Money and Safekeeping

The following table sets out relevant rules and the assessment of their conceptual divergence or CTR (excluding rules on regulatory notifications to EU-level and national competent authorities).

<table>
<thead>
<tr>
<th>EU Rules</th>
<th>UK Rules*</th>
<th>Irish Rules</th>
<th>Conceptual divergence of CTR</th>
</tr>
</thead>
<tbody>
<tr>
<td>- MiFID II</td>
<td>- MiFID II p</td>
<td>- Commission Delegated Regulation*</td>
<td>- Commission Delegated Directive*</td>
</tr>
</tbody>
</table>
| CASS Sourcebook of PFA Handbook
(referred to herein as the CASS and which, as indicated below, may be read in conjunction with the transpositional legislation of MiFID II and the Commission Delegated Directive as well as other parts of the PFA Handbook – see Endnotes)
NB: in assessment of Chapters in the STIP and SYSC Sourcebooks of the PFA Handbook or relevant provision from the PRA Rulebook are beyond the scope of this assessment and would not materially extend beyond the analysis in respect of the CASS Sourcebook
| Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Investment Firms) Regulations 2017**
(referred to herein as the IFR 2017 and which, as indicated below, may be read in conjunction with Irish transposition legislation of MiFID II and the Commission Delegated Directive – see MiFID Regulations (body as well as Sch. 3 (Referred) – see Endnotes))
| Investor Money Requirements Guidance 2018, Central Bank of Ireland***
(referred to herein as the IMRG Guidance)
NB: the text below regarding IMRG Guidance excludes the Hanson referenced Appendices (or exercise of space of this table, but these may nevertheless prove useful for practitioners, policymakers and other interested parties)
| Guidance on Client Asset Requirements For Investment Firms****
(referred to herein as the CAR Guidance)

(Yes/No) N/A

- MiFID II
- MiFID II p
- Commission Delegated Regulation*
- Commission Delegated Directive*

l. Recital 12 MiFID II

The purpose of this Directive is to cover adequately the regular occupation of business of which is to provide investment services and perform investment activities on a professional basis. It should therefore not cover any person with a different professional activity.

Recital 1 Commission Delegated Regulation Directive 2014/65/EU establishes the framework for a regulatory regime for financial markets in the Union, governing operating conditions relating to the performance by investment firms of investment services and, where appropriate, ancillary services and investment activities, organisational requirements for investment firms performing such services and activities, for regulated markets and data reporting services providers, reporting requirements in respect of transactions in financial instruments; position limits and position management controls in commodity derivatives; transparency requirements in respect of transactions in financial instruments.

Recital 2 Commission Delegated Directive

The protection of client financial instruments and funds is an important part of the regime. Investment firms being subject to an obligation to make adequate arrangements to safeguard the regular occupation of business of which is to provide investment services and perform investment activities on a professional basis. It should therefore not cover any person with a different professional activity.

In addition to the obligations of CASS, relevant firms are required to comply with the 12 Principles set out in PRIN 2 of the PFA Handbook. These include:

1. Integrity
A firm must conduct its business with integrity.
2. Skill, care and diligence
A firm must conduct its business with skill, care and diligence.
3. Management and control
A firm must make reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
4. Financial soundness
A firm must maintain adequate financial resources.
5. Market conduct
A firm must observe proper standards of market conduct.
6. Customer’s business
A firm must pay due regard to the interests of its customers and treat fairly.
7. Communications with clients
A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair, and not misleading.
8. Conflicts of interest
A firm must take reasonable care to ensure the possibility of a conflict of interest is avoided and to determine how any conflict will be resolved.
9. Customers’ relations of trust
A firm must make reasonable care to ensure the possibility of a conflict of interest is avoided and to determine how any conflict will be resolved.
10. Clients’ assets
A firm must arrange adequate protection for client assets when is a responsibility for them.
11. Relations with regulators
A firm must deal with its regulators in an open and cooperative way, and must disclose to the PFA appropriately anything relating to the firm which the FCA or another regulator has requested.
12. Rules with regulations
A firm must deal with its regulators in an open and cooperative way, and must disclose to the PFA appropriately anything relating to the firm which the

Regulation 5 of the IFR 2017 provides
(a) the Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) Investment Firms Regulations 2017 (S.I. No. 60 of 2017)**
(b) the Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) Investor Money Regulations 2015 for Pooled Service Providers (S.I. No. 105 of 2015)**
(c) the Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) Client Asset Requirements 2015 (S.I. No. 184 of 2015)**

Regulation 3 IFR 2017
Scope and application
5. Where the context provides otherwise—
(a) MiFID investment firms are subject to the requirements in Parts 2 and 6.
(b) investment business firms who are not fund administrators are subject to the requirements in Parts 2, 6 and 7.
(c) fund administrators are subject to the requirements in Parts 2, 3 and 6.
(d) management companies authorised pursuant to the UCITS Regulations are subject to the requirements in Parts 2 to 5.
(e) alternative investment fund managers authorised pursuant to the AIFMD Regulations are subject to the requirements in Parts 2 to 5.
(f) fund service providers are subject to the requirements in Part 2.

General comment:
A number of provisions of both the UK and Irish rules were permitted by the European Commission to be retained as they were considered to be "super-equivalent" to the provisions on Clients Assets and Safekeeping as required to be implemented in accordance with the provisions of MiFID II, MiFID II and the Commission Delegated Regulation as well as the Commission Delegated Directive and hence are retained in the national regimes of the UK and that of the Republic of Ireland. This, while of course beneficial in providing better protections than the minimum protections set at the EU level, does still contribute to conceptual divergence and CTR as analysed below.

This is case even where the UK rules are drafted in a more prescriptive manner when compared to the EU rules and the Irish rules where covering the same concepts and subject matter or equally more prescriptive than the EU rules go beyond a number of items that the EU rules cover. The Irish Rules are also generally more prescriptive than the EU Rules when it relates to the same subject matter and in limited circumstances in the issues, which the EU Rules do not cover.

2. General Requirements MiRMR Guidance

Guidance is only provided where it is considered it may assist in the interpretation of the Regulations, it is not provided for all the Regulations. The Guidance should not be read as in a new way from the relevant excerpted Guidance on the left hand side of the Guidance document and the related Guidance where warranted in the corresponding right hand side of the Guidance document. The Guidance is not comprehensive and does not replace or pre-empt any legislative provisions.

2.1 IFR Guidance
Examples of circumstances in which money is investor money

<table>
<thead>
<tr>
<th>Status of the entity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cheques and electronic transfers and other payable orders</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Cheques, electronic transfers and other payable orders received from investors will be investor money from the time of receipt of the cheque or other payable order by the fund service provider. Money sent to an investor by way of, cheque, electronic transfers or other payable order does not cease to be investor money until the cheque, electronic transfers or other payable order is presented and paid by the third party (as defined in Part 7).</td>
</tr>
</tbody>
</table>

Structure of the Guidance

1. General Requirements MiRMR Guidance

Guidance is only provided where it is considered it may assist in the interpretation of the Regulations, it is not provided for all the Regulations.

1.1 IFR Guidance

Interpretation
This Guidance relates to the Central Bank’s Investor Money Requirements which are set out in Part 7 of the Central Bank (Supervision and Enforcement) Act 2013 and (the “Regulations”). Defined terms in the Regulations have the same meaning in this Guidance. All of the Contributions are set out following the seven headings which the Central Bank regards as the seven core Client Asset Principles of a client asset regime. For ease of reference this Guidance document is set out on one clear basis, but for ease of interpretation, it is provided as a Q&A format.

1. Segregation
An investment firm should physically hold, or arrange for the holding of, client assets separate from the investment firm’s own assets and maintain accounting segregation between the investment firm’s own assets and client assets. For the avoidance of doubt this principle applies to client assets that may be held by a nominee.

2. Designation and Registration
An investment firm should ensure that client assets are clearly identified in its internal records and in the records of third parties. The client assets must be identified and separate from the investment firm’s own assets.

3. Reconciliation
An investment firm should keep accurate books and records of third parties. The client assets must be clearly identified in its internal records and in the records of third parties. The client assets must be identified and separate from the investment firm’s own assets.

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</tr>
</tbody>
</table>

[1] investment firm
[2] on behalf of which
[3] the client assets
[4] the investment firm’s own assets and maintain accounting segregation between the investment firm’s own assets and client assets. For the avoidance of doubt this principle applies to client assets that may be held by a nominee.


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[8] to ensure that client assets are clearly identified in its internal records and in the records of third parties. The client assets must be identified and separate from the investment firm’s own assets.

[9] an investment firm should keep accurate books and records of third parties. The client assets must be clearly identified in its internal records and in the records of third parties. The client assets must be identified and separate from the investment firm’s own assets.

[10] the investment firm’s own assets and maintain accounting segregation between the investment firm’s own assets and client assets. For the avoidance of doubt this principle applies to client assets that may be held by a nominee.

**CHAPTER 1**

1.1 Application and purpose

Application

CASS applies to a firm as specified in the remainder of this chapter.

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**Regulation 4(2) IFRR 2017**

(2) In addition to these obligations imposed on investment firms under the MiFIR Regulations, an investment firm shall notify the Bank, in writing, as soon as it becomes aware of any of the following:

(a) a breach by the investment firm of——

(i) these Regulations;

(ii) supervisory and regulatory requirements, and

(iii) any other enactment or legal instrument which may reasonably be considered to be of prudential concern to the Bank, or which may impact on the reputation or good standing of the investment firm;

(b) any situation or event which impacts, or potentially impacts, on the investment firm in a significant extent;

(c) the commencement of any legal proceedings by, or against, the investment firm;

(d) the initiation of any criminal proceeding against——

(i) the investment firm, or

(ii) any officer or employee of the investment firm for offences relating to money laundering, terrorist financing, fraud, misrepresentation, dishonesty or breach of trust;

(e) a visit to the investment firm by——

(i) any regulatory, professional, statutory or law enforcement authority or body operating in the State, or

(ii) any authority in any other jurisdiction that performs a function similar to the functions performed by the Bank;

(f) any imposition on the investment firm of any sanction, fine, penalty or other administrative measure by any of the authorities or bodies referred to in subparagraph (e); and

(g) any other event which impacts, or potentially impacts, on the investment firm to a significant extent.

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**IMR Guidance**

1.1 IMR Guidance

Examples of Another Money

The following examples are not exhaustive. If doubt, a fund service provider should be prudent in its approach and act in the best interest of the investor.

- **Investment Fund Asset**

  If money held in a third party collection account is an asset of an investment fund, Part 7 of the Regulations does not apply.

- **Money Payable to a fund service provider or to other party**

  Money that is due and payable to a fund service provider itself, or to a third party, is other money where it is due and payable in accordance with the following provisions:

  (a) the amount is in accordance with a formula or basis previously disclosed to the investor by the fund service provider; or

  (b) a statement showing the amount of fees and commission has been issued to the investor and a number of working days, not less than 10, can be determined by the fund service provider.

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**Notes**

- **client financial instruments** means financial instruments as defined in Regulation 3(1) of the MiFID Regulations or investment instruments as defined in section 2(1) of the Investment Intermediaries Act 1995, which is held by an investment firm on behalf of a client and includes, without limitation, any——

  (a) client financial instrument that is held with a nominee, and

  (b) claim relating to, or a right in or respect of a financial instrument;

- **client funds** means any money, to which a client is beneficially entitled, received from or on behalf of a client or held by the investment firm on behalf of a client and includes (without limitation)——

  (a) client funds held by or with a nominee, and

  (b) in the case of money that is comprised partly of client funds and partly of other money, that part of the money that is client funds, but does not include money that an investment firm——

  (i) receives from or on behalf of the client, or

  (ii) owes to or retains on behalf of the client and which relates exclusively to an activity of the investment firm which is not a regulated financial service;
provider and recorded in its investor money management plan, has elapsed, and the investor has not raised any queries; or c) the precise amount of fees or commissions has been agreed by the investor in writing, or has been finally determined by a court of competent jurisdiction.

Examples of money, once known, which may be due to a third party include, but are not limited to, the following:
- Commission;
- Transaction Charges;
- Performance Fees;
- Management Fees; and
- Contingent Deferred Sales Charges.

(iii) Cheques
A cheque or other payable order received from an investor is not honoured by the paying third party.

(iv) Transferred Money
Investor money paid ceases to be investor money where the money is paid or transferred, from the third party collection account to:
- a bank account in the name of the investor (not being an account which is also in the name of the fund service provider);
- a third party upon the written instructions of the investor and is no longer under the control of the fund service provider.

- The seven core Client Asset Principles of CAR reinforce (even though see comments re application of CAR Guidance) the principles introduced in the IMR 2017 and the IMR Guidance. Conceptually they

385 Which is defined in Part 6 of the IMR 2017 as Regulation 47(1) as:
“collateral” means, with respect to a client—
(i) client funds, or
(ii) client financial instruments which has been paid for in full by the client,
which are held by an investment firm as security for amounts which may be due to that investment firm by that client;”

386 Which is defined in Part 6 of the IMR 2017 as Regulation 47(1) as:
“collateral margined transaction” means a transaction effected by an investment firm with or for a client relating to a financial instrument under the terms of which the client will, or may, be liable to make a deposit of cash or collateral, either at the outset or subsequently, in order to secure performance of an obligation which the client may have to perform when the transaction falls to be completed or upon the earlier closing out of the client’s position with such financial instruments;”

387 Which is defined in Part 6 of the IMR 2017 as Regulation 47(1) as:
“margin” means funds or other forms of asset which a client deposits as security to open and maintain an investment position;”

388 Which is defined in Part 6 of the IMR 2017 in Regulation 47(1) as: “other money” means any money which is not client funds;”
### Part 2. As Above in Row 1 and:

**Recital 1 MiFID II**

The financial crisis has exposed weaknesses in the functioning and in the transparency of financial markets. The evolution of financial markets has exposed the need to strengthen the framework for the regulation of markets in financial instruments, including where trading in such markets takes place outside the central OTC'

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**Recital 2 MiFID II**

In order to protect an investor’s ownership and other similar rights in respect of securities and the investor’s rights in respect of funds entrusted to a firm, these rights should in particular be kept distinct from those of the firm. This principle should not, however, prevent a firm from doing business in its name but on behalf of the investor, where that is required by the very nature of the transaction and the investor is in agreement, for example stock lending.

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**Recital 3 MiFID II**

The requirements concerning the protection of client assets are a crucial tool for the protection of clients in the provision of services and activities. These requirements can be placed within the broad context of the rules and regulations concerning the safeguarding of client assets. Thus, at least when retail client assets are involved, it is appropriate to limit the possibility of investment firms to conclude title transfer financial collateral arrangements as defined under Directive 2013/36/EU of the European Parliament and of the Council (4), for the purpose of securing or otherwise covering their obligations.

### Table 1.4. Scope and application: who? what?

<table>
<thead>
<tr>
<th>Purpose</th>
<th>AS ABOVE AS IN ROW 1 – see also for the jurisdiction-specific concept of “fund administrator”</th>
<th>AS ABOVE AS IN ROW 1 – see also for the jurisdiction-specific concept of “fund administrator”</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.2.1G</td>
<td>The purpose of this chapter is to set out to whom, for what activities, and within what territorial limits the rules, evidential provisions and guidance in CASS apply.</td>
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</tr>
</tbody>
</table>

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### Table 1.2. General application: who? what?

<table>
<thead>
<tr>
<th>General application: who?</th>
<th>AS ABOVE AS IN ROW 1 – see also for the jurisdiction-specific concept of “fund administrator”</th>
<th>AS ABOVE AS IN ROW 1 – see also for the jurisdiction-specific concept of “fund administrator”</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.2.10G</td>
<td>The rules in CASS 1.2 set out the maximum scope of this sourcebook. The application of CASS is modified for certain activities by CASS 1.4. Also particular chapters or sections of CASS may have provisions which limit their application.</td>
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</tr>
</tbody>
</table>

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### Table 3.

#### Article 1 and 2 MiFID II

[Not replicated here for reasons of space as well as not being fully relevant for the purposes of the analysis in this row.]

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#### 1.2 General application: who? what?

<table>
<thead>
<tr>
<th>Scope and application</th>
<th>To whom do the Client Asset Regulations apply?</th>
</tr>
</thead>
<tbody>
<tr>
<td>5. Where the context provides otherwise—</td>
<td>61 (b) The Regulations issued in pursuant of Section 48 of the Central Bank (Supervision and Enforcement) Act 2013 apply to the following regulated entities holding client assets:</td>
</tr>
<tr>
<td>(a) MiFID investment firms are subject to the requirements in Parts 2 and 6;</td>
<td>a) investment firms authorised under Part 4 of MiFID;</td>
</tr>
<tr>
<td>(b) investment business firms who are not fund administrators are subject to the requirements in Parts 2, 5 and 6;</td>
<td>b) investment business firms authorised under Section 10 of the IA;</td>
</tr>
<tr>
<td>(c) fund administrators are subject to the requirements in Parts 2, 5 and 6;</td>
<td>c) UCITS management companies authorised under UCITS which is authorised to conduct services pursuant to Regulation 16(2) of S.I. No 257 of 2013;</td>
</tr>
<tr>
<td>(d) management companies authorised pursuant to the UCITS Regulations are subject to the requirements in Parts 2, 5 and 6;</td>
<td>d) alternative investment fund managers authorised under AIFM which is authorised to conduct services pursuant to Regulation 3(1) of the AIFM Directive which is the broadest sense of “alternative investment fund manager” as defined in Directive 2011/61/EU of the European Parliament and of the Council (4);</td>
</tr>
<tr>
<td>(e) alternative investment fund managers authorised pursuant to the AIFM Regulations are subject to the requirements in Parts 2, 5 and 6;</td>
<td>e) any of the above firms (a, b, c &amp; d) in respect of passported activities carried out by the firm from a branch in another European Economic Area (“EEA”) country.</td>
</tr>
<tr>
<td>(f) fund service providers are subject to the requirements in Part 7;</td>
<td>The Regulations do not apply to an incoming EEA investment firm with respect to its passported activities operating in Ireland;</td>
</tr>
<tr>
<td>(g) market operators are subject to the requirements in Part 8.</td>
<td>61 (d) In this Guidance:</td>
</tr>
</tbody>
</table>

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#### 3. Generally conceptually equivalent across the relevant rules.

No in terms of aims, but Yes in terms of terminology and some jurisdiction-specifics that exist in Ireland in particular:

- Part 7 of the IMR 2017 as it applies to “fund service providers” which is much narrower than in the EU Rules, which looks at “investment firms”, and in the UK where CASS 1.2.2, states “CASS applies to every firm” except certain exemptions – which is the broadest sense of application.

- Part 7 of the IMR 2017 (Regulations 71 to and including 88) applies the requirements set in the IMR 2017 as it applies to client assets applies to investor money.
<table>
<thead>
<tr>
<th>Row</th>
<th>1.2.7G</th>
<th>1.2.8G</th>
<th>5.1-3R</th>
<th>1.7-16F</th>
<th>1.7-16F</th>
<th>1.2.8F</th>
<th>1.2.8F</th>
<th>1.2.3R</th>
<th>1.2.8G</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.</td>
<td>1.2.8G</td>
<td>CASI applies to every firm, except as provided for in CASI 1.2.3R, with respect to the carrying on of:</td>
<td>1.2.8F</td>
<td>CASI does not apply to:</td>
<td>1.7-16F</td>
<td>The insurance client money chapter does not apply to:</td>
<td>1.7-16F</td>
<td>The debt management client money chapter generally applies to:</td>
<td>1.2.3R</td>
</tr>
<tr>
<td>5.</td>
<td>1.2.8F</td>
<td>(1) all regulated activities except to the extent that a provision of CASI provides for a narrower application; and</td>
<td>1.7-16F</td>
<td>(1) an ICVC, or</td>
<td>1.7-16F</td>
<td>The insurance client money chapter does not apply to:</td>
<td>1.7-16F</td>
<td>The UK-specific exclusion mentioning these types of firms and their activity does not exist in the same form, although it is implied by way of use of definitions, in the EU drafting. Ireland has no corresponding provisions to that of the UK’s drafting.</td>
<td>1.2.8G</td>
</tr>
<tr>
<td>6.</td>
<td>1.7-16F</td>
<td>(2) an incoming EEA firm other than an insurer, with respect to its passported activities; or</td>
<td>1.7-16F</td>
<td>(2) the Society.</td>
<td>1.7-16F</td>
<td>The UK-specific exclusion mentioning these types of insurance firms and their activity does not exist in the same form, although it is implied by way of use of definitions, in the EU drafting. Ireland has no corresponding provisions to that of the UK’s drafting.</td>
<td>1.7-16F</td>
<td>The UK-specific exclusion mentioning these types of debt management firms and their activity does not exist in the same form, although it is implied by way of use of definitions, in the EU drafting. Ireland has no corresponding provisions to that of the UK’s drafting.</td>
<td>1.2.3R</td>
</tr>
<tr>
<td>7.</td>
<td>1.2.3R</td>
<td>Articles 1 and 2 MiFID II</td>
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<td>1.7-16F</td>
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</tr>
<tr>
<td>8.</td>
<td>1.2.3R</td>
<td>Articles 1 and 2 MiFID II</td>
<td>1.2.8G</td>
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<td>1.7-16F</td>
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<td>1.7-16F</td>
</tr>
<tr>
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<td>1.2.3R</td>
<td>Articles 1 and 2 MiFID II</td>
<td>1.2.8G</td>
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<td>1.7-16F</td>
</tr>
</tbody>
</table>

- an investment firm shall mean an investment firm, an insurance business firm, an alternative investment fund manager or a UCITS management company as described in (b) (1) a), b), c), and d); and, definitions in the Regulations have the same meaning as in the Guidance.
10. Articles 1 and 2 MiFID II

[Not replicated here for reasons of space as well as not being fully relevant for the purposes of the analysis in this row.]

Application for affiliates

1.5.5.5

(1) The fact that a firm’s client is an affiliated company for MiFID II purposes does not affect the operation of CASS to the firm in relation to that client.

(2) For businesses that are MiFID business, the operation of the custody chapter or the client money chapter may differ if a firm’s client is an affiliated company and depending on certain other conditions (see, for example, CASS 6.1.1 HR and CASS 7.10.20 R).

11. Articles 1 and 2 MiFID II

[Not replicated here for reasons of space as well as not being fully relevant for the purposes of the analysis in this row.]

Investments and money held under different regimes

1.2.1.2

(1) A firm must not keep money in respect of which any one of the following chapters applies in the same client bank account or client transaction account as money in respect of which another of the following chapters applies:

(a) the client money chapter;

(b) the insurance client money chapter;

(c) the debt management client money chapter.

(2) In accordance with CASS 7.10.50 R, a firm which is subject to the client money chapter and holds money both (i) in its capacity as a trustee firm and (ii) other than in its capacity as a trustee firm must not keep money held in its capacity as a trustee firm in the same client bank account or client transaction account as money held other than in its capacity as a trustee firm.

(3) The client that the restriction under (1) or (2) applies to a firm, the bank client account and client transaction accounts that a firm holds in respect of different chapters or in its different capacities (as the case may be) must be separately designated.

Regulation 49 IMR 2017

Holding and depositing client funds

49. (1) All money received from, or on behalf of, a client shall be held as client funds in accordance with this Part unless such money relates exclusively to an activity of the investment firm which is not a regulated financial service.

(2) For the purposes of this Part, an investment firm is deemed to hold client funds where:

(a) the funds have been deposited on behalf of a client of the investment firm to a third party client asset account within a third party or a relevant party in the name of the investment firm or of a nominee, and

(b) the investment firm has the capacity to effect transactions on that third party client asset account.

(3) Client funds received from, or on behalf of, a client shall be deposited into a third party client asset account without delay, and in any event not later than one working day after the receipt of such client funds.

(4) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(5) Where an investment firm receives client funds from, or on behalf of, a client, the investment firm shall, as soon as practicable after receiving those client funds, send to the client a receipt in writing for those client funds, except where the client funds are received by electronic transfer or in settlement of a specific contract.

(6) Where an investment firm receives funds from, or on behalf of, a client, money that is comprised of a mixture of client funds and other money, the investment firm shall first pay off the client funds and other money into a third party client asset account and thereafter shall, without delay, transfer out of, or withdraw, from the third party client asset account the other money.

(7) If an investment firm receives or identifies at any stage that it is holding money where—

(a) it is not clear that the money is client funds, or

(b) there is insufficient documentation to identify the client who owns such money,

the investment firm shall, first pay the money into a third party client asset account and within 5 working days of the initial receipt of such money, or identifying that it is holding money where subparagraphs (a) or (b) apply, either identify the client concerned or return the money.

(8) Where client funds are deposited with a third party the investment firm shall review the arrangements for the holding of client funds with that third party—

(a) in accordance with the criteria set out in paragraphs 5(3) and 6(b) of Schedule 3 to the MiFID Regulations.

What are client assets?

G1. (3) Client assets consist of client funds and client financial instruments/investment instruments. Use of the term client financial instrument in this guidance document will also mean investment instrument.

G1. (4) Client funds are defined in the Regulations and include funds owed to or held on behalf of clients including cash, cheques or other payable orders, current and deposit accounts including margin collateral associated with client positions.

Examples of circumstances in which assets are client assets

G2. (1) Cheques and other payable orders will be client funds from the time of receipt of the cheque or other payable order by the investment firm except where G2 (5) applies. Funds sent to a client by way of cheques or other payable order do not cease to be client funds until the cheque or other payable order is presented and paid by the eligible credit institution.

G2. (2) If an investment firm has agreed in writing to pay interest to a client, such interest is client funds when the interest is paid. Payment of accrued interest to clients prior to its receipt should not be paid from the client asset account unless previously funded by an investment firm.

G2. (3) Where an investment firm receives margin in respect of margin transactions, such margin will be deemed to be client assets unless full ownership has been transferred (refer to G2 (4)).

These examples are not exhaustive and if a dispute arises between the firm and its customer the client financial instrument in this guidance document will also mean investment instrument.

Examples of circumstances in which assets are not client assets

G2. (4) Where a client transfers full ownership of client assets to an investment firm for the purpose of securing or otherwise covering present or future, actual or contingent or prospective obligations, such client assets should not longer be regarded as belonging to the client.

Where an investment firm has received full title or full ownership of money under a collateral arrangement, the firm that it has also taken a security interest over its obligation to repay that money to the client would not result in the money being client funds. But where an investment firm takes a charge or security interest over money held in a client asset account, then money would still be client funds if there was no absolute transfer of title.

When a client enters into an arrangement to transfer full ownership of client funds, the Central Bank would expect an investment firm to ensure that it has considered the appropriateness of such a transaction for each client and has clearly explained to the client the implications of this transaction, (i.e. of which in turn these assets will not be regarded as client assets. An investment firm...}
Holding and depositing client financial instruments

91. (1) All financial instruments received from, or on behalf of, a client shall be held in client financial instruments in accordance with this Part.

(2) For the purposes of this Part, an investment firm is deemed to hold client financial instruments where the investment firm—

(a) has been entrusted by, or on account of, a client with those client financial instruments; and

(b) either—

(i) holds those client financial instruments, including by way of holding documents of title to them; or

(ii) entrusts those client financial instruments to a nominee,

and the investment firm has the capacity to effect transactions in respect of those client financial instruments.

(3) An investment firm shall hold a client financial instrument in a place and a manner that, clearly and at all times, identifies it as a client financial instrument and distinguishes it from a financial instrument that the investment firm may hold that is not a client financial instrument.

(4) An investment firm shall hold documents of title to client financial instruments—

(a) itself, or

(b) with a nominee company of an investment firm, or

(c) with a relevant party in a safe custody account designated as a third party client asset account subject to client management agreement or the client management agreement or the client is not honoured by the paying eligible credit institution.

(5) An investment firm shall have procedures to record client financial instruments, including procedures to receive, hold, and withdraw physical or client financial instruments (including client instructions) and such procedures shall enable the effective monitoring of the movement of such client financial instruments.

(6) Client financial instruments shall not be deposited by an investment firm with a third party client asset account maintained by the investment firm at the third party.

(7) Where client financial instruments are deposited with a third party, the investment firm shall review the arrangements for the holding of the client financial instruments with that third party—

(a) in accordance with the criteria set out in paragraph 2 of Schedule 3 to the MiFID Regulations,

(b) if there is any material change to the relationship with the third party which affects the manner by which client instruments are held, and

(c) in any event, at least on an annual basis.

(8) An investment firm shall not hold client assets without the prior written approval of the Bank.

(9) An investment firm shall not hold client assets without the prior written approval of the Central Bank.

(10) An investment firm that receives a cheque, or other payable order made payable to a third party (e.g., a product producer), and which directly transmits that cheque or other payable order to that party.

G2 (5) An investment firm which receives a cheque, or other payable order made payable to a third party (e.g., a product producer), and which directly transmits that cheque or other payable order to that party.

G2 (6) Funds that are due and payable to an investment firm shall, in accordance with the following provisions:

• the amount is in accordance with a formula or basis previously disclosed to the client by the investment firm;

• a number of working days as determined by the investment firm and recorded in its Client Asset Management Plan ("CAMP") have elapsed since a statement showing the amount of fees and commissions issued to the client, and the client has not raised any queries.

The Central Bank expects the investment firm to allow at least ten working days to elapse;

• the precise amount of fees or commissions has been agreed by the client in writing; or

• has been finally determined by a court of competent jurisdiction.

G2 (7) A cheque or other payable order received from a client is not honoured by the paying eligible credit institution.

G2 (8) Client assets cease to be client assets where:

• they are paid, or transferred, to a third party on the written instruction of the client and are no longer under the control of the investment firm. In addition, acting in accordance with the terms of an investment management agreement or the completion of an order or application form will be considered to be a request from the client to pay the client assets to the relevant third party.

These examples are not exhaustive and it is down as an investment firm should act honestly, fairly and professionally in accordance with the best interests of its clients.
### 2.1 IMR Guidance

**When is a fund service provider deemed to hold investor money**

1. **(i) Subscriptions**
   - **Money received prior to the cash transfer cut-off time for the investment fund on the dealing date** is considered investor money. On the cash transfer cut-off time on the dealing date, this money should be transferred to the investment fund and entrusted to the depositary. Where money is received from an investor after the cut-off time on the dealing date, this money should be held in a collection account. This money is not investor money and should be dealt with in accordance with the legal arrangement between the fund service provider and the investment fund.

2. **(ii) Redemption proceeds / Dividends**
   - A fund service provider will be deemed to hold investor money when money is received by the fund service provider from an investment fund and deposited into a third party collection account for onward transmission to the investor. This would apply in the case of a redemption of the investment fund or where an investment fund pays a dividend.

3. **(iii) Investor money denominated in another currency**
   - The Central Bank expects a fund service provider to receive money into a third-party collection account from the investor in the currency of the transaction as instructed by the investor or in the base currency of the investment fund. Where the fund service provider has no third party collection account denominated in that currency and it would be unduly burdensome for it to open such an account, the fund service provider may convert investor money on receipt and hold it in a third-party collection account in a different currency.

4. **(iv) Mixed Remittances**
   - Examples of mixed remittances include but are not limited to the following:
     - Commissions,
     - Transaction Charges,
     - Performance Fees,
     - Management Fees, and
     - Contingent Deferred Sales Charges.

### 2.2 IMR Guidance

**How should an investment firm deal with money received for investment in an activity that is not a regulated financial service?**

Money received by an investment firm for investment in an activity that is not a regulated financial service should not be deposited in a client asset account; this money should be held in a segregated account. If an investment firm chooses to operate a client asset regime for its non-regulated business, the Central Bank does not have any objection. However, it is critical the investment firm clearly explains to its clients that such assets:

- are held separately from client assets;
- will not be protected as client assets; and
- will not be covered under the Investor Compensation Scheme.

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For a further discussion of this development (incl. the table on Page 398 and 399 of comparative existing deposit and investor protection schemes versus EDIS) see *Huertas* in EDIS – *The Third Pillar of the EU’s Banking Union: Big, Bold but can it be beautiful?* first published in 2016, Vol. 31, Issue 11, Journal of International Banking Law & Regulation.
a) As part of the process provided for in Regulation 72(5), when addressing instances of mixed remittances in the investor money management plan (i.e. the steps a fund service provider would follow in assessing how to deal with the receipt of investor money in this manner), consideration of other regulations/legislation should be taken into account, e.g. anti-money laundering obligations. A fund service provider should consider adopting cut-off time limits for the collection of the missing investor documents. The timeframe adopted should be reflective of the level of importance of documents omitted by the investor, ensuring the adoption of such timeframes will not result in the fund service provider breaching any other regulations/legislation; a fund service provider should seek legal advice if it is in any doubt such assessment should be made without delay. In any event, a fund service provider should ensure it takes action in order to act in accordance with Regulation 72(5). A fund service provider should have clear procedures in place to ensure that the unallocated money is monitored and reconciled each working day. All such investor money should be included in the fund service provider’s daily reconciliation and daily calculation.

b) If an investor pays investor money into an incorrect bank account in error (e.g., the fund service provider’s own firm bank account), the fund service provider should transfer that investor’s money into a third party collection account without delay but in any event no later than one working day in accordance with Regulation 72 (3) of the Regulations. A fund service provider should not ignore such an occurrence and, if such an exception occurs, the fund service provider should:

A. investigate as to why an investor’s money was deposited into the incorrect bank account;
B. put in place a procedure to prevent such an event from reoccurring; and
C. reflect this procedure in the fund service provider’s investor money management plan.

13. 1.2.1G
A firm may, where permitted by the relevant rules opt to hold under a single chapter money that would otherwise be held under different chapters (CASS 7.10.3 R and CASS 7.10.30 R). However, making such an election does not remove the requirement under CASS 1.2.11R (1). While conceptually this is implied in jurisdiction-specific legislation the UK’s drafting is much more explicit.

14. 1.3 G

| 1.3 General application: where? |
|---------------------------------
| 1.3.1G |
| The rules in CASS 1.3 set out the maximum territorial scope of this sourcebook. Particular rules may have express territorial limitations. |

While conceptually implied in other jurisdiction-specific legislation the UK’s drafting is much more explicit.

15. UK establishments: general

| 1.3.2R |
|---------------------------------
| Except as provided for in CASS 1.2.1 R (2), CASS applies to every firm, in relation to regulated activities carried on by it from an establishment in the United Kingdom. |

While conceptually implied in other jurisdiction-specific legislation the UK’s drafting is much more explicit.
UK firms: passported activities from EEA branches

1.3.3R CASS applies to every UK firm, other than an insurer, in relation to passported activities carried on by it from a branch in another EEA State.

While conceptually implied in other jurisdiction-specific legislation the UK's drafting is much more explicit.

1.3.4R CASS does not apply to an incoming ECA provider acting as such.

No equivalent in other jurisdictions.

Application: particular activities

1.4 Occupational pension scheme firms (OPS firms)

In the case of OPS activity undertaken by an OPS firm, CASS applies with the following general modifications:

(1) references to customer are to the OPS or welfare trust, whichever fits the case, in respect of which the OPS firm is acting or intends to act, and with or for the benefit of which the relevant activity is to be carried on;

(2) if an OPS firm is required by any rule in CASS to provide information to, or obtain consent from, a customer, then that firm must ensure that the information is provided to, or consent obtained from, each of the trustees of the OPS or welfare trust in respect of which that firm is acting, unless the context requires otherwise.

No equivalent in other jurisdictions.

Stock lending activity with or for clients

(1) The custody chapter and the client money chapter apply in respect of any stock lending activity that is undertaken with or for a client by a firm.

(2) The collateral rules apply, where relevant, in respect of stock lending activity.

No equivalent in other jurisdictions.

Corporate finance business

(1) The custody chapter and the client money chapter apply in respect of corporate finance business that is undertaken by a firm.

(2) The collateral rules apply, where relevant, in respect of corporate finance business.

No equivalent in other jurisdictions.

Oil market activity and energy market activity

(1) The custody chapter and the client money chapter apply in respect of oil market activity and other energy market activity that is undertaken by a firm.

(2) The collateral rules apply, where relevant, in respect of energy market activity.

No equivalent in other jurisdictions.

Appointed representatives and tied agents

(1) Although CASS does not apply directly to a firm's appointed representative, a firm will always be responsible for the acts and omissions of its appointed representatives in carrying on business for which the firm has accepted responsibility (section 39(3) of the Act).

In determining whether a firm has complied with any provision of CASS, anything done or omitted by a firm's appointed representative when acting as such must be treated as having been done or omitted by the firm (section 39(4) of the Act). Equally, CASS does not apply directly to tied agents. A MiFID investment firm will be fully and unconditionally responsible for the acts and omissions of the tied agents that it appoints.

Firms should also refer to SUP 12 (Appointed representatives), which sets out requirements which apply to firms using appointed representatives and tied agents.

No equivalent in other jurisdictions.

Articles 1 and 2 MiFID II

Depositaries

The client money chapter does not apply to a depositary when acting as such.

The UK rules differ in terms of concept by explicitly stating that depositaries, which at the EU level are introduced as a regulatory concept by the AIFMD Regime (which came into force in 2011 thus well after the EU FOD), are outside the scope of the EU FUD, and thus also considered separately by the Irish rules.

Firms acting as trustee or depositary of an AIF are reminded of the obligations in FUND 3.11 (Depositaries and Chapter IV (Depositary) of the AIFMD level 2 regulation which apply in addition to those in CASS.

As in Row 25.
25. Articles 1 and 2 MiFID II

[Not replicated here for reasons of space as well as not being fully relevant for the purposes of the analysis in this row.]

1.4.6BG
Firms acting as trustee or depositary of a UCITS are reminded of the obligations in COLL 4.1B (UCITS depositaries) and in the UCITS level 2 regulation, which apply in addition to those in CASS.

As in Row 23.

26. Articles 1 and 2 MiFID II

[Not replicated here for reasons of space as well as not being fully relevant for the purposes of the analysis in this row.]

1.4.7R
Subject to CASS 1.4.6 R, CASS applies to a depositary, when acting as such, with the following general modifications: 'client' means 'trustee', 'trust', 'AIF', 'AIFM acting on behalf of the AIF', 'UCITS scheme', 'authorised fund manager acting on behalf of the UCITS scheme', or 'collective investment scheme', as appropriate.

As in Row 23.

27. Articles 1 and 2 MiFID II

Subject to CASS 1.4.6 R, CASS applies to a depositary, when acting as such, with the following general modifications: 'client' means 'trustee', 'trust', 'AIF', 'AIFM acting on behalf of the AIF', 'UCITS scheme', 'authorised fund manager acting on behalf of the UCITS scheme', or 'collective investment scheme', as appropriate.

As in Row 23.

28. Auction regulation bidding

Auction regulation bidding Debt management activities

1.4.15
(1) The application of CASS for a trustee firm acting as a depositary is set out in CASS 1.4.3 R and CASS 1.4.7 R.
(2) The application of CASS for a trustee firm that is not acting as a depositary in limited as follows:
(a) the mandate rules apply;
(b) for MiFID business, the custody chapter and the client money chapter apply; and
(c) for business that is not MiFID business, the custody chapter and the client money chapter apply only to trustee firms acting as trustees of personal pension schemes or stakeholder pension schemes, including SSIPs.
(3) To the extent that CASS applies to a trustee firm, it applies with the following general modification: 'client' means 'relevant trustee', 'trustee', or 'beneficiary', as appropriate.

As in Row 23.

29. Application: electronic media and E-Commerce

Application to electronic media

1.5.1G
DEN 2.2.14 R (References to writing) has the effect that electronic media may be used to make communications that are required by the Handbook to be 'in writing' unless a contrary intention appears.

No explicit conceptual equivalent in other jurisdictions, which is otherwise implied (but not for same subject matter) generally for communications, as set out in MiFID II/MiFIR or in Ireland in the IMR 2017 as MiFID Regulations.

30. Application: electronic media and E-Commerce

For any electronic communication with a customer, a firm should:

(1) have in place appropriate arrangements, including contingency plans, to ensure the secure transmission and receipt of the communication; it should also be able to verify the authenticity and integrity of the communication; the arrangements should be proportionate and take into account the different levels of risk in a firm's business;
(2) be able to demonstrate that the customer wishes to communicate using this form of media; and
(3) if entering into an agreement, make it clear to the customer that a contractual relationship is created that has legal consequences.

No conceptual equivalent in other jurisdictions.

31. Application: electronic media and E-Commerce

Firms should note that GEN 2.2.14 R does not affect any other legal requirement that may apply in relation to the form or manner of executing a document or agreement.

No conceptual equivalent in other jurisdictions.

32. CHAPTER 1A

CASS firm classification and operational oversight

1A.1 Application

1A.1.1R
(1) Subject to (2), (3) and (4), this chapter applies to a firm to which either or both of CASS 6 (Custody rules) and CASS 7 (Client money rules) applies.
(2) In relation to a firm to which CASS 5 (Client money: insurance distribution activity) and CASS 7 (Client money rules) apply, this chapter does not apply to activities that a firm conducts in accordance with CASS 5.
(3) The rules and guidance in CASS 1A.2 apply to a firm even if at the date of the determination or, as the case may be, the notification, no conceptual equivalent in other jurisdictions. Other jurisdictions do not require a similar type of classification as in the UK.
either or both of CASS 6 and CASS 7 do not apply to it, provided that:
(a) it is, was, or is projected to be a firm which arranges safeguarding and administration of assets, or
(b) when acting as a small AIFM in relation to excluded custody activities, it would be, would have been or would be projected to be a firm which arranges safeguarding and administration of assets for the reason set out in Article 72A of the RA2.

35.
1A.1.2R

The rules and guidance in CASS 1.2 (CASS firm classification) do not apply to a firm following its failure.

36.
1A.1.2R

CASS 1A.2.3R

For the purpose of calculating the value of the total amounts of client money and safe custody assets held during the previous calendar year, calculate the higher of the highest total amount of client money and the highest total value of safe custody assets that it held during the previous calendar year ending on 31 December and use that figure to determine its ‘CASS firm type’;
(b) if it did not hold client money or safe custody assets in the previous calendar year but projects that it will do so in the current calendar year, calculate the higher of the highest total amount of client money and the highest total value of safe custody assets that it projects that it will hold during that year and use that figure to determine its ‘CASS firm type’;
(c) in other cases, exclude from its calculation any client money held in accordance with CASS 5 (Client money: insurance distribution activity) or CASS 13 (Claims management: client money).

37.
1A.1.2.

CASS 1A.2.3R

The application of certain rules in this chapter depends upon the ‘CASS firm type’ within which a firm falls. The ‘CASS firm types’ are defined in accordance with CASS 1A.2.7 R. The ‘CASS firm type’ within which a firm falls is also used to determine whether it is required to have the CASS operational oversight function described in CASS 1A.3.1R and whether the reporting obligations in SUP 16.14 (Client money and asset scrutiny) apply to it.

38.
1A.1.2R

(1) A firm must once every year, and by the time it is required to make a notification in accordance with CASS 1A.2.6R (4), determine whether it is a CASS large firm, CASS medium firm or a CASS small firm according to the amount of client money or safe custody assets which it holds, using the limits set out in the table in CASS 1A.2.7 R.
(2) For the purpose of determining its ‘CASS firm type’ in accordance with CASS 1A.2.7 R, a firm must:
(a) if it currently holds client money or safe custody assets, calculate the higher of the highest total amount of client money and the highest total value of safe custody assets held during the previous calendar year ending on 31 December and use that figure to determine its ‘CASS firm type’;
(b) if it did not hold client money or safe custody assets in the previous calendar year but projects that it will do so in the current calendar year, calculate the higher of the highest total amount of client money and the highest total value of safe custody assets that it projects that it will hold during that year and use that figure to determine its ‘CASS firm type’;
(c) in other cases, exclude from its calculation any client money held in accordance with CASS 5 (Client money: insurance distribution activity) or CASS 13 (Claims management: client money).

39.
1A.1.2R

CASS 1A.2.7 R

Regulation 48(5) SI 2017

(1) Without prejudice to Regulations 48(3), 49(5) and 49(6), an investment firm is not required to pay into a third party client asset account such client assets that it receives on behalf of a client where to do so would result in the investment firm breaching any law or order of any court of competent jurisdiction.

Regulation 48(6) SI 2017

(6) When, in accordance with an instruction from a client, a client asset is transferred to a third party, the investment firm shall ensure that such transfer is overseen and approved, prior to or at the time of transfer, by a relevant person other than the relevant person who is conducting the transfer.

Regulation 57 SI 2017

57. (1) In relation to third party client asset accounts, other than fixed term deposit accounts, which hold client funds, an investment firm shall reconcile daily, the balance of all client funds held, as recorded by the investment firm, with the balance of all client funds deposited, as recorded by the third party as set out in a statement or other form of

Regulation 2.2 How a fund service provider should hold investor money

(1) Investor money denominated in another currency
The Central Bank expects a fund service provider to receive money into a third party collection account from the investor in the currency of the transaction as instructed by the investor or in the base currency of the investment fund. Where the fund service provider has no third party collection account denominated in that currency and it would be unduly burdensome for it to open such an account, the fund service provider may convert investor money on receipt and hold it in a third party collection account in a different currency.

(2) Mixed Remittances
Examples of mixed remittances include but are not limited to the following:

(a) Mixed Remittances

Examples of mixed remittances include but are not limited to the following:

(i) Mixed Remittances

Examples of mixed remittances include but are not limited to the following:

(ii) Mixed Remittances

Examples of mixed remittances include but are not limited to the following:

(iii) Mixed Remittances

Examples of mixed remittances include but are not limited to the following:

What must an investment firm reconcile?

(5) The Central Bank expects a fund service provider to receive money into a third party collection account from the investor in the currency of the transaction as instructed by the investor or in the base currency of the investment fund. Where the fund service provider has no third party collection account denominated in that currency and it would be unduly burdensome for it to open such an account, the fund service provider may convert investor money on receipt and hold it in a third party collection account in a different currency.

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(iii) Mixed Remittances

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What must an investment firm reconcile?

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Examples of mixed remittances include but are not limited to the following:

(ii) Mixed Remittances

Examples of mixed remittances include but are not limited to the following:

(iii) Mixed Remittances

Examples of mixed remittances include but are not limited to the following:

What must an investment firm reconcile?

(5) The Central Bank expects a fund service provider to receive money into a third party collection account from the investor in the currency of the transaction as instructed by the investor or in the base currency of the investment fund. Where the fund service provider has no third party collection account denominated in that currency and it would be unduly burdensome for it to open such an account, the fund service provider may convert investor money on receipt and hold it in a third party collection account in a different currency.

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Examples of mixed remittances include but are not limited to the following:

(i) Mixed Remittances

Examples of mixed remittances include but are not limited to the following:

(ii) Mixed Remittances

Examples of mixed remittances include but are not limited to the following:

(iii) Mixed Remittances

Examples of mixed remittances include but are not limited to the following:
(2) In relation to third party client asset accounts which hold client-held securities, an investment firm shall reconcile, at least monthly, the balance of all client funds held, as recorded by the investment firm, with the balance of all client funds held, as recorded by the third party as set out in a statement or other form of confirmation from the third party and such a reconciliation shall be carried out within 10 working days of the date to which the reconciliation relates.

(3) In relation to third party client asset accounts which hold client financial instruments, an investment firm shall reconcile, at least monthly, the balance of client financial instruments held, as recorded by the investment firm, with the balance of all client financial instruments held, as recorded by the third party as set out in a statement or other form of confirmation from the third party, and such a reconciliation shall be carried out within 10 working days of the date to which the reconciliation relates.

(4) An investment firm shall ensure that the quantity and type of client financial instruments held by the investment firm or nominee, are the same quantity and type as those recorded by the third party who is independent of the person who carried out the reconciliation and the person who produced and maintained the records used for the purpose of carrying out the reconciliation.

(5) Each reconciliation shall be carried out by a relevant person who is independent of the production and maintenance of the records used for the purpose of carrying out the reconciliation.

(6) Each reconciliation shall be reviewed by a relevant person who is independent of the person who carried out the reconciliation and of the person who produced and maintained the records used for the purpose of carrying out the reconciliation.

(7) An investment firm shall—

(a) ensure that the reconciliations required pursuant to Regulations 57(1), 57(2) and 57(3) are performed using client asset records that are accurate and the reconciliation itself is performed accurately.

(b) investigate within one working day the cause of any reconciliation difference in the reconciliation required pursuant to Regulations 57(1), 57(2) and 57(3),

(c) identify the cause of any reconciliation difference identified in Regulation 57(3) within 10 working days, and

(d) review any reconciliation difference identified in Regulation 57(7)(a) as soon as practicable.

Regulation 58 EIR 2017

Daily calculation

58. (1) An investment firm shall, each working day, ensure that the client funds recorded as at the close of business on the previous working day is equal to the client funds requirement.

(2) For the purposes of Regulation 58(1), an investment firm shall use values in its own accounting records which may have been reconciled with statements from a third party rather than values contained in statements received from a third party.

(3) In the event of a shortfall of client funds, an investment firm shall deposit into a third party, client asset account, within delay and in any event within one working day from the date to which the calculation

deal with the receipt of investor money in its treasury, consideration of other regulatory/legislation should be taken into account, anti-money laundering obligations. A fund service provider should consider stepping back on time limits for the collection of the missing investor documents. The timeframe adopted should reflect the level of importance of documents emitted by the investor, ensuring that such timeshribs will not result in the fund service provider breaching any other regulatory/legislation, a fund service provider should seek legal advice if it is in any doubt such requirement being met, but in any event, a fund service provider should ensure it takes action in order to act in accordance with Regulation 72(1). A fund service provider should have clear procedures in place to ensure that validated client money is monitored and reconciled each working day. All such investor money should be included in the fund service provider’s daily reconciliation and daily calculation.

(6) Any investor money held in an account that does not belong to each client who has given consent, so as to enable the correct allocation of any fees or gains.

What is the daily calculation for an Investment Firm?

What is the client money requirement for an Investment Firm?

G6. (1) The client money requirement represents all client funds held on behalf of clients or videally due to clients as of the date of the calculation, that should be included in the books and records of the investment firm, appropriately adjusted for reconciliation items on the client agent bank reconciliation. The client fund should be held at the agent bank as the client's bank account in accordance with Regulation 81. An investment firm should have procedures in place to monitor when transactions are processed through its client asset bank accounts.

G7. (1) The client money requirement for a fund service provider, the investor money requirement includes:

(a) cash which is received from investors for purchasing subscriptions prior to the cash transaction cut-off time on the dealing date of the investment fund(s),

(b) cash received from the investment fund(s) as a result of, for example, redemption/ dividends that have to be paid to the investors of the investment fund(s), or

(c) cash refunds, distributions or any other investor related payments.

(1) The client fund requirement of a fund service provider is calculated on a monthly basis: note all other client asset bank accounts containing client funds should be reconciled on a daily basis in accordance with Regulation 58(1). An investment firm should have procedures in place in order to monitor when transactions are processed through its client asset bank accounts.

G8. (1) The client fund requirement for a fund service provider is calculated on a monthly basis: note all other client asset bank accounts containing client funds should be reconciled on a daily basis in accordance with Regulation 58(1). An investment firm should have procedures in place in order to monitor when transactions are processed through its client asset bank accounts.

What is the calculation for an Investment Firm?

What is the client money requirement for an Investment Firm?

G6. (1) The client money requirement represents all client funds held on behalf of clients or videally due to clients as of the date of the calculation, that should be included in the books and records of the investment firm, appropriately adjusted for reconciliation items on the client agent bank reconciliation. The client fund should be held at the agent bank as the client's bank account in accordance with Regulation 81. An investment firm should have procedures in place to monitor when transactions are processed through its client asset bank accounts.

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(c) cash refunds, distributions or any other investor related payments.

(1) The client fund requirement of a fund service provider is calculated on a monthly basis: note all other client asset bank accounts containing client funds should be reconciled on a daily basis in accordance with Regulation 58(1). An investment firm should have procedures in place in order to monitor when transactions are processed through its client asset bank accounts.

What is the calculation for an Investment Firm?

What is the client money requirement for an Investment Firm?

G6. (1) The client money requirement represents all client funds held on behalf of clients or videally due to clients as of the date of the calculation, that should be included in the books and records of the investment firm, appropriately adjusted for reconciliation items on the client agent bank reconciliation. The client fund should be held at the agent bank as the client's bank account in accordance with Regulation 81. An investment firm should have procedures in place to monitor when transactions are processed through its client asset bank accounts.
(4) In the event of an excess of client funds, an investment firm shall withdraw from a third party client asset account, without delay and in any event within one working day from the date to which the calculation relates, each money from a third party client asset account as is necessary to ensure that the client funds resource is equal to the client funds requirement.

(5) The daily calculation shall be carried out by a relevant person who is independent of the production and maintenance of the records used for the purpose of carrying out the daily calculation.

(6) The daily calculation shall be reviewed by a relevant person who is independent of the person who produced and maintained the records used for the purpose of carrying out the calculation.

8.2 When is a fund service provider required to notify the Central Bank of an excess or shortfall in completing its daily calculation?

[i] The Central Bank will require each fund service provider to assess what level of shortfall or surplus is considered material and record this rationale in its investor money management plan.

[ii] The Central Bank expects a fund service provider to immediately notify the Central Bank via the ONR when the level of money it deposits or withdraws from its third party collection account is material and to explain in the notification the reasons for this transfer. The Central Bank, where it considers necessary, may engage with the fund service provider to discuss its funding and its rationale.

[iii] A fund service provider should ensure that each daily calculation has the relevant supporting backup material available to enable the verification of figures in the daily calculation.

[iv] Where a fund service provider outsources the performance of the daily calculation, it should have appropriate oversight of the process to ensure that the third party (including a group entity) has appropriate processes, systems and controls for the performance of this activity. The fund service provider should maintain a record to evidence the oversight of the process.

An investment firm writing margins instructions should also include:

a) any excess margins due to clients and
b) the amount an investment firm would be liable to pay to clients in respect of their margined transactions, if each client’s open position was liquidated and the account was closed.

Less:

c) the net amount an investment firm would receive in respect of an investment firm’s margined transactions for clients with counterparties, if each such open position was liquidated and the investment firm’s account with the counterparty was closed. Negative balances should be deducted from positive balances; if negative balances are greater than positive balances, this figure should be treated as zero for the purpose of calculating the client money requirement.

G6 (2) When calculating the client money requirement, an investment firm should ensure the provisions of Regulation 3(4) are adhered to.

What is the client money resource for an Investment Firm?

G6 (3) The client money resource represents all of the investment firm’s client asset bank balances that should be recorded in the books and records of an investment firm, appropriately adjusted by reconciliation items on the client asset bank reconciliation. Any funds held in foreign currency may be included in the individual foreign currencies or may be converted to the base currency using the Central Bank rate for that day or any other established automatic rate feed. In effect, the client money resource may be more commonly referred to as an investment firm’s client asset bank ledger appropriately adjusted by reconciliation items on the client asset bank reconciliation. In the event of an investment firm having an overdraft bank balance in a particular client asset bank account, it should include this overdraft balance in the client money resource for the purpose of the daily calculation in order to provide a true client money resource position.

What should an investment firm do if its client money resource is not equal to its client money requirement?

G6 (4) A shortfall occurs when an investment firm’s client money resource is less than its client money requirement. An excess occurs when an investment firm’s client money resource is greater than its client money requirement. An investment firm should ensure that the Daily Calculation is completed in adequate time to enable an investment firm to fund a shortfall or transfer an excess within the permitted industry banking cut-off times; cut-off times may vary depending on currency type.

When is an investment firm required to notify the Central Bank of an excess or shortfall in completing its daily calculation?

G6 (5) The level of funding required as a result of a shortfall in client funds for each investment firm will vary and whether this level of funding is material will also depend on the size of the shortfall or surplus as a result of a surplus will also differ for each investment firm. As a result, the Central Bank will require each investment firm to assess what level of shortfall or surplus is considered material and record this rationale in its CAMP.

The Central Bank expects an investment firm to immediately notify the Central Bank via the ONR when the level of money it deposits or withdraws from its client asset bank account is material and to explain in the
notification the reasons for this transfer. The Central Bank where necessary may engage with an investment firm to discuss its funding and its rationale.

How and who in an investment firm should carry out the daily calculation and what records should be kept?

G6 (6) An investment firm should be in a position to demonstrate upon request, the date upon which a calculation was prepared; this evidence can be maintained in electronic form.

G6 (7) An investment firm may perform its daily calculations electronically provided that the daily calculations can be reproduced without delay (refer to Regulation 3(24)).

G6 (8) An investment firm should ensure that each daily calculation has the relevant supporting backup material for each calculation to enable the verification of figures in the daily calculation.

G6 (9) Where an investment firm oversees the performance of the daily calculation, it should have adequate oversight of the process to ensure that the third party has appropriate processes, systems and controls for the performance of this activity. This would also apply where the outsourced provider is part of the same group.

The manner in which the investment firm oversees this activity should be documented in the investment firm’s CASS. The investment firm should maintain a record to evidence the oversight of the process.

37. 1A.2.4G One of the consequences of CASS 1A.2.2 R is that a firm that determines itself to be a CASS small firm or a CASS medium firm will, at least if it exceeds during the course of a calendar year either of the limits in CASS 1A.2.7 R that applies to it, become in the next calendar year:

(1) in the case of a CASS small firm, a CASS medium firm or a CASS large firm; and
(2) in the case of a CASS medium firm, a CASS large firm.

38. 1A.2.5R (1) Notwithstanding CASS 1A.2.2 R, provided that the conditions in (2) are satisfied a firm may elect to be treated:

(a) as a CASS medium firm, in the case of a firm that is classed by the application of the limits in CASS 1A.2.7 R as a CASS small firm; and
(b) as a CASS large firm, in the case of a firm that is classed by the application of the limits in CASS 1A.2.7 R as a CASS medium firm.

(2) The conditions to which (1) refers are that in either case:

(a) the election is notified to the FCA in writing;
(b) the notification in accordance with (a) is made at least one week before the election is intended to take effect; and
(c) the FCA has not objected.

39. 1A.2.6R CASS 1A.2.5 R provides a firm with the ability to opt in to a higher category of ‘CASS firm type’. This may be useful for a firm whose holding of client money and safe custody assets is near the upper categorisation limit for a CASS small firm or a CASS medium firm.

40. 1A.2.7R CASS firm types

<table>
<thead>
<tr>
<th>CASS firm type</th>
<th>Highest total amounts of client money held during the firm's last calendar year or as the case may be that is</th>
<th>Highest total value of safe custody assets held by the firm during the firm's last calendar year or as the case may be that is</th>
</tr>
</thead>
</table>

Same as in Row 32.
Once every calendar year a firm must notify to the FCA in writing the information specified in (1), (2) or (3) as applicable, and the information specified in (4), in each case no later than the day specified in (1) to (4):

(1) if it held client money or safe custody assets in the previous calendar year, the highest total amount of client money and the highest total value of safe custody assets held during the previous calendar year, notification of which must be made no later than the fifteenth business day of January; or

(2) if it did not hold client money or safe custody assets in the previous calendar year but at any point up to the fifteenth business day of January the firm projects that it will do so in the current calendar year, the highest total amount of client money and the highest total value of safe custody assets that the firm projects that it will hold during the current calendar year, notification of which must be made no later than the fifteenth business day of January; or

(3) in any other case, the highest total amount of client money and the highest total value of safe custody assets that the firm projects that it will hold during the remainder of the current calendar year, notification of which must be made no later than the business day before the firm begins to hold client money or safe custody assets; and

(4) in every case, of its ‘CASS firm type’ classification, notification of which must be made at the same time the firm makes the notification under (1), (2) or (3).
46. Recital 7 Commission Delegated Directive

A single officer with overall responsibility for the safeguarding of client assets and funds should be appointed in order to reduce risks of conflicts of interest and to ensure that the client financial instruments and funds are effectively safeguarded. Where a firm can demonstrate that it has a system in place to identify risks to the investment firm’s overall effectiveness, processes and policies on safeguarding client assets, the account of the entity having overall responsibility for the safeguarding of client assets may be considered to be meeting this requirement.

Article 7 Commission Delegated Directive

Governance arrangements concerning the safeguarding of client assets

Member States shall ensure that investment firms appoint a single officer with sufficient skill and authority with specific responsibility for matters relating to the compliance by firms with their obligations regarding the safeguarding of client financial instruments and funds.

Member States shall allow investment firms to decide, ensuring full compliance with this Directive, whether the appointed officer is to be a director or senior manager who is approved to perform a significant influence function for that firm. [Note: article 7, first paragraph of the MiFID Delegated Directive]

Recital 5 Commission Delegated Directive

Any written notification made to the FCA under this chapter should be marked for the attention of “Client Assets Firm Classification”.

1A.3 Responsibility for CASS operational oversight

Para. 6 of Schedule 3 of MiFID Regulations

Governing arrangements concerning the safeguarding of client assets

1. (1) Investment firms shall appoint a single officer of sufficient skill and authority with specific responsibility for matters relating to the compliance by firms with their obligations regarding the safeguarding of client financial instruments and funds.

2. Investment firms shall decide, ensuring full compliance with this Schedule, whether the appointed officer is to be the dedicated solely to this task or whether the officer can discharge responsibilities effectively whilst having additional responsibilities.

Regulation 63 DIF 2017

Risk management

45. (1) An investment firm shall ensure that the Head of Client Asset Oversight shall have the necessary resources, including staff that are adequately trained with sufficient skill and expertise, to carry out the responsibilities listed in Regulation 65(2) being regarded to the nature, scale and complexity of the business of the investment firm.

(2) The Board of Client Asset Oversight shall perform relevant duties including but not limited to the following:

(a) ensuring that every Fund’s Facilities Agreement and Financial Instruments Facilities Agreement referred to in Regulation 65(2) is reviewed in respect of the resources available and maintained in accordance with Regulation 65(2);

(b) reviewing, at least on an annual basis, the provisions of every Fund’s Facilities Agreement and Financial Instruments Facilities Agreement to ensure compliance with the requirements of this Part; in particular Regulations 51(1) and 51(2), or the terms of the Fund’s Facilities Agreement or the Financial Instruments Facilities Agreement;

(c) providing approval, in writing, of the reviews referred to in Regulations 49(8) and 49(9);

(d) ensuring that the client asset management plan referred to in Regulation 66(4) is produced, maintained, reviewed and updated; and information upon which client asset management plan is based, change;

(e) ensuring that any potential or actual breaches of this Part are reported to writing to the board of the investment firm or the cease to be relevant or cease to be of the parties in the case of a partnership;

(f) ensuring that the ultimate and final, in accordance with Regulation 66, of any breaches of this Part without delay;

(g) approving any transfers in relation to client assets that are required by this Part to be submitted to the Bank;

(h) reporting in writing to the board of the investment firm in the case of a company or each of the partners in the of any breaches of this Part to be submitted to the Bank;

(i) ensuring that any evolution processes performance on relevant performance returns referred to in the provisions 51(3) to 51(5) and the daily calculations referred to in Regulation 66(1).

1D.3 Guidelines for investor money management plan

What is meant by Risk Management for client assets and how an investment firm demonstrate risk management for client assets?

(1) The Central Bank expects an investment firm to have appropriate risk management process to ensure that it has in place to identify risks to the investment firm’s objectives, processes and policies in respect of safeguarding client assets. While the risk management policy for client assets is distinct, it may be incorporated as part of the investment firm’s governance framework.

(2) The investment firm is expected to consider and document in its report in respect of safeguarding client assets and the controls to its business model to mitigate these risks.

(3) The investment firm is required to carry out the following: appoint an individual to the role of “Head of Client Asset Oversight” (“HCAO”), which is a Pre- Approved Controlled Function (“PCF”) (refer to, Regulation 8(1); and b) document and maintain a CAMP (see to, Regulation 8(3).

(4) An investment firm is not limited to Regulations 8(1) and 8(3); it may adopt additional risk management processes to fully safeguard client assets appropriate to the nature, scale and complexity of its business model. The responsibilities of the HCAO and the content of the CAMP should be aligned to the business model of the investment firm.

What should the responsibilities of the Head of Client Asset Oversight include?

(1) The Board is ultimately responsible for safeguarding client assets, the reporting framework or they have a PCF does not derive from this. In most cases, the Central Bank expects a director to be nominated for the role of HCAO. Where an investment firm proposes to appoint an individual who is not a director (e.g., in a large investment firm), the individual should be a senior manager at the investment firm who has direct access to the Board in respect of its function.

(2) The Board should ensure that the individual undertaking the role of HCAO can demonstrate that he is free from any conflicts of interest in this role, including but not limited to the following: a) appoint an individual to the role of ‘Head of Client Asset Oversight’ (HIMO); b) document and maintain a CAMP (see to, Regulation 8(3).

(3) The Board should ensure that the HCAO is capable of carrying out the functions relating to the administration of investor money. The Board should document in the investor money management plan the rationale for the nomination and appointment of the HIMO, including the criteria used by the fund service provider in making the appointment.

(4) The fund service provider should arrange for appropriate measures to ensure the HIMO is free from any conflicts of interest in this area. In this regard, the HIMO should be sufficiently removed from the performance of the day-to-day operational functions relating to the administration of investor money.

(10) Investor Money Management Plan

What is meant by Risk Management for client assets and how can an investment firm demonstrate risk management for client assets?

(1) The investor money management plan should be regarded as a master document and must be sufficiently reviewed to ensure it remains current and reflective of the fund service provider’s matching business model. Not all material referred to in the investor money management plan needs to be contained within the document itself. However, it should record the location of such information is readily available (for example, including any hypertext within the investor money management plan that direct the reader to the relevant information and documentation, and/or

1. Investor Money Management Plan

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- Broadly conceptually equivalent use of "single officer" and requirement, for risk and control functions, UK and Ireland regimens have single officer as part of either a specific approved regulator – in the case of Ireland the regulator approved “Pre Approved Control Function” concept and in the case of the UK, these persons being self-approved in line with the UK’s Senior Managers and Certification Regime that replaced the Regulatory “Approved Persons” Regime.

- The Irish expectations on the CAMP and the DMAP are more prescriptive than requirements in the UK and do not exist as concepts at the EU level.
Client asset management plan

G8 (12) The CAMP should be regarded as a master document and not all material referred to in the CAMP needs to be contained within the document; however it should record the location of where the information is usually available. Note: Regulation 9(2) provides that, where information is held electronically, an investment firm shall ensure that it can produce such records without delay.

When should the CAMP be approved and by whom?

G8 (13) Regulations 8(4) and (9) set out when the CAMP should be approved and by whom. Material changes to the CAMP should be notified to the Board and discussed; this should include any significant changes to the investment firm’s business model, arrangements or any errors, omissions or control weaknesses highlighted from the regular monitoring, including the external auditors review (refer to Client Asset Examination section), to ensure the CAMP remains current. Any changes to the CAMP should be documented and reported to the Board and an updated CAMP should be prepared and approved by the Board.

G8 (14) An investment firm should define and document an insolvency threshold level in its CAMP. The rationale for these thresholds and related triggers should be set for dealing with breaches of its controls, processes and procedures. These thresholds and related triggers should be approved by the Board and take into account both quantitative and qualitative factors, e.g. the level of client assets, the complexity of client assets, the type of client, and prior history of breaches relating to client assets.

G8 (15) An investment firm should specify and document a quantitative level of materiality, taking into account the amount of client assets held but also considering the investment firm’s own net assets. Furthermore, a breach may be qualitatively material and give rise to an action, e.g., a materiality level may indicate a risk to effectively safeguarding client assets. An investment firm should document in its CAMP the basis for its judgment in this area. Staff within the investment firm that are responsible for taking actions in response to breach thresholds under the Regulations should be sufficiently qualified, knowledgeable and experienced to identify both qualitative and quantitative. The investment firm may have different materiality levels or risk triggers for different processes and controls.

G8 (16) An investment firm should document the insolvency threshold level for reporting and escalating matters to the Board in respect of any errors or breaches in its controls to safeguard client assets. In areas of judgement, an investment firm should document its approach and any triggers set.

What is the purpose of the CAMP?

- To document an investment firm’s business model and related risks in respect of the safeguarding of client assets and the controls in place to mitigate these;
- To demonstrate how an investment firm’s systems and controls meet the principles of the client assets regime;
- To enable the Board to document and monitor material changes to an investment firm’s business model, changes to controls and processes and therefore the changes in the associated risks to safeguarding client assets, and to make information readily available to assist in the prompt distribution of client assets particularly in the event of the investment firm’s insolvency.

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An investment firm should document the insolvency threshold level for reporting and escalating matters to the Board in respect of any errors or breaches in its controls to safeguard client assets. In areas of judgement, an investment firm should document its approach and any triggers set.

What is the purpose of the CAMP?
(i) the process that an investment firm will follow to carry out the reviews referred to in Regulation 49(8) and 50(7);
(ii) the procedures referred to in Regulation 59(8);
(iii) when, in accordance with Regulation 66, an investment firm outsources to another party, the performance of the reconciliation or the daily calculation, the manner in which an investment firm will exercise oversight over the outsourced activity;
(iv) the process that an investment firm will follow to ensure that client trades or client financial instruments are not deposited into an investment firm’s own bank account or custody account;
(v) the process and timelines that an investment firm will follow if, in error, client funds or client financial instruments are deposited by a client into an investment firm’s own bank account or custody account;
(vi) the basis and criteria that will be used by an investment firm to determine materiality in order to safeguard client assets, including for the purposes of the investment firm’s own bank account or custody account;
(vii) the process that an investment firm will follow to carry out the reviews referred to in Regulations 49(8) and 50(7);
(viii) the manner in which an investment firm will exercise oversight over the outsourced activity;
(ix) for the purpose of Regulation 79(4)(a), a fund service provider should document in the CAMP the fund service provider’s own net assets.

A fund service provider should specify and document in its investor money management plan a qualitative level of materiality, taking into account the amount of investor money held but also considering the fund service provider’s own net assets. Furthermore, a breach may be quantitatively immaterial but indicative of a qualitative issue which may indicate a risk to effectively safeguarding investor money.

A fund service provider should document in its investor money management plan the basis for its judgment in determining materiality thresholds for the purposes of Regulation 5(3) of the Regulations.

A fund service provider should document the materiality level for reporting and escalating matters to the Board in respect of any errors or breaches in the controls to safeguard investor money, including, its approach to making judgements and any relevant trigger set. Threshold levels should be monitored and amended if necessary, particularly where there is a change in business model, operating environment or levels of investor money held.

For the purpose of Regulation 79(4)(a) a fund service provider should consider:

a. The reporting lines to the Board and/or senior management in relation to investor money management. A fund service provider should document the

What should be included in the CAMP? A fund service provider should consider the following where relevant:

a. reporting lines to the Board and/or senior management in relation to client asset management. An investment firm should document the management information provided to the Board to monitor the risks and mitigants associated with the safeguarding of client assets including details of the recipients of this information. This management information should be included in the firm’s CAMP or, as outlined in GR (12), recorded where such information is located;

b. the rationale for holding client assets. As part of this, consideration should be given where there is an outsourcing arrangement in place, with a group company or a third party, for the safeguarding of client assets. The investment firm should clearly document the arrangement, identifying the outsourced company, the rationale for the outsourcing arrangement and an explanation as to where the arrangement fits into the overall control process. The statement should also specify what is included from the outsourcing arrangement. The investment firm should document how the effectiveness of the outsourcing arrangement is reviewed and monitored, including identifying when within the investment firm is responsible for oversight of such outsourcing arrangement;

c. a record of how an investment firm is able to differentiate, monitor and control the client assets subject to the Regulations from those assets which are not within the scope of the Regulations. The investment firm should document its rationale and judgement when there is ambiguity on concluding where a service or product is subject to the Regulations;

d. a record of the particular responsibilities of the HCAO.
management information provided to the Board to monitor the risks and mitigants associated with the safeguarding of investor money, including details of the recipients of this information.

b. The rationale for holding investor money: as part of this, consideration should be given where there is an outsourcing arrangement in place to hold investor money with a group company or a third party for the safeguarding of investor money. The fund service provider should clearly document the arrangement, identifying the outsourced company, the rationale for the outsourced arrangement and an explanation as to where the arrangement fits into the overall control process. The statement should also specify what is excluded from the outsourcing arrangement. The fund service provider should document how the effectiveness of the outsourced arrangement is overseen and monitored, including identifying who within the fund service provider is responsible for oversight of each outsourced arrangement.

c. A record of the particular responsibilities of the Head of Investor Money Oversight.

(x) A fund service provider should document the material risks to investor money held as well as the processes and controls to mitigate those risks, as provided for under Regulations 79(4)(c) and 79(4)(d). This should include items such as:

a. counterparty risk including jurisdiction and associated legal risks.
b. concentration risk.
c. operational risk including risk of fraud.
d. compliance with investor mandates.
e. outsourcing.
f. group arrangements.
g. any other relevant issues.

(xii) The Central Bank expects a fund service provider to map the material risks identified to the relevant controls and processes in place, in order to mitigate these risks. When considering these risks, a fund service provider should consider the life cycle of the transaction - the receipt of money from the investor to the point where the money is transferred to the investment fund and, likewise, from the investment fund until it is returned back to the investor.

(xiv) Consideration of the life cycle could include, but is not limited to, flowcharts or illustrative diagrams showing critical interventions, particularly in cases where
the processing of investor money requires manual intervention. The fund service provider should record how cash is received and disbursed.

(iii) A description of relevant systems should be captured including how access to these systems is controlled and how segregation is implemented in practice.

(iv) A list of the fund service provider’s third parties holding investor money including all account numbers, details of the authorised persons to the third party collection accounts and whether such third party collection accounts are pooled. The Central Bank expects a fund service provider to have and apply a process to ensure that any amendments to the list of third parties are made only following approval by senior management. Counterparty risks and the controls in place to mitigate them should be documented. A fund service provider should document its processes in maintaining and updating relevant legal agreements associated with the holding of investor money.

(v) A description of the systems and controls in relation to the production of information in relation to investor money and submission of such information to a third party. The Central Bank expects a fund service provider to have appropriate segregation of duties to ensure documented controls are reviewed by independent and appropriately qualified and knowledgeable persons.

(vi) For the purpose of Regulation 79(4)(d), the fund service provider should consider the following, where relevant:

a. all legal agreements between a fund service provider and a third party holding investor money and any amendments to such agreements;

b. all legal agreements between a fund service provider and any third party nominated by the fund service provider to hold investor money on behalf of the fund service provider;

c. details of third party collection accounts held with a third party nominated by the fund service provider;

d. all Investor Money Facilities Agreements from third parties holding investor money, confirming segregation of such investor money;

e. details of the relevant accounts on the general ledger system recording investor money transactions, including instructions on how to access reports on the system;
f. details of all persons with access to the ledger system;
g. details of how to access or generate any relevant reports from the general ledger system;
h. description of any key reports used to monitor investor money with instructions on how to generate such reports;
i. record of where the most recent daily calculation is stored and details of how to access previous daily calculations;
j. records of where the most recent bank reconciliation is stored and details of how to access previous reconciliations.

(xvii) The investor management plan should be sufficiently detailed to enable the reader, including the Central Bank and an insolvency practitioner, to understand the business model and controls for safeguarding investor money. An insolvency practitioner needs to know the location and the value of investor money. A fund service provider should ensure there is sufficient information available to enable the distribution of investor money to take place as quickly as possible with minimum cost to investors. This information should also be available in the event that a fund service provider is required to facilitate an orderly transfer of investor money to another fund service provider.

47. 1A.3.1-AG

The material in CASS 1A.3.1BG about how CASS 1A.3 fits into the FCA senior managers and certification regime for SMCR firms also applies to a CASS small firm that is an SMCR firm and the function in CASS 1A.3.1R. However:

(1) the function in CASS 1A.3.1R is not a separate FCA certification function; and
(2) the person performing that function will not necessarily be subject to the employee certification regime described in SYSC 27 (Senior managers and certification regime). See comments in Row 46.


Governance arrangements concerning the safeguarding of client assets

Member States shall ensure that investment firms appoint a single officer of sufficient skill and authority with specific responsibility for matters relating to the compliance by firms with their obligations regarding the safeguarding of client financial instruments and funds.

The approved persons regime and the certification regime

1A.3.1R

A CASS medium firm and a CASS large firm must allocate to a single director or senior manager of sufficient skill and authority the function of:

(1) oversight of the operational effectiveness of that firm’s systems and controls that are designed to achieve compliance with CASS;
(2) reporting to the firm’s governing body in respect of that oversight; and
(3) completing and submitting a CMAR to the FCA in accordance with SUP 16.14.

[Note: article 7, first paragraph of the MiFID Delegated Directive]

Regulation 14

Directors

14. (1) A fund administrator shall ensure that no person appointed as a director of the fund administrator is a director of a depositary, manager or custodian-appointed to an investment fund in respect of which the fund administrator provides administration services.

(2) A fund administrator, who is not a sole trader, shall ensure that—

(a) it has a minimum of 2 directors who are present in the State for the whole of 110 working days in a year, and
(b) its directors disclose, in writing, to the fund administrator any concurrent directorship which they hold on the board of an investment fund or an entity which provides services to such investment fund.

1 Risk Management

(1) In general, the Central Bank expects that a director to be appointed as Head of Investor Money Oversight (HIMO). If this is not the case, the HIMO should be a senior manager within the fund service provider with direct access to the board in respect of that function.

(2) The board of the fund service provider (the “Board”) is ultimately responsible for safeguarding investor money, the requirement to have a Head of Investor Money Oversight role does not detract from this. In most cases, the Central Bank expects a director to be nominated and appointed for the Head of Investor Money Oversight position. If this is not the case, the Head of Investor Money Oversight should be a senior manager within the fund service provider with direct access to the Board in respect of that function.

(3) The Board should ensure that the individual undertaking the Head of Investor Money Oversight role can demonstrate that he/she is free from any conflicts of
interest in this area and document this in the investor money management plan. In this regard, the Head of Investor Money Oversight should be sufficiently removed from the performance of day-to-day operational functions relating to the administration of investor money. The Board should document in the investor money management plan the rationale for the nomination and appointment of the HIMO, including the criteria used by the fund service provider in making the appointment.

(iv) The fund service provider should arrange for appropriate cover to ensure the HIMO duties are addressed where the HIMO is on leave.

49. 1A.3.1BG

(1) CASS 1A.3.1AR describes the FCA controlled function known as the CAS operational oversight function (CF10a). The table of FCA controlled functions in SUP 10A.4.4R together with SUP 10A.7.9R specify the CAS operational oversight function as an FCA required function for a firm to which CASS 1A.3.1AR applies.

(b) The CAS operational oversight function does not apply to an SMCR firm. For an SMCR firm, the function in CASS 1A.3.1AR is not a separate controlled function and performing that function does not require approval as an approved person. Paragraphs (1A) to (4) describe how CASS 1A.3.1AR applies to SMCR firms.

(c) However, nothing in paragraphs (1A) to (4) affects the requirement for the function in CASS 1A.3.1AR to be allocated to a single director or senior manager of sufficient skill and authority in accordance with CASS 1A.3.1AR and CASS 1A.3.2AR.

(1A) There are three elements of the regime for SMCR firms that are particularly relevant to CASS 1A, although they do not all apply to all SMCR firms:

(a) A firm’s obligation to allocate certain responsibilities to its SMF managers (see SYSC 24 (Senior managers and certification regime: Allocation of prescribed responsibilities)).

(b) A firm’s obligation to ensure that one or more of its SMF managers have overall responsibility for each of its activities, business areas and management functions (see SYSC 26 (Senior managers and certification regime: Overall and local responsibility)); and

(c) The certification regime (see SYSC 27 (Senior managers and certification regime: Certification regime)).

(2) This paragraph (2) explains how CASS 1A.3.1AR applies to an SMCR firm to which SYSC 24 and SYSC 26 both apply.

(b) The firm must allocate responsibility for the firm’s compliance with CASS to one of its SMF managers (see SYSC 24.2.1R). That responsibility is an “FCA prescribed senior management responsibility.” The full list of FCA prescribed senior management responsibilities is in the table in SYSC 24.2.6R.

(c) Although the CASS function in SYSC 24.2.1R is different from the function in CASS 1A.3.1AR, the firm may allocate the function in CASS 1A.3.1AR to the SMF manager in (b).

(d) The firm may allocate the CASS FCA prescribed senior management responsibility described in (b) to an SMF manager who does not perform any other function coming within the FCA regime for SMF managers in SMCR firms. See SUP 10C.7 (Other overall responsibility function (SMF18)) and SUP 10C.8.1R (Other local responsibility function (SMF22)) for details. Where this is the case, the manager will be performing the other overall responsibility function or the other local responsibility function.

(e) The firm may choose to allocate the function in CASS 1A.3.1AR to someone who is not an approved person and SMF manager. If so:

(i) That person will be subject to the employee certification regime described in SYSC 27 (Senior managers and certification regime: Certification regime).

See comments in Row 46.
1A.3.1CR
If, at the time a firm that is not an SMCR firm becomes a CASS medium firm or a CASS large firm in accordance with CASS 1A.2.12R(1) or CASS 1A.2.12R(2), the firm is not able to comply with CASS 1A.3.1AR because it has no director or senior manager who is an approved person in respect of the CASS operational oversight function, the firm must:
(1) take the necessary steps to ensure that it complies with CASS 1A.3.1AR as soon as practicable, which must at least include submitting an application for a candidate to perform the function in CASS 1A.3.1AR. The function in CASS 1A.3.1AR will fall into the certification regime. The function in CASS 1A.3.1AR will be the CASS oversight function in SYSC 27.8.1R.

50.
1A.3.1CR
If, at the time a firm that is not an SMCR firm becomes a CASS medium firm or a CASS large firm in accordance with CASS 1A.2.12R(1) or CASS 1A.2.12R(2), the firm is not able to comply with CASS 1A.3.1AR because it has no director or senior manager who is an approved person in respect of the CASS operational oversight function, the firm must:
(1) take the necessary steps to ensure that it complies with CASS 1A.3.1AR as soon as practicable, which must at least include submitting an application for a candidate to perform the function in CASS 1A.3.1AR. The function in CASS 1A.3.1AR will fall into the certification regime. The function in CASS 1A.3.1AR will be the CASS oversight function in SYSC 27.8.1R.

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If, at the time a firm that is not an SMCR firm becomes a CASS medium firm or a CASS large firm in accordance with CASS 1A.2.12R(1) or CASS 1A.2.12R(2), the firm is not able to comply with CASS 1A.3.1AR because it has no director or senior manager who is an approved person in respect of the CASS operational oversight function, the firm must:
(1) take the necessary steps to ensure that it complies with CASS 1A.3.1AR as soon as practicable, which must at least include submitting an application for a candidate to perform the function in CASS 1A.3.1AR. The function in CASS 1A.3.1AR will fall into the certification regime. The function in CASS 1A.3.1AR will be the CASS oversight function in SYSC 27.8.1R.

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If, at the time a firm that is not an SMCR firm becomes a CASS medium firm or a CASS large firm in accordance with CASS 1A.2.12R(1) or CASS 1A.2.12R(2), the firm is not able to comply with CASS 1A.3.1AR because it has no director or senior manager who is an approved person in respect of the CASS operational oversight function, the firm must:
(1) take the necessary steps to ensure that it complies with CASS 1A.3.1AR as soon as practicable, which must at least include submitting an application for a candidate to perform the function in CASS 1A.3.1AR. The function in CASS 1A.3.1AR will fall into the certification regime. The function in CASS 1A.3.1AR will be the CASS oversight function in SYSC 27.8.1R.

51.
1A.3.1DG
(1) CASS 1A.3.1CR provides a grace period for a firm that is not an SMCR firm to apply for someone to be approved to perform the CASS operational oversight function.
(2) There is no equivalent to CASS 1A.3.1CR for an SMCR firm, because a person does not need specific FCA approval before carrying out the function. This is explained in (3) to (5), below.
(3) As explained in CASS 1A.3.1BG(2), the function in CASS 1A.3.1AR is not, by itself, a controlled function. Therefore, if an approved person is to perform the function for an SMCR firm, it can be allocated to any director or senior manager who is already an approved person who is suitable to carry it out. However, if the firm wishes to allocate the function to someone as described in CASS 1A.3.1BG(2)(d), it will need to get FCA approval before the firm appoints them.
(4) If the function is to be carried out by a certification employee:
(a) FCA approval is not needed because performance of a role that falls into the certification regime does not require FCA approval;
(b) the firm should:
(i) either issue them with a certificate under SYSC 27 (Senior managers and certification regime: Certification regime) before the firm becomes a CASS medium firm or a CASS large firm; or
(ii) give the function to a suitable approved person pending issue of the certificate.

52.
Commission Delegated Directive (EU) 2017/593
(CMISD Delegated Directive)
Article 7
Governance arrangements concerning the safeguarding of client assets
Member States shall allow investment firms to decide, ensuring full compliance with this Directive, whether the appointed officer is to be dedicated solely to this task or whether the officer can discharge responsibilities collectively while having additional responsibilities.

53.
1A.3.3R
(1) Subject to (2), a firm may allow the CASS oversight responsibilities to be shared amongst one or more directors or senior managers where this is done as part of a job share between these persons.

54.
1A.3.3R
(1) Subject to (2), a firm may allow the CASS oversight responsibilities to be shared amongst one or more directors or senior managers where this is done as part of a job share between these persons.
(2) A CASS small firm must make and retain such a record only where it allocates responsibility to a person other than the person in that firm who performs the compliance oversight function.

(3) A firm must ensure that the record made under this rule is retained for a period of five years after it is made.

### CHAPTER 3

**Collateral**

3.1 Application and Purpose

**Application**

3.1.1R

This chapter applies to a firm when it receives or holds assets in connection with an arrangement to secure the obligation of a client in the course of, or in connection with, its designated investment business, including MiFID business.

#### Regulation 55 FISR 2017

**Collateral margined transactions**

55. (1) With respect to collateral margined transactions, an investment firm, in advance of depositing collateral with, or pledging, charging or granting a security arrangement over the collateral to, a relevant party or eligible custodian, shall—

(a) notify the credit institution, relevant party or eligible custodian that the investment firm—

(i) is under an obligation to keep the collateral separate from the investment firm’s collateral, and

(ii) that the relevant party or eligible custodian must not claim any lien or right of retention or sale over the collateral except to cover the obligations to the relevant party or eligible custodian which gave rise to that deposit, pledge, charge or security arrangement, or any charges relating to the administration or safekeeping of the collateral,

(b) instruct the relevant party or eligible custodian that—

(i) the value of the collateral passed by the investment firm on behalf of clients must be credited to the investment firm’s third party client asset account with the relevant party or eligible custodian,

(ii) where collateral has been passed and the initial margin has been liquidated to satisfy margin requirements, any balance of the sale proceeds that is not a margin requirement must be paid into a third party client asset account without delay, and

(iii) where collateral is passed to an exchange or clearing house, any balance of the sale proceeds that is not a margin requirement must be dealt with in accordance with the rules of the relevant exchange or clearing house,

(c) ensure that a client’s fully paid (non-collateral) financial instruments and a client’s margin financial instruments will be held in separate third party client asset accounts with the relevant party or eligible custodian and that no right of set-off will apply to either of these accounts.

(2) An investment firm shall not use one client’s collateral as security for the obligations of another client or another person, unless legally enforceable agreements to do so are in place.

3.1.2G

Firms are reminded that this chapter does not apply to an incoming EEA firm, other than an insurer, with respect to its passported activities. The application of this chapter is also dependent on the location from which the activity is undertaken (see CASS 1.3.2 R and CASS 1.3.3 R).

No conceptual equivalent outside of the UK.

3.1.3R

This chapter does not apply to a firm that has only a bare security interest (without rights to hypothecate) in the client’s asset. In such circumstances, the firm must comply with the custody rules or client money rules as appropriate.

Regulation 48(4) IMR 2017

Except in accordance with a legally enforceable agreement, an investment firm shall not use the assets of a client for any purpose other than for the sole account of that client.

Irish rules are drafted to cover a slightly different point than the UK’s point which permits blanket right of use.

3.1.4G

For the purpose of this chapter only, a bare security interest in the client’s asset gives a right the right to realise the assets only on a client’s default and without the right to use other than in default.

Regulation 48(4) IMR 2017

Except in accordance with a legally enforceable agreement, an investment firm shall not use the assets of a client for any purpose other than for the sole account of that client.

Irish rules are drafted to cover a slightly different point than the UK’s point which permits blanket right of use.

#### Purpose

3.1.5R

Same content as in Row 35.
The purpose of this chapter is to ensure that an appropriate level of protection is provided for those assets over which a client gives a firm certain rights. The arrangements covered by this chapter are those under which the firm is given right to use the asset, and the firm treats the asset as if it had legal title and associated rights to that asset. This is in accordance with the client's best interests, and a firm shall provide the client with an explanation of the rights covered in this chapter. The arrangements covered by this chapter do not include any arrangements by which the firm has only a bare security interest in the client's asset (in which case the custody rules or client money rules apply).

Examples of the arrangements covered by this chapter include the taking of a collateral by a firm, under the ISDA English Law (transfer of title) and the New York Law Credit Support Annexes (assigning the right to a hypothecate under the client's title has not been disapplied).

This chapter recognises the need to apply a differing level of regulatory protection to the assets which form the basis of the two different types of arrangement described in CASS 3.1.5G. Under the basic security interest arrangement, the assets continue to belong to the client until the firm's right to realise that asset crystallises (that is, on the client's default). But under a "right to use arrangement", the client has transferred to the firm the legal title and associated rights to the asset, so that when the firm exercises its right to treat the asset as its own, the asset ceases to belong to the client and in effect becomes the firm's asset and is no longer in need of the full range of client asset protection. The firm may exercise its right to treat the asset as its own by, for example, clearly so identifying the asset in its own books and records.

Firms are reminded of the client's best interests rule which requires a firm to act honestly, fairly and professionally, in accordance with the best interests of its clients, when agreeing to, entering into, exercising its rights under and fulfilling its obligations under an arrangement covered by this chapter, and when structuring its business to include such arrangements.

A prime brokerage firm is reminded of the additional obligations in CASS 9.3.1R which apply to prime brokerage agreements.
request, firms shall provide such statement more frequently at a commercial cost. The first subparagraph shall not apply to a credit institution authorised under Directive 2000/12/EC of the European Parliament and of the Council in respect of deposits within the meaning of that Directive held by that institution.

2. The statement of client assets referred to in paragraph 1 shall include the following information:
   (a) details of all the financial instruments or funds held by the investment firm for the client at the end of the period covered by the statement;
   (b) the extent to which any client financial instruments or client funds have been the subject of securities financing transactions;
   (c) the extent of any benefit that has accrued to the client by virtue of participation in any securities financing transactions, and the basis on which that benefit has accrued;
   (d) a clear indication of the assets or funds which are subject to the rules of Directive 2014/65/EU and its implementing measures and those that are not, such as those that are subject to Title Transfer Collateral Agreement;
   (e) a clear indication of which assets are affected by some peculiarities in their ownership status, for instance due to a security interest;
   (f) the market or estimated value, where the market value is not available, of the financial instruments included in the statement with a clear indication of the fact that the absence of a market price is likely to be indicative of a lack of liquidity. The evaluation of the estimated value shall be performed by the firm on a best effort basis.

In cases where the portfolio of a client includes the proceeds of one or more unsettled transactions, the information referred to in point (a) may be based either on the trade date or the settlement date, provided that the same basis is applied consistently to all such information in the statement.

The periodic statement of client assets referred to in paragraph 1 shall not be provided where the investment firm provides its clients with access to an online system, which qualifies as a durable medium, where up-to-date statements of client's financial instruments or funds can be easily accessed by the client and the firm has evidence that the client has accessed this statement at least once during the relevant quarter.

3. Investment firms which hold financial instruments or funds and which carry out the service of portfolio management for a client may include the statement of client assets referred to in paragraph 1 in the periodic statement it provides to that client pursuant to Article 60(1).

CHAPTER 5
Client money: insurance distribution activity

5.1.1R (1) CASS 5.1 to CASS 5.6 apply, subject to (2), (3) and CASS 5.1.3 R to CASS 5.1.6 R, to a firm that receives or holds money in the course of or in connection with its insurance distribution activity.

(2) CASS 5.1 to CASS 5.6 do not, subject to (3), apply:
   (a) to a firm to the extent that it acts in accordance with the client money chapter;
   (b) to an insurance undertaking in respect of its permitted activities;
   (c) to a managing agent when acting as such;
   (d) to a firm that receives or holds money in connection with its insurance distribution activity.

(3) CASS 5.1 to CASS 5.6 do not, subject to (4), apply to a firm that receives or holds money:
   (a) in connection with the client money chapter; or
   (b) in connection with the client money chapter, to the extent that it acts in accordance with the client money chapter;
   (c) in connection with its permitted activities; or
   (d) in connection with its permitted activities, to the extent that it acts in accordance with the client money chapter.

(4) CASS 5.1 to CASS 5.6 do not apply:
   (a) to a firm that is an approved bank; and
   (b) to a firm that is an approved bank, to the extent that it is not subject to the regulations of the IDD only when held by the firm in an account with itself, in which case the firm may notify the client (whether through a client agreement, terms of business, or otherwise in writing) that:
   (i) it is not subject to the regulations of the IDD; and
   (ii) it is subject to regulations in another Member State.
(iii) money held for that client in an account with the approved bank will be held by the firm as banker and not as trustee (or in Scotland as agent); and

(iv) as a result, the money will not be held in accordance with CASS 5.1 to CASS 5.6.

(3) A firm may elect to comply with

(a) CASS 5.1, CASS 5.2 and CASS 5.4 to CASS 5.6 in respect of money which it receives in the course of carrying on an activity which would be insurance distribution activity, and which money would be claim money, but for article 72D of the Regulated Activities Order (Large risks contracts where risk situated outside the EEA); but the election must be in respect of all the firm’s business which consists of that activity.

(4) A firm must keep a record of any election made.

68.5.1.2G

A firm that is an approved bank, and relies on the exemption under CASS 5.1.1 R (2)(e), should be able to account to all of its clients for amounts held on their behalf at all times. A bank account opened with the firm in the name of the client would generally be sufficient. When money from clients deposited with the firm is held in a pooled account, this account should be clearly identified as an account for clients. The firm should also be able to demonstrate that an amount owed to a specific client that is held within the pool can be reconciled with a record showing that individual’s client balance and is, therefore, identifiable at any time.

4.1M Guidance – Designation

4.1.2 Designation of third party collection accounts in the financial records of a fund service provider

(i) A fund service provider may hold investor money in an individually designated third party collection account e.g., “XYZ Ltd third party collection account Investment Fund A” or a pooled designated third party collection account(s) for all investment funds e.g., “XYZ Ltd third party collection account”.

(ii) Where a fund service provider holds investor money in a pooled third party collection account, accounting segregation should be maintained. In its internal records, a fund service provider should maintain detailed and accurate records in order to identify how much each investor holds in that pooled third party collection account and movements in that balance.

(iii) The designation in respect of a third party collection account requires the specific designation to be used with no variation permitted. The designation should be in the name field of the third party collection account and not in the address field.

4.2 Designation of third party collection accounts in the financial records of a third party

(i) Where the third party collection accounts are designated in the financial records of a third party, the designation should be in the name field of the third party collection account and not in the address field or any other field within the third party’s financial records. If a third party has limited capacity to record the full title, an abbreviation such as “Coll a/c” is acceptable. The Central Bank expects the verification of the designation to take the form of a bank statement or other electronic form. A fund service provider may hold this verification electronically.

(ii) The verification process should be followed each time a third party collection account is opened and not each time investor money is deposited into that particular third party collection account. Arising from Regulation 75(2), the fund service provider has to keep the following:

Broadly, conceptual equivalent between UK and Irish rules – save for comments in Row 67 and the fact that no rules outside of UK contain a concept of primary pooling event and/or secondary pooling event (see below) which is of relevance to concept of “pooled account”.

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| 69. | 5.1.3R | An authorised professional firm regulated by The Law Society (of England and Wales), The Law Society of Scotland or The Law Society of Northern Ireland that, with respect to its regulated activities, is subject to the rules of its designated professional body as specified in CASS 5.1.4 R, in force on 14 January 2005, must comply with those rules and if it does so, it will be deemed to comply with CASS 5.2 to CASS 5.4. |

| 70. | 5.1.4R | For the purposes of CASS 5.1.3 R the relevant rules are: (1) If regulated by the Law Society (of England and Wales), (a) the Solicitors’ Accounts Rules 1998; or (b) where applicable, the Solicitors Overseas Practice Rules 1990; (2) if regulated by the Law Society of Scotland, the Solicitors’ (Scotland) Accounts, Accounts Certificate, Professional Practice and Guarantee Fund Rules 2001; (3) if regulated by the Law Society of Northern Ireland, the Solicitors’ Accounts Regulations 1998. |

| 71. | 5.1.4AR | (1) A firm will, subject to (3), be deemed to comply with CASS 5.3 to CASS 5.6 if it receives or holds client money and it either: (a) in relation to a service charge, complies with the requirement to segregate such money in accordance with section 42 of the Landlord and Tenant Act 1987 (“the 1987 Act”); or (b) in relation to money which is clients’ money for the purpose of the Royal Institution of Chartered Surveyors’ Rules of Conduct (“RICS rules”) in force as at 14 January 2005, it complies with the requirement to segregate and account for such money in accordance with the RICS Members’ Accounts rules. (2) Paragraph (1)(a) also applies to a firm in Scotland or in Northern Ireland if it is acting as a property manager the firm receives or holds a

days after the initial deposit of the money to withdraw the money if the third party collection account is not correctly designated. This process of designation verification is a separate process to what is required under Regulation 75(2)(b), which relates to ensuring that the third party collection account is set up in accordance with the provisions of the Investor Money Facilities Agreement.

6 IMR Guidance

Verification and Third Party Collection Accounts

Where third party collection accounts are opened simultaneously (i.e. on the same day), one confirmation may be obtained but the fund service provider should ensure that the confirmation from the third party lists all applicable account numbers. This confirmation can be provided and received in electronic form. No real conceptual equivalent in EU (to a lesser degree) or Irish rules (to a greater degree) but implied elsewhere.

Same comment as in Row 69.

Same comment as in Row 69.
service charge and complies (so far as practicable) with section 42 of the 1987 Act as if the requirements of that provision applied to it.

(3) In addition to complying with (1), a firm must ensure that an account in which money held pursuant to the trust fund mentioned in section 42(3) of the 1987 Act or an account maintained in accordance with the RICS rules satisfies the requirements in CASS 5.5.49 R to the extent that the firm will hold money in trust or otherwise on behalf of its clients.

5.1.5R

Subject to CASS 5.1.5A R, money is not client money when:

(1) it becomes properly due and payable to the firm:
   (a) for its own account; or
   (b) in its capacity as agent of an insurance undertaking where the firm acts in accordance with CASS 5.2; or

(2) it is otherwise received by the firm pursuant to an arrangement made between an insurance undertaking and another person (other than a firm) by which that other person has authority to underwrite risks, settle claims or handle refunds of premiums on behalf of that insurance undertaking outside the United Kingdom and where the money relates to that business.

5.1.6R

Except where a firm and an insurance undertaking have (in accordance with CASS 5.1.5A R) agreed otherwise, for the purposes of CASS 5.1 to CASS 5.6 an insurance undertaking (when acting as such) with whom a firm conducts insurance distribution activity is not to be treated as a client of the firm.

5.1.7G

(1) Principle 10 (Clients’ assets) requires a firm to arrange adequate protection for clients’ assets when the firm is responsible for them. An essential part of that protection is the proper accounting and handling of client money. The rules in CASS 5.1 to CASS 5.6 also give effect to the requirement in article 10.6 of the IDD that all necessary measures should be taken to protect clients against the inability of an insurance intermediary to transfer premiums to an insurance undertaking or to transfer the proceeds of a claim or premium refund to the insured.

(2) There are two particular approaches which firms can adopt which reflect options given in article 10.6. The first is to provide by law or contract for a transfer of risk from the insurance intermediary to the insurance undertaking (CASS 5.2). The second is that client money is strictly segregated by being transferred to client accounts that cannot be used to reimburse other creditors in the event of the firm’s insolvency (CASS 5.3 and CASS 5.4 provide different means of achieving such segregation). CASS 5.1.5A R permits a firm subject to certain conditions to treat money which it collects as agent of an insurance undertaking as client money; the principle of strict segregation is, however, satisfied because such undertakings must agree to their interests being subordinated to the interests of the firm’s other clients.

5.1.8G

A firm which carries on MiFID business or designated investment business in relation to life assurance business may, in accordance with CASS 7.10.3R and in relation to that business only, either comply with CASS 7 or elect to comply with the insurance client money chapter.

5.1.9G

Firms are reminded that SUP 3 contains provisions which are relevant to the preparation and delivery of reports by auditors.

Article 8 Commission Delegated Directive

Member States shall require investment firms to ensure that their external auditors report at least once in three years on the firm’s compliance with Principle 10 (Clients’ assets).
5.1 An investment firm shall arrange for an external auditor to prepare a report as part of, or in addition to, the report required under paragraph 7 of Schedule 3 to the MiFID Regulations (in this Part referred to as an “assurance report”) in relation to that investment firm’s safeguards of client assets at least on an annual basis.

5.2 An investment firm shall ensure that the external auditor appointed for the purposes of paragraph (1)—

(a) has the necessary resources and skills relating to the business of the investment firm,

(b) receives the investment firm’s full cooperation in a timely manner in relation to conducting the client asset examination and the preparation of the assurance report,

(c) in addition to the requirements of paragraph 7 of Schedule 3 to the MiFID Regulations, reports as to whether, throughout the period to which the client asset examination relates—

(i) the investment firm has maintained processes and systems adequate to meet the requirements of this Part,

(ii) the investment firm was compliant with this Part as at the period end date,

(iii) any matter has come to the attention of the external auditor to suggest that the investment firm has acted in a manner which is not consistent with that documented within the client asset management plan which has been in operation, and

(iv) any changes made to the client asset management plan have been drafted in sufficient detail to meet the requirements of this Part, capturing the rules faced by the investment firm in holding client assets, given the nature and complexity of the business of the investment firm

(3) The board of the investment firm shall assess the findings of the assurance report.

(4) The investment firm shall ensure that any remedial actions necessary arising from the assurance report are set out in writing, submitted to the Bank in accordance with Regulation 68, and that such remedial actions are carried out without delay.

(5) If an investment firm which is permitted to hold client assets, claim not to have held client assets throughout the period to which the client asset examination relates, the investment firm shall—

(a) arrange that an external auditor performs such procedures as the external auditor deems appropriate to enable the auditor to determine whether or not the investment firm held client assets during that period, and

(b) ensure that the external auditor provides the assurance report to the investment firm in a timely manner and in any event, in good time to enable the investment firm to comply with its reporting obligations under Regulation 68.

11.1 Who may conduct the Investor Money Examination

The investor money examination may be conducted by the fund service provider’s statutory auditor or another external auditor. A fund service provider should provide the auditor with all information and explanations that the auditor requires for the purposes of conducting the investor money examination.

11.2 The Scope of the Investor Money Examination

(1) In relation to the assessment of the investor money management plan, a fund service provider should ensure that the auditor reviews the process undertaken by the fund service provider to assess the on-going appropriateness of the investor money management plan, including evidence of the steps taken by the fund service provider to test and maintain the investor money management plan.

(2) In addition to all other procedures which the auditor deems necessary for the completion of the investor money examination, subject to the considerations as set out within the auditor’s technical standard on auditing compliance with the Regulations, the Central Bank expects a fund service provider to engage with the auditor to seek, at a minimum, third party confirmations (internal confirmations) for a representative sample of balances held in respect of client assets both at year-end and also on one other randomly scheduled date during the year;

(a) positive confirmation requests from a representative sample of clients, as determined by the auditor, of client asset balances at the randomly selected date during the year, other than the period end date;

(b) positive confirmation requests from a representative sample of balances held in respect of client assets both at year-end and also on one other randomly scheduled date during the year;

(3) The assurance report prepared by the auditor following the investor money examination should make provision for the fund service provider to comment and to set out actions it considers to be necessary to bring the investor money management plan into line with the relevant requirements of the Regulations, the Central Bank’s technical standard on auditing compliance with the Regulations, and the timeframes referred to in Regulation 9(3)(a) and (b) and a limited assurance opinion in respect of Regulation 9(3)(c) and (d).

11.3 When any findings arise from the Investor Money Examination

The assurance report prepared by the auditor following the investor money examination should be sent to the Central Bank. The auditor’s technical standard on auditing compliance with the Regulations, the Central Bank expects the assurance audit report should provide a reasonable assurance opinion in respect of Regulation 9(3)(a) and (b) and a limited assurance opinion in respect of Regulation 9(3)(c) and (d).
undertaking. Firms should refer to CASS 5.1.5 R to determine the circumstances in which they may treat money held on behalf of insurance undertakings as client money.

5.2.2G
(1) Agency agreements between insurance intermediaries and insurance undertakings may be of a general kind and facilitate the introduction of business to the insurance undertaking. Alternatively, an agency agreement may confer on the intermediary contractual authority to commit the insurance undertaking to risk or authority to settle claims or handle premium refunds (often referred to as "binding authorities"). CASS 5.2.3 R requires that binding authorities of this kind must provide that the intermediary is to act as the agent of the insurance undertaking for the purpose of receiving premiums and handling claims money (if the intermediary has authority to settle claims on behalf of the insurance undertaking) and premium refunds (if the intermediary has authority to settle claims on behalf of the insurance undertaking). Accordingly, such money is not, except where a firm and an insurance undertaking have in compliance with CASS 5.1.5A R agreed otherwise, client money for the purposes of CASS 5.

(2) Other introductory agency agreements may also, depending on their precise terms, satisfy some or all of the requirements of the type of written agreement described in CASS 5.2.3 R. It is desirable that an intermediary should, before informing its clients (in accordance with CASS 5.2.3 R (3)) that it will receive money as agent of an insurance undertaking, agree the terms of that notification with the relevant insurance undertaking.

No conceptual equivalent outside the UK; although this is implied in EU and Irish rules depending on license. See Row 7.

5.2.3R
(1) A firm must not agree to:
(a) deal in investments as agent for an insurance undertaking in connection with an insurance distribution activity; or
(b) act as agent for an insurance undertaking for the purpose of settling claims or handling premium refunds; or
(c) otherwise receive money as agent of an insurance undertaking; unless:
(d) it has entered into a written agreement with the insurance undertaking to that effect; and
(e) it is satisfied on reasonable grounds that the terms of the policies issued by the insurance undertaking to the firm's clients are likely to be compatible with such an agreement; and
(f)
(i) (in the case of (a)) the agreement required by (d) expressly provides for the firm to act as agent of the insurance undertaking for the purpose of receiving premiums from the firm's clients; and
(ii) (in the case of (b)) the agreement required by (d) expressly provides for the firm to act as agent of the insurance undertaking for the purpose of receiving and holding claims money (or, as the case may be, premium refunds) prior to transmission to the client making the claim (or, as the case may be, entitled to the premium refund) in question.

(2) A firm must retain a copy of any agreement it enters pursuant to (1) for a period of at least six years from the date on which it is terminated.

(3) Where a firm holds, or is to hold, money as agent for an insurance undertaking it must ensure that it informs those of its clients which are not insurance undertakings and whose transactions may be affected by the arrangement (whether in its terms of business, client agreements or otherwise in writing) that it will hold their money as agent of the insurance undertaking and if necessary the extent of such agency and whether it includes all items of client money or is restricted, for example, to the receipt of premiums.

(4) A firm may (subject to the consent of the insurance undertaking concerned) include in an agreement in (1) provision for client money received by its appointed representative, field representatives and other agents to be held as agent for the insurance undertaking (in which event it must ensure that the representative or agent provides the information to clients required by (3)).

No conceptual equivalent outside the UK; although this is implied in EU and Irish rules depending on license. See Row 7.

5.2.4G
Firms are reminded that CASS 5.1.5A R provides that, if the insurance undertaking has agreed in writing, money held in accordance with an agreement made under CASS 5.2.3 R may be

No conceptual equivalent outside the UK; although this is implied in EU and Irish rules depending on license. See Row 7.
82. **5.2.6G** A firm which provides for the protection of a client (which is not an insurance undertaking) under CASS 5.2 is relieved of the obligation to provide protection for that claim under CASS 5.3 or CASS 5.4 to the extent of the items of client money protected by the agency agreement.

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83. **5.2.7G** A firm may, in accordance with CASS 5.2.3 R (4), arrange for an insurance undertaking to accept responsibility for the money held by its appointed representatives, field representatives, and other agents, to which clause CASS 5.2.4 R does not apply.

84. **5.2.7G** A firm may operate on the basis of an agency agreement as provided for by CASS 5.2.3 R for some of its clients and with protection provided by a client money trust in accordance with CASS 5.3 or CASS 5.4 for other clients. A firm may also operate on either basis for the same client but in relation to different transactions. A firm which does so should be satisfied that its administrative systems and controls are adequate and, in accordance with CASS 5.2.4 G, should ensure that money held for both types of client and business is kept separate.

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85. **5.3 Statutory trust**

**5.3.1G** Section 137B(1) of the Act (Miscellaneous ancillary matters) provides that rules may make provision which results in client money being held by a firm on trust (England and Wales and Northern Ireland) or as agent (Scotland only) CASS 5.3.2 R creates a fiduciary relationship between the firm and its client under which client money is in the legal ownership of the firm but remains in the beneficial ownership of the client. In the event of failure of the firm, costs relating to the distribution of client money may have to be borne by the trust.

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86. **5.3.2B** A firm (other than a firm acting in accordance with CASS 5.4) receives and holds client money as trustee (or in Scotland as agent) on the following terms:

1. for the purposes of and on the terms of CASS 5.3, 5.5 and the client money (insurance) distribution rules;
2. subject to (4), for the clients (other than clients which are insurance undertakings when acting as such) for whom that money is held, according to their respective interests in it;
3. after all valid claims (2) have been met, for clients which are insurance undertakings according to their respective interests in it;
4. on the failure of the firm, for the payment of the costs properly attributable to the distribution of the client money in accordance with (2) and (3); and
5. after all valid claims and costs under (2) to (4) have been met, for the firm itself.

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87. **5.3.5G** (1) A firm which holds client money can discharge its obligation to ensure adequate protection for its clients in respect of such money by complying with CASS 5.3 which provides for such money to be held by the firm on the terms of a trust imposed by the rules.

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88. **5.4 Non-statutory client money trust**

**Introduction**

1. **CASS 5.4 permits a firm, which has adequate resources, systems and controls, to declare a trust on terms which expressly authorizes it,**
A firm may elect to comply with the requirements in this section, and may do so for some of its business whilst complying with CASS 5.3 for other parts.

(1) the firm must have and maintain systems and controls which are adequate to ensure that the firm is able to monitor and manage its client money transactions and any credit risk arising from the operation of the trust arrangement and, if in accordance with CASS 5.4.2 R a firm complies with both the rules in CASS 5.3 and CASS 5.4, such systems and controls must extend to both arrangements;

(2) the firm must obtain, and keep current, written confirmation from its auditor that it has in place systems and controls which are adequate to meet the requirements in (1);

(3) the firm must designate a manager with responsibility for overseeing the firm's day to day compliance with the systems and controls in (1) and the rules in this section;

(4) the firm, if, under the terms of the non-statutory trust, it is to handle client money for retail customers, must have and at all times maintain capital resources of not less than £500,000 calculated in accordance with MIPRU 4.1 R, and

(5) in relation to each of the client money transactions and any credit risk arising from the operation of the trust arrangement and, if in accordance with CASS 5.4.2 R a firm complies with both the rules in CASS 5.3 and CASS 5.4, such systems and controls must extend to both arrangements.

The deed referred to in CASS 5.4.6 R must provide that the money is to be held in accordance with the rules in this section unless each of the following conditions is satisfied:

(a) CASS 5.4.5 G01/01/2007 must be an agreement which satisfies CASS 5.1.5A R.

(b) the applicable provisions of CASS 5.5, and

(c) the client money (insurance) distribution rules (2) subject to (4), for the clients (other than clients which are insurance undertakings) when acting according to their respective interests in it.

(1) No conceptual equivalent outside the UK although this is implied in EU and Irish rules albeit not with reference to a statutory trust. The UK rules are very (welcomingly) prescriptive as to requirements.

(2) No conceptual equivalent outside the UK although this is implied in EU and Irish rules albeit not with reference to a statutory trust. The UK rules are very (welcomingly) prescriptive as to requirements.

(3) No conceptual equivalent outside the UK although this is implied in EU and Irish rules albeit not with reference to a statutory trust. The UK rules are very (welcomingly) prescriptive as to requirements.

(4) No conceptual equivalent outside the UK although this is implied in EU and Irish rules albeit not with reference to a statutory trust. The UK rules are very (welcomingly) prescriptive as to requirements.
The FCA expects that in most circumstances it will be practicable for a firm to pay client money into a client bank account by not later than the next business day after receipt.

The FCA expects that in most circumstances it will be practicable for a firm to pay client money into a client bank account by not later than the next business day after receipt.

Money due to a client from a firm

5.5.4R
If a firm is liable to pay money to a client, it must as soon as possible, and no later than one business day after the money is due and payable:

(1) pay it into a client bank account, in accordance with CASS 5.5.5 R; or
(2) pay it to, or to the order of, the client.

Broadly conceptually equivalent to EU and Irish rules.

Segregation

5.5.5R
A firm must segregate client money by either:

(1) paying it as soon as practicable into a client bank account; or
(2) paying it out in accordance with CASS 5.5.60 R.

Broadly conceptually equivalent to EU and Irish rules.

5.5.6G
The FCA expects that in most circumstances it will be practicable for a firm to pay client money into a client bank account by not later than the next business day after receipt.

Broadly conceptually equivalent to EU and Irish rules.

Where an insurance transaction involves more than one firm acting in a chain such that example money is transferred from a “producing” broker who has received client money from a consumer to an intermediate broker and thereafter to an insurance undertaking, each broker firm will owe obligations to its immediate client to segregate client money which it receives (in this example the producing broker in relation to the consumer and the intermediate broker in relation to the producing/broker). A firm which allows a third party broker to hold or control client money will not thereby be relieved of its fiduciary obligations (see CASS 5.5.34 R).

Broadly conceptually equivalent to EU and Irish rules.

5.5.7G

Broadly conceptually equivalent to EU and Irish rules.

5.5.8R

Broadly conceptually equivalent to EU and Irish rules.

5.5 Segregation and the operation of client money accounts

Application

5.5.1R
Unless otherwise stated each of the provisions in CASS 5.5 applies to firms which are acting in accordance with CASS 5.3 (Statutory trust) or CASS 5.4 (Non-statutory trust).

Broadly conceptually equivalent to EU and Irish rules.

5.5.2G
One purpose of CASS 5.5 is to ensure that, unless otherwise permitted, client money is kept separate from the firm’s own money. Segregation, in the event of a firm’s failure, is important for the effective operation of the trust that is created to protect client money. The aim is to clarify the difference between client money and general creditors’ entitlements in the event of the failure of the firm.

Broadly conceptually equivalent to EU and Irish rules.

Requirement to segregate

5.5.3R
A firm must, except to the extent permitted by CASS 5.5, hold client money separate from the firm’s money.

Broadly conceptually equivalent to EU and Irish rules.

5.5.4G

Broadly conceptually equivalent to EU and Irish rules.

5.5.5G

Broadly conceptually equivalent to EU and Irish rules.

5.5.6G

Broadly conceptually equivalent to EU and Irish rules.

5.5.7R

Broadly conceptually equivalent to EU and Irish rules.

5.5.8G

Broadly conceptually equivalent to EU and Irish rules.

5.5.9R

Broadly conceptually equivalent to EU and Irish rules.
A firm may segregate client money in a different currency from that of receipt. If it does so, the firm must ensure that the amount held is adjusted at intervals of not more than twenty-five business days to an amount at least equal to the original currency amount (or the currency in which the firm has its liability to its clients, if different), translated at the previous day's closing spot exchange rate.

102. 5.5.1R
A firm must not hold money other than client money in a client bank account unless it is:
(1) a minimum sum required to open the account, or to keep it open; or
(2) money temporarily in the account in accordance with CASS 5.5.16 R (Withdrawal of commission and mixed remittance); or
(3) interest credited to the account which exceeds the amount due to clients as interest and has not yet been withdrawn by the firm.

103. Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

104. 5.5.11R
A firm, when acting in accordance with CASS 5.3 (statutory trust), must ensure that the total amount of client money held for each client in any of the firm's client money bank accounts is positive and that no payment is made from any such account for the benefit of a client unless the client has provided the firm with cleared funds to enable the payment to be made.

105. Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

106. 5.5.12R
If client money is received by the firm in the form of an automated transfer, the firm must take reasonable steps to ensure that:
(1) the money is received directly into a client bank account; and
(2) if money is received directly into the firm's own account, the money is transferred into a client bank account no later than the next business day after receipt.

107. Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

108. Non-statutory trust - segregation of designated investments 5.5.14R
A firm which handles client money in accordance with the rules for a non-statutory trust at CASS 5.4 may, to the extent it considers appropriate, but subject to (2), satisfy the requirement to segregate client money by segregating or arranging for the segregation of designated investments with a value at least equivalent to such money as would otherwise have been segregated into a client bank account.

330
(2) A firm may not segregate designated investments unless it:
(a) takes reasonable steps to ensure that any consumers whose client money interests may be protected by such segregation are aware that the firm may operate such an arrangement and have (whether through its terms of business, client agreements, or otherwise in writing) an adequate opportunity to give their informed consent;
(b) ensures that the terms on which it will segregate designated investments include provision for it to take responsibility for meeting any shortfall in its client money resource which is attributable to falls in the market value of a segregated investment;
(c) provides in the deed referred to in CASS 5.4.6 R for designated investments which it segregates to be held by it on the terms of the non-statutory trust; and
(d) takes reasonable steps to ensure that the segregation is at all times in conformity with the range of permitted investments, general principles and conditions in CASS 5 Annex 1 R.

109. (5.5.14G) A firm which takes advantage of CASS 5.5.14 R will need to consider whether its permission should include the permitted activity of managing investments. If the firm is granted a power to manage with discretion the funds over which it is appointed as trustee under the trust deed required by CASS 5.4 then it will be likely to need a permission to manage investments. It is unlikely to need such a permission, however, if it is merely granted power to invest but the deed stipulates that the funds may only be managed with discretion by another firm (which has the necessary permission). Such an arrangement would not preclude the firm holding client money as trustee from appointing another firm (or firms) as manager and setting an appropriate strategy and overall asset allocation, subject to the limits set out in CASS 5.5.1 R. A firm may also need to consider whether it needs a permission to operate a collective investment scheme if any of its clients are to participate in the income or gains arising from the acquisition or disposal of designated investments.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

110. (5.5.16R) (1) A firm may draw down commission from the client bank account if:
(a) it has received the premium from the client (or from a third party premium finance provider on the client's behalf); and
(b) this is consistent with the firm's terms of business which it maintains with the relevant client and the insurance undertaking to whom the premium will become payable, and the firm may draw down commission before payment of the premium to the insurance undertaking, provided that the conditions in (a) and (b) are satisfied.

(2) If a firm receives a mixed remittance (that is part client money and part other money), it must:
(a) pay the full sum into a client bank account in accordance with CASS 5.5.5 R; and
(b) pay the money that is not client money out of the client bank account as soon as reasonably practicable and in any event by not later than twenty-five business days after the day on which the remittance is cleared (or, if earlier, when the firm performs the client money calculation in accordance with CASS 5.5.63 R (1)).

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

111. (5.5.17G) (1) As soon as commission becomes due to the firm (in accordance with CASS 5.5.16 R (1)) it must be treated as a remittance which must be withdrawn in accordance with CASS 5.5.16 R (2). The procedure required by CASS 5.5.16 R will also apply where money is due and payable to the firm in respect of fees due from clients (whether to the firm or other professionals).

(2) Firms are reminded that money received in accordance with CASS 5.2 must not, except where a firm and an insurance undertaking have (in accordance with CASS 5.1A R) agreed otherwise, be kept in a client bank account. Client money received from a third party premium finance provider should, however, be segregated into a client bank account.

(3) Where a client makes payments of premium to a firm in instalments, CASS 5.5.16 R (1) applies in relation to each instalment.

(4) If a firm is unable to match a remittance with a transaction it may be unable to immediately determine whether the payment comprises a mixed remittance or client money. In such cases the remittance should be treated as client money while the firm takes steps to match the remittance to a transaction as soon as possible.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.
<table>
<thead>
<tr>
<th>Rule</th>
<th>Description</th>
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<tr>
<td>7.2G</td>
<td>332. A fund which acts in accordance with CASS 5.5.19 R to CASS 5.5.21 R (Periodic segregation and reconciliation) must ensure that in its client bank account or client bank accounts to which (if it were a firm) CASS 5.4 R or CASS 5.4.4 R (Periodic segregation and reconciliation) would apply, it holds client money in accordance with CASS 5.5.19 R, the requirements of CASS 5.5.49 R, or CASS 5.5.21 R or with CASS 5.5.23 R.</td>
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<tr>
<td>7.2H</td>
<td>332. A fund which acts in accordance with CASS 5.5.19 R to CASS 5.5.21 R (Periodic segregation and reconciliation) must ensure that in its client bank account or client bank accounts to which (if it were a firm) CASS 5.4 R or CASS 5.4.4 R (Periodic segregation and reconciliation) would apply, it holds client money in accordance with CASS 5.5.19 R, the requirements of CASS 5.5.49 R, or CASS 5.5.21 R or with CASS 5.5.23 R.</td>
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<tr>
<td>7.3</td>
<td>332. The balance on each third-party collection account is included in the reconciliation of that statement or similar document issued by the fund service provider.</td>
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</table>

**Immediate segregation**

A firm must immediately establish procedures to ensure that client money received on behalf of its clients is received and that the firm or its appointed representatives, field representatives, or other agents of the firm are:

1. Paid into a client bank account of the firm in accordance with CASS 5.5.5 R, or
2. Forwarded to the firm, or in the case of a field representative, forwarded to a specified business address of the firm, so as to ensure that the money arrives at the specified business address by the close of the third business day.

**Periodic segregation and reconciliation**

A firm must ensure that its appointed representatives, field representatives, or other agents keep client money (whether in the form of premiums, claims money or premium refunds) separately identifiable from any other money (including that of the firm) until the client money is paid into a client bank account or sent to the firm.

**Conceptually jurisdiction-specific to the UK.**

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.
The statement or other form of confirmation from the third party may be provided in an electronic format, on condition that the fund service provider retains a copy, either in electronic or hard copy format, and can be reproduced without delay. A fund service provider should ensure that the reconciliation is performed from investor money records that are accurate and that the reconciliation itself is performed accurately.

(iii) A fund service provider should be in a position to demonstrate upon request, the date on which a reconciliation was prepared. This evidence can be in electronic form.

(iv) A fund service provider should ensure each reconciliation has relevant supporting backup material to facilitate the verification of figures in the reconciliation; the backup material should include statements received from third parties. (v) The manner in which the fund service provider exercises oversight should be documented in the fund service provider’s investor money management plan. The fund service provider should maintain a record to evidence the ongoing oversight of the process.

7.2 IMR Guidance

Material reconciliation differences for the purposes of reporting to the Central Bank

(i) When considering whether a reconciliation difference is material, the Central Bank expects the following considerations to be taken into account:

a) The monetary value of the reconciliation difference;

b) The number of reconciliation differences appearing within reconciliations over time;

c) The length of time that a reconciliation difference remains outstanding; and

d) The nature of the reconciliation difference.

(ii) Taking the quantum of the reconciliation difference into account alone when seeking to establish whether an amount is material may result in a number of low value reconciliation differences being ignored when in aggregate these issues may prove to be material to a fund service provider. Low value items by virtue of their nature, age or number of occurrences may be indicative of significant underlying issues within a fund service provider, which should be reported to the Central Bank. While not an exhaustive list, in general, reconciliation differences may arise as a result of:
a) Timing differences: The Central Bank expects any reconciliation timing difference that has not cleared within ten (10) working days to be reported as a material reconciliation difference.

b) Errors on the part of a third party: It is a fund service provider’s responsibility to contact the third party in order to resolve any errors which it identifies. The Central Bank expects errors which remain unreconciled in excess of fifteen (15) working days to be reported as material reconciliation differences.

c) Errors on the part of the fund service provider: The Central Bank expects errors which remain unreconciled in excess of 15 working days to be reported as material reconciliation differences. However, errors identified in the fund service provider’s records which result in the fund service provider having to lodge own firm money into the third party collection account should be reported to the Central Bank without delay.

(iii) The Central Bank may engage with a fund service provider to discuss how its material reconciliation differences have been determined and to assess if other factors need to be considered.

5.5.24G 14/01/2005 RP

(1) CASS 5.5.23 R allows a firm with appointed representatives, field representatives and other agents to avoid the need for the representative to forward client money on a daily basis but instead requires a firm to segregate into its client money bank account amounts which it reasonably estimates to be sufficient to cover the amount of client money which the firm expects its representatives or agents to receive and hold over a given period. At the expiry of each such period, the firm must obtain information about the amount of client money received and held by its representatives so that it can reconcile the amount of client money it has segregated with the amounts actually received and held by its representatives and agents. The frequency at which this reconciliation is to be performed is not prescribed but it must be at regular and reasonable intervals having regard to the nature and frequency of the insurance business carried on by its representatives and agents. For example, a period of six months might be appropriate for a representative which conducts business involving the receipt of premiums only infrequently whilst for other representatives a periodic reconciliation at monthly intervals (or less) may be appropriate.

(2) Where a firm operates on the basis of CASS 5.5.23 R, the money which is segregated into its client bank account is client money and will be available to meet any obligations owed to the clients of its representatives who for this purpose are treated as the firm’s clients.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.25G A firm which acts in accordance with CASS 5.5.23 R need not comply with CASS 5.5.19 R to 5.5.21 R.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.26R A firm must take reasonable steps to ensure that it is notified promptly of any receipt of client money in the form of client entitlements.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.
121. **5.5.27G**
The ‘entitlements’ mentioned in CASS 5.5.26 R refer to any kind of miscellaneous payment which the firm receives on behalf of a client and which are due to be paid to the client.

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122. **5.5.28R**
When a firm receives a client entitlement on behalf of a client, it must pay any part of it which is client money:

1. for client entitlements received in the United Kingdom, into a client bank account in accordance with CASS 5.5.5 R; or
2. for client entitlements received outside the United Kingdom, into any bank account operated by the firm, provided that such client money is:
   a. paid to, or in accordance with, the instructions of the client concerned; or
   b. paid into a client bank account in accordance with CASS 5.5.5 R (1), as soon as possible but no later than five business days after the firm is notified of its receipt.

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123. **5.5.29R**
A firm must take reasonable steps to ensure that a client entitlement which is client money is allocated within a reasonable period of time after notification of receipt.

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124. **Interest and investment returns**

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<th>Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.</th>
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125. **5.5.30R**
In relation to consumers, a firm must, subject to (2), take reasonable steps to ensure that its terms of business or other client agreements adequately explain, and where necessary obtain a client’s informed consent to, the treatment of interest and, if applicable, investment returns, derived from its holding of client money and any segregated designated investments.

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126. **5.5.31R**
If no interest is payable to a consumer, that fact should be separately identified in the firm’s client agreement or terms of business.

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127. **5.5.32R**
If a firm outlines its policy on its payment of interest, it need not necessarily disclose the actual rates prevailing at any particular time; the firm should disclose the terms, for example, LIBOR plus or minus ‘x’ percentage points.

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128. **Transfer of client money to a third party**

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<th>Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.</th>
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129. **5.5.34 R**
CASS 5.5.34 R sets out the requirements a firm must comply with when it transfers client money to another person without discharging its fiduciary duty owed to that client. Such circumstances arise when, for example, a firm passes client money to another broker for the purposes of the client’s transaction being effected. A firm can only discharge itself from its fiduciary duty by acting in accordance with, and in the circumstances permitted by, CASS 5.5.80 R.

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<th>Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.</th>
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130. **5.5.35R**
A firm may allow another person, such as another broker to hold or control client money, but only if:

1. the firm transfers the client money for the purpose of a transaction for a client throughout with that person; and
2. in the case of a consumer, that customer has been notified whether through a client agreement, terms of business, or otherwise in writing that the client money may be transferred to another person.

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<th>Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.</th>
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131. **5.5.36G**
A firm should not hold excess client money with another broker. It should be held in a client bank account.

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<th>Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.</th>
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5.5.37G

The FCA generally requires a firm to place client money in a client bank account with an approved bank. However, a firm which is an approved bank must not (subject to CASS 5.1.1 R (2)(e)) hold client money in an account with itself.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.38R

(1) A firm must ensure that client money is held in a client bank account at one or more approved banks.

(2) If the firm is a bank, it must not hold client money in an account with itself.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.39R

A firm may open one or more client bank accounts in the form of a designated client bank account. Characteristics of these accounts are that:

(1) the account holds money of one or more clients;

(2) the account includes in its title the word ‘designated’;

(3) the clients whose money is in the account have each consented in writing to the use of the bank with which the client money is to be held; and

(4) in the event of the failure of that bank, the account is not pooled with any other type of account unless a primary pooling event occurs.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.40G

(1) A firm may operate as many client accounts as it wishes.

(2) A firm is not obliged to offer its clients the facility of a designated client bank account.

(3) Where a firm holds money in a designated client bank account, the effect upon either:

(a) the failure of a bank where any other client bank account is held; or

(b) the failure of a third party to whom money has been transferred out of any other client bank account in accordance with CASS 5.5.34 R; is that money held in the designated client bank account is not pooled with money held in any other client bank account. Accordingly, clients whose money is held in a designated client bank account will not share in any shortfall resulting from a failure of the type described in (a) or (b).

(4) Where a firm holds client money in a designated client bank account, the effect upon the failure of the firm is that money held in the designated client bank account is pooled with money in every other client bank account of the firm. Accordingly, clients whose money is held in a designated client bank account will share in any shortfall resulting from a failure of the firm.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.41R

A firm may hold client money with a bank that is not an approved bank if all the following conditions are met:

(1) the client money relates to one or more insurance transactions which are subject to the law or market practice of a jurisdiction outside the United Kingdom;

(2) because of the applicable law or market practice of that overseas jurisdiction, it is not possible to hold the client money in a client bank account with an approved bank;

(3) the firm holds the money with such a bank for no longer than is necessary to effect the transactions;

(4) the firm notifies each relevant client and has, in relation to a consumer, a client agreement, or terms of business which adequately explain that:

(a) client money will not be held with an approved bank;

(b) in such circumstances, the legal and regulatory regime applying to the bank with which the client money is held will be different from that of the United Kingdom and, in the event of a failure of the bank, the client money may be treated differently from the treatment which would apply if the client money were held by an approved bank in the United Kingdom; and

(c) if it is the case, the particular bank has not accepted that it has no right of set-off or counterclaim against money held in a client bank account, in respect of any sum owed on any other account of the firm, notwithstanding the firm's request to the bank as required by CASS 5.5.49 R; and

(5) the client money is held in a designated bank account.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.
A firm's selection of a bank

5.5.42

A firm owes a duty of care to a client when it decides where to place client money. The review required by CASS 5.5.43 R is intended to ensure that the risks inherent in placing client money with a bank are minimised or appropriately diversified by requiring a firm to consider carefully the bank or banks with which it chooses to place client money. For example, a firm which is likely only to hold relatively modest amounts of client money will be likely to be able to satisfy this requirement if it selects an authorised UK clearing bank.

5.5.43 R

Before a firm opens a client bank account and as often as is appropriate on a continuing basis (and no less than once in each financial year), it must take reasonable steps to establish that the bank is appropriate for that purpose.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.44

A firm should consider diversifying placements of client money with more than one bank where the amounts are, for example, of sufficient size to warrant such diversification.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.45 R

When considering where to place client money and to determine the frequency of the appropriate test under CASS 5.5.43 R, a firm should consider taking into account, together with any other relevant matters:

1. the capital of the bank;
2. the amount of client money placed, as a proportion of the bank's capital and deposits;
3. the credit rating of the bank (if available); and
4. to the extent that the information is available, the level of risk in the investment and loan activities undertaken by the bank and its affiliated companies.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.46 G

A firm will be expected to perform due diligence when opening a client bank account with a bank that is authorised by an EEA regulator. Any continuing assessment of that bank may be restricted to verification that it remains authorised by an EEA regulator.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.47 R

Subject to CASS 5.5.41 R, a firm that holds or intends to hold client money with a bank which is in the same group as the firm must:

1. undertake a continuous review in relation to that bank which is at least as rigorous as the review of any bank which is not in the same group, in order to ensure that the decision to use a group bank is appropriate for the client;
2. disclose in writing to its client at the outset of the client relationship (whether by way of a client agreement, terms of business or otherwise in writing) or, if later, not less than 20 business days before it begins to hold client money of that client with that bank:
   a. that it is holding or intends to hold client money with a bank in the same group;
   b. the identity of the bank concerned; and
   c. that the client may choose not to have his money placed with such a bank.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.48 R

If a client has notified a firm in writing that he does not wish his money to be held with a bank in the same group as the firm, the firm must either:

1. place that client money in a client bank account with another bank in accordance with CASS 5.5.38 R; or
2. return that client money to, or pay it to the order of, the client.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.49 R

When a firm opens a client bank account, the firm must give or have given written notice to the bank requesting the bank to acknowledge in writing:

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.
<table>
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<tr>
<th>Section</th>
<th>Relevant Text</th>
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<tbody>
<tr>
<td>144.5.5.50R</td>
<td>In the case of a client bank account in the United Kingdom, if the bank does not provide the acknowledgement referred to in CASS 5.5.49 R within 20 business days after the firm dispatched the notice, the firm must withdraw all money standing to the credit of the account and deposit it in a client bank account with another bank as soon as possible.</td>
</tr>
<tr>
<td>145.5.5.51R</td>
<td>In the case of a client bank account outside the United Kingdom, if the bank does not provide the acknowledgement referred to in CASS 5.5.49 R within 20 business days after the firm dispatched the notice, the firm must notify the client of this fact as set out in CASS 5.5.53 R.</td>
</tr>
<tr>
<td>146.5.5.52G</td>
<td>Firms are reminded of the provisions of CASS 5.5.41 R (4), which sets out the notification and consents required when using a bank that is not an approved bank.</td>
</tr>
<tr>
<td>147.5.5.53R</td>
<td>A firm must not hold, for a consumer, client money in a client bank account outside the United Kingdom, unless the firm has previously disclosed to the consumer (whether in its terms of business, client agreement or otherwise in writing): (1) that his money may be deposited in a client bank account outside the United Kingdom but that the client may notify the firm that he does not wish his money to be held in a particular jurisdiction; (2) that in such circumstances, the legal and regulatory regime applying to the approved bank will be different from that of the United Kingdom and, in the event of a failure of the bank, his money may be treated in a different manner from that which would apply if the client money were held by a bank in the United Kingdom; and (3) if it is the case, that a particular bank has not accepted that it has no right of set-off or counterclaim against money held in a client bank account in respect of any sum owed to it on any other account of the firm, notwithstanding the firm's request to the bank as required by CASS 5.5.49 R.</td>
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<tr>
<td>148.5.5.54G</td>
<td>There is no need for a firm to make a separate disclosure under CASS 5.5.53 R (1) and CASS 5.5.53 R (2) in relation to each jurisdiction.</td>
</tr>
<tr>
<td>149.5.5.55G</td>
<td>Firms are reminded of the provisions of CASS 5.5.41 R (4), which sets out the notification and consents required when using a bank that is not an approved bank.</td>
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<tr>
<td>150.5.5.56R</td>
<td>If a client has notified a firm in writing before entering into a transaction that client money is not to be held in a particular jurisdiction, the firm must either: (1) hold the client money in a client bank account in a jurisdiction to which the client has not objected; or (2) return the client money to, or to the order of, the client.</td>
</tr>
<tr>
<td>151.5.5.57G</td>
<td>Firms are reminded of the provisions of CASS 5.5.41 R (4), which sets out the notification and consents required when using a bank that is not an approved bank.</td>
</tr>
<tr>
<td>152.5.5.58G</td>
<td>Notification to consumers: use of broker or settlement agent outside the United Kingdom 5.5.58R</td>
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</table>
A firm must not undertake any transaction for a consumer that involves client money being passed to another broker or settlement agent located in a jurisdiction outside the United Kingdom, unless the firm has previously disclosed to the consumer (whether in its terms of business, client agreement or otherwise in writing):

1. that his client money may be passed to a person outside the United Kingdom but the client may notify the firm that he does not wish his money to be passed to a money in a particular jurisdiction; and
2. that, in such circumstances, the legal and regulatory regime applying to the broker or settlement agent will be different from that of the United Kingdom and, in the event of a failure of the broker or settlement agent, this money may be treated in a different manner from that which would apply if the money were held by a broker or settlement agent in the United Kingdom.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.59G

There is no need for a firm to make a separate disclosure under CASS 5.5.58 R in relation to each jurisdiction.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.60R

If a client has notified a firm before entering into a transaction that he does not wish his money to be passed to another broker or settlement agent located in a particular jurisdiction, the firm must either:

1. hold the client money in a client bank account in the United Kingdom or a jurisdiction to which the money has not objected and pay in own money to the firm’s own account with the broker, agent or counterparty; or
2. return the money to, or to the order of, the client.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.61R

On the failure of a third party with which client money is held, a firm must notify the FCA:

1. as soon as it becomes aware, of the failure of any bank, other broker or settlement agent or other entity with which it has placed, or to which it has passed, client money; and
2. as soon as reasonably practical, whether it intends to make good any shortfall that has arisen or may arise and of the amounts involved.

Client money calculation and reconciliation

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.62G (1) In order that a firm may check that it has sufficient money segregated in its client bank account (and held by third parties) to meet its obligations to clients it is required periodically to calculate the amount which should be segregated (the client money requirement) and to compare this with the amount shown as its client money resource. This calculation is, in the first instance, based upon the firm’s accounting records and is followed by a reconciliation with its banking records. A firm is required to make a payment into the client bank account if there is a shortfall or to remove any money which is not required to meet the firm’s obligations.

(2) For the purpose of calculating its client money requirement two alternative calculation methods are permitted, but a firm must use the same method in relation to CASS 5.3 and CASS 5.4. The first refers to individual client cash balances; the second to aggregate amounts of client money recorded on a firm business ledgers.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.63R (1) A firm must, as often as is necessary to ensure the accuracy of its records and at least at intervals of not more than 25 business days:

(a) check whether its client money resource, as determined by CASS 5.5.65 R on the previous business day, was at least equal to the client money requirement, as determined by CASS 5.5.66 R or CASS 5.5.68 R, as at the close of business on that day; and
(b) ensure that:
   (i) any shortfall is paid into a client bank account by the close of business on the day the calculation is performed; or
   (ii) any excess is withdrawn within the same time period unless CASS 5.5.9 R or CASS 5.5.10 R applies to the extent that the firm is satisfied on reasonable grounds that it is prudent to maintain a positive margin to ensure the calculation in (a) is satisfied having regard to any uncorrected items in its business ledgers as at the date on which the calculations are performed; and
(c) include in any calculation of its client money requirement (whether calculated in accordance with CASS 5.5.66 R or CASS

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.
5.5.68 R any amounts attributable to client money received by its appointed representatives, field representatives or other agents and which, as at the date of calculation, it is required to segregate in accordance with CASS 5.5.19 R.

2. A firm must within ten business days of the calculation in (a) reconcile the balance on each client bank account as recorded by the firm with the balance on that account as set out in the statement or other form of confirmation used by the bank with which the account is held.

3. When any discrepancy arises as a result of the reconciliation carried out in (2), the firm must identify the reason for the discrepancy and correct it as soon as possible, unless the discrepancy arises solely as a result of timing differences between the accounting systems of the party providing the statement or confirmation and those of the firm.

4. While a firm is unable to resolve a difference arising from a reconciliation, and one record or a set of records examined by the firm during its reconciliation indicates that there is a need to have a greater amount of client money than is in fact the case, the firm must assume until the matter is finally resolved, that the record or set of records is accurate and either pay its own money into a relevant account or make a withdrawal of any excess.

5. A firm must keep a record of whether it calculates its client money requirement in accordance with CASS 5.5.66 R or CASS 5.5.68 R and may only use one method during each annual accounting period (which method must be the same in relation to both CASS 5.3 and CASS 5.4).

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.
161. The individual client balance for each client must be calculated as follows:

1. the amount paid by a client to the firm (to include all premiums);
2. the amount due to the client (to include all claims and premium refunds);
3. the amount of any interest or investment returns due to the client;
4. less the amount paid to insurance undertakings for the benefit of the client (to include all premiums and commission due to itself (i.e. commissions that are due but have not yet been removed from the client account));
5. less the amount paid by the firm to the client (to include all claims and premium refunds);

and where the individual client balance is found by the sum ((1) + (2) + (3)) - ((4) + (5)).

165. A firm which calculates its client money requirement on the preceding basis must in addition and within a reasonable period be able to match its client money resource to its requirement by reference to individual clients (with such matching being achieved for the majority of its clients and transactions).

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Third party assets

A firm which pays professional fees (for example to a loss adjuster or valuer) on behalf of a client may do so in accordance with CASS 5.5.80 R (2), where this is done on the instruction of or with the consent of the client.

When a firm wishes to transfer client money balances to a third party in the course of transferring its business to another firm, it should do so in compliance with CASS 5.5.80 R and a transferee firm will come under an obligation to treat any client money so transferred in accordance with these rules.

Firms are reminded of their obligation, when transferring money to third parties in accordance with CASS 5.5.34 R, to use appropriate skill, care and judgment in their selection of third parties in order to ensure adequate protection of client money.

Firms are reminded that, in order to calculate their client money resource in accordance with CASS 5.5.63 R to CASS 5.5.65 R, they will need to have systems in place to produce an accurate accounting record showing how much client money is being held by third parties at any point in time. For the purposes of CASS 5.5.63 R to CASS 5.5.65 R, however, a firm must assume that monies remain at an intermediate broker awaiting completion of the transaction unless it has received confirmation that the transaction has been completed.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.82R

When a firm draws a cheque or other payable order to discharge its fiduciary duty under CASS 5.5.80 R, it must continue to treat the sum concerned as client money until the cheque or order is presented and paid by the bank.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.5.83R

For the purposes of CASS 5.1.5 R, if a firm makes a payment to, or on the instructions of, a client, from an account other than a client bank account, until that payment has cleared, no equivalent sum will become due and payable to the firm or may be withdrawn from a client bank account by way of reimbursement.

Broadly conceptually equivalent to EU and Irish rules, even if UK rules are considerably more prescriptive.

5.6 Client money distribution

Application

5.6.1R

(1) CASS 5.6 (the client money (insurance) distribution rules) applies to a firm that in holding client money is subject to CASS 5.3 (statutory trust) or CASS 5.4 (Non-statutory trust) when a primary pooling event or a secondary pooling event occurs.

(2) In the event of there being any discrepancy between the terms of the trust as required by CASS 5.4.7 R (1)(c) and the provisions of CASS 5.6, the latter shall apply.

British jurisdiction specific concepts.

5.6.2G

(1) The client money (insurance) distribution rules have force and effect on any firm that holds client money in accordance with CASS 5.3 or CASS 5.4. Therefore, they may apply to a UK branch of a non-EEA firm. In this case, the UK branch of the firm may be treated as if the branch itself is a free-standing entity subject to the client money (insurance) distribution rules.

(2) Firms that act in accordance with CASS 5.4 (Non-statutory trust) are reminded that the client money (insurance) distribution rules should be given effect in the terms of trust required by CASS 5.4.

British jurisdiction specific concepts.
The client money (insurance) distribution rules seek to facilitate the timely return of client money to a client in the event of the failure of a firm or third party at which the firm holds client money. A primary pooling event triggers a notional pooling of all the client money, in every type of client money account, and the obligation to distribute it.

A primary pooling event occurs:
1) on the failure of the firm; or
2) on the vesting of assets in a trustee in accordance with an 'assets requirement' imposed under 55P(1)(b) or (c) (as the case may be) of the Act; or
3) on the coming into force of a requirement for all client money held by the firm; or
4) when the firm notifies, or is in legal pro of its duty to notify, the PFA, in accordance with CASS 5.3.77 R, that it is unable correctly to identify and allocate in its records all valid claims arising as a result of a secondary pooling event.

CASS 5.6.5 R (4) does not apply so long as:
1) the firm is taking steps, in consultation with the PFA, to establish those records; and
2) there are reasonable grounds to conclude that the records will be capable of rectification within a reasonable period.

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

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

Client money received after the failure of the firm:
1) Client money received by the firm (including in its capacity as trustee under CASS 5.4 (Non-statutory trust)) after a primary pooling event must not be pooled with clear money held in any client money account operated by the firm at the time of the primary pooling event. It must be placed in a client bank account that has been opened after that event and must be handled in accordance with the client money rules, and returned to the relevant client without delay, except to the extent that:
   1. it is client money relating to a transaction that has not completed at the time of the primary pooling event; or
   2. it is money relating to a claim, for which the client money requirement, calculated in accordance with CASS 5.5.66 R of CASS 5.5.68 R, shows that money is due from the client to the firm including in its capacity as trustee under CASS 5.4 (Non-statutory trust) at the time of the primary pooling event.
Client money received after the primary pooling event relating to an incomplete transaction should be used to complete that transaction.

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

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

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

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

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

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

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

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

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

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

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

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

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

1) in relation to every general client bank account of the firm, the provisions of CASS 5.6.22 R and CASS 5.6.28 R to CASS 5.6.28 G will apply.
(2) in relation to every designated client bank account held by the firm with the failed bank, the provisions of CASS 5.6.24 R and CASS 5.6.26 R to CASS 5.6.28 G will apply; and

(3) any money held at a bank, other than the bank that has failed, in designated client bank accounts is not pooled with any other client money.

192.

5.6.21R

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

UK jurisdiction specific concepts.

193.

5.6.22R

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

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

(2) a new client money entitlement must be calculated for each client by the firm, to reflect the requirements in (1), and the firm's records must be amended to reflect the reduced client money entitlement;

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

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

UK jurisdiction specific concepts.

194.

5.6.23G

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

UK jurisdiction specific concepts.

195.

5.6.24R

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

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

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

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

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

UK jurisdiction specific concepts.

196.

5.6.25R

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

UK jurisdiction specific concepts.

197.

Client money received after the failure of a bank

5.6.24R

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

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

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

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

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

UK jurisdiction specific concepts.

198.

5.6.27R

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

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

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

Failed of an intermediate broker or settlement agent: pooling

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

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

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

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

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

(1) must not be transferred to the failed third party unless specifically instructed by the client in order to settle an obligation of that client to the failed broker or settlement agent; and
(2) must be subject to (1), placed in a separate client bank account that has been opened after the secondary pooling event and either:
   (a) held for written instruction of the client, transferred to a third party other than one that has failed; or
   (b) returned to the client as soon as possible.

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

The provisions of CASS 5.5.61 R apply.

7. Mandates

7.1 Mandates

7.2 IR [deleted]

7.2B [deleted]

7.3 [deleted]

7.4 [deleted]

7.5 [deleted]

7.6IR [deleted]

7.7 Safekeeping of client’s documents and other assets

Application 7.8 IR

(1) CASS 5.8 applies to a firm (including in its capacity as trustee under CASS 5.4) which in the course of insurance distribution activity

UK jurisdiction specific concepts.
takes into its possession for safekeeping any client title documents (other than documents of no value) or other tangible assets belonging to clients.

(2) CASS 5.8 does not apply to a firm when:
(a) carrying on an insurance distribution activity which is in respect of a reinsurance contract; or
(b) acting in accordance with CASS 6 (Custody rules).

206. Purpose
5.8.2G
The rules in this section amplify the obligation in Principle 10 which requires a firm to arrange adequate protection for client’s assets. Firms carrying on insurance distribution activities may hold, on a temporary or longer basis, client title documents such as policy documents (other than policy documents of no value) and also items of physical property if, for example, a firm arranges for a valuation. The rules are intended to ensure that firms make adequate arrangements for the safekeeping of such property.

207. Requirement
5.8.3R
(1) A firm which has in its possession or control documents evidencing a client’s title to a contract of insurance or other similar documents (other than documents of no value) or which takes into its possession or control tangible assets belonging to a client, must take reasonable steps to ensure that any such documents or items of property:
(a) are kept safe until they are delivered to the client;
(b) are not delivered or given to any other person except in accordance with instructions given by the client; and that a record is kept as to the identity of any such documents or items of property and the dates on which they were received by the firm and delivered to the client or other person.

(2) A firm must retain the record required in (1) for a period of three years after the document or property concerned is delivered to the client or other person.

208. For Deposits with Money Market Funds see Recital 4 Commission Delegated Directive
Where an investment firm deposits funds it holds on behalf of a client with a qualifying money market fund, the units or shares in that money market fund should be held in accordance with the requirements for holding financial instruments belonging to clients. Clients should be required to explicitly consent to the depositing of these funds. When assessing the quality of money market instrument there should be no mechanistic reliance on external ratings. However a downgrade below the two highest short-term credit ratings by any agency registered and supervised by ESMA that has rated the instrument should lead the manager to undertake a new assessment of the credit quality of the money market instrument to ensure it continues to be of high quality.

CASs 5 Annex 1 Segregation of designated investments:
permitted investments, general principles and conditions (This Annex belongs to CASS 5.5.14 R)

<table>
<thead>
<tr>
<th>Investment type</th>
<th>Qualification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negotiable debt security (including a certificate of deposit)</td>
<td></td>
</tr>
<tr>
<td>(a) Remaining term to maturity of 5 years or less; and</td>
<td></td>
</tr>
<tr>
<td>(b) The issuer or investment must have a short-term credit rating of A1 by Standard and Poor’s, or</td>
<td></td>
</tr>
<tr>
<td>P1 by Moody’s, Investor Services, or</td>
<td></td>
</tr>
<tr>
<td>P1 by Fitch if the instrument has a</td>
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</tbody>
</table>

UK jurisdiction specific concepts.
remaining term to maturity of 366 days or less, or a minimum long-term credit rating of Aa3 by Moody's Investor Services or AA- by Fitch if the instrument has a term to maturity of more than 366 days.

2. A repo in relation to negotiable debt security

As for 1 above and where the credit rating of the counterparty also meets the criteria in 1.

3. Bond funds

(a) An authorised fund or a recognised scheme or an investment company which is registered by the Securities and Exchange Commission of the United States of America under the Investment Company Act 1940;

(b) A minimum credit rating and risk rating of Aa3 and S2 respectively by Standard and Poor's or Aa and MR2 respectively by Moody's Investor Services or AA and V2 respectively by Fitch.

4. Money market fund

(a) An authorised fund or a recognised scheme;

(b) A minimum credit and risk rating of Aaa and MR1+ respectively by Moody's Investor Services or AAA+ by Standard and Poor's or AAA and V1+ respectively by Fitch.

5. Derivatives

Only for the purpose of prudently managing foreign currency risks.

The general conditions which must be satisfied in the segregation of designated investments are:

(a) any redemption of an investment must be by payment into the firm's client money bank account;

(b) where the credit or risk rating of a designated investment falls below the minimum set out in the Table, the firm must dispose of the investment as soon as possible and in any event not later than 20 business days following the downgrade;

(c) where any investment or issuer has more than one rating, the lowest shall apply.
6.1 Application

6.1.1 This chapter (the custody rules) applies to a firm:

(1A) when it holds financial instruments belonging to a client in the course of its MiFID business;
(1B) when it is safeguarding and administering investments, in the course of business that is not MiFID business;
(1C) when it is acting as trustee or depositary of an AIF;
(1D) when it is acting as trustee or depositary of a UCITS; and
(1E) in respect of any arrangement for a client to transfer full ownership of a safe custody asset (or an asset which would be a safe custody asset but for the arrangement) to the firm which is:

(a) in the course of, or in connection with, the firm’s designated investment business; and
(b) for the purpose of securing or otherwise covering present or future, actual or contingent or prospective obligations, and the application of the custody rules to a firm under this paragraph is set out in the rules and guidance in CASS 6.1.6 R to CASS 6.1.9 G; and
(1F) when it is a small AIFM carrying on excluded custody activities.

6.1.1AR

In applying the custody rules to a small AIFM’s excluded custody activities, any reference to a firm carrying on the regulated activities of safeguarding and administering investments, safeguarding and administering assets (without arranging) or arranging safeguarding and administration of assets includes those excluded custody activities that would, but for the exclusion in article 72AA of the RAO, amount to whichever of those regulated activities is referred to.

6.1.1AG

The regulated activity of safeguarding and administering investments covers both the safeguarding and administration of assets (without arranging) 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.

6.1.1BR

(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;
(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.

6.1.1CG

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.

6.1.1CH

(1) Firms to which the custody rules apply by virtue of CASS 6.1.1R (1B) or (1E) 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.
(2) Firms to which the custody rules apply by virtue of CASS 6.1.1R (1C) 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.

6.1.1CI

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.
for the protection of clients in the provision of services and activities. These requirements can be concluded that full ownership of funds and financial instrument is transferred to an investment firm to cover any present or future, actual or contingent or prospective obligations. That broad possibility may create uncertainty and jeopardise the effectiveness of the requirements concerning the safeguard of client assets. Thus, at least when retail client assets are involved, it is appropriate to limit the possibility of investment firms to conclude title transfer financial collateral arrangements as defined under Directive 2002/47/EC of the European Parliament and of the Council (24), for the purpose of securing or otherwise covering their obligations.

**Article 16(18) MiFID II**

An investment firm shall not conclude title transfer financial collateral arrangements with retail clients for the purpose of securing or covering present or future, actual or contingent or prospective obligations of clients.

**Recital 52 MiFID II**

The requirements concerning the protection of client assets are a crucial tool for the protection of clients in the provision of services and activities. Those requirements can be concluded that full ownership of funds and financial instrument is transferred to an investment firm to cover any present or future, actual or contingent or prospective obligations. That broad possibility may create uncertainty and jeopardise the effectiveness of the requirements concerning the safeguard of client assets. Thus, at least when retail client assets are involved, it is appropriate to limit the possibility of investment firms to conclude title transfer financial collateral arrangements as defined under Directive 2002/47/EC of the European Parliament and of the Council (24), for the purpose of securing or otherwise covering their obligations.

**Article 16(18) MiFID II**

An investment firm shall not conclude title transfer financial collateral arrangements with retail clients for the purpose of securing or covering present or future, actual or contingent or prospective obligations of clients.

**Recital 5 Commission Delegated Directive**

Directive 2014/65/EU requires investment firms to safeguard client assets. Article 16(18) of Directive 2014/65/EU prohibits firms from concluding title transfer collateral arrangements (TTCA) with retail clients for the purpose of securing or covering present or future, actual or contingent or prospective obligations. Investment firms are, however, not prohibited from concluding TTCA with non-retail clients. This is therefore a risk that without further guidance investment firms could use TTCA more often than reasonably justified when dealing with non-retail clients, understanding the overall regime put in place to protect client assets. Therefore, in light of the effects of TTCA on firm’s duties towards clients and in order to ensure the safeguarding and segregation rules pursuant to Directive 2014/65/EU are not undermined, investment firms should consider the appropriateness of title transfer collateral arrangements.

**Title transfer collateral arrangements**

1. TTCA

(a) A firm must not enter into a TTCA in respect of an asset belonging to a retail client.

(b) Where a firm enters into a TTCA in respect of an asset belonging to a retail client (or one which would belong to a retail client but for the arrangement) before 3 January 2018, the firm must terminate that TTCA.

[Note: article 16(10) of MiFID and article 5(7) of the MiFID Delegated Directive]

2. TTCA are not with a retail client, the custody rules do not apply to a retail client (or one which would belong to a retail client but for the arrangement) before 3 January 2018, the firm must terminate that TTCA.

[Note: article 16(10) of MiFID and article 5(7) of the MiFID Delegated Directive]

3. Except for CASS 6.1.6GR and 6.1.6G and provided that the TTCA is not with a retail client, the custody rules do not apply to a firm in respect of an asset which is subject to a TTCA and which otherwise would be a safe custody asset.

[Note: recital 52 to MiFID]
use client financial instruments

Article 7 Commission Delegated Directives

Use of client financial instruments

1. Member States shall not allow investment firms to enter into arrangements for securities financing transactions in respect of financial instruments held by them on behalf of a client, or otherwise use such financial instruments for their own account or the account of any other person unless, in addition to the conditions set out in paragraph 1, at least one of the following conditions is met: (a) the client has given his prior express consent to the use of the instruments on specified terms, as clearly evidenced in writing and affirmatively accepted by the investment firm, and that the instruments provide the appropriate collateral and that the client monitors the continued appropriateness of such collateral; (b) the client has given his prior express consent to the use of the instruments on specified terms, as clearly evidenced in writing and affirmatively accepted by the investment firm, and the client monitors the continued appropriateness of such collateral and takes the necessary steps to ensure the continued appropriateness of such collateral; and (c) the client has given his consent, so as to enable the correct allocation of any loss.

2. Member States shall not allow investment firms to enter into arrangements for securities financing transactions in respect of financial instruments held by them on behalf of a client, or otherwise use such financial instruments for their own account or the account of any other person unless, in addition to the conditions set out in paragraph 1, at least one of the following conditions is met: (a) the client has given his prior express consent to the use of the instruments on specified terms, as clearly evidenced in writing and affirmatively accepted by the investment firm, and that the instruments provide the appropriate collateral and that the client monitors the continued appropriateness of such collateral; (b) the client has given his prior express consent to the use of the instruments on specified terms, as clearly evidenced in writing and affirmatively accepted by the investment firm, and the client monitors the continued appropriateness of such collateral and takes the necessary steps to ensure the continued appropriateness of such collateral; and (c) the client has given his consent, so as to enable the correct allocation of any loss.

2. Member States shall not allow investment firms to enter into arrangements for securities financing transactions in respect of financial instruments held by them on behalf of a client, or otherwise use such financial instruments for their own account or the account of any other person unless, in addition to the conditions set out in paragraph 1, at least one of the following conditions is met: (a) the client has given his prior express consent to the use of the instruments on specified terms, as clearly evidenced in writing and affirmatively accepted by the investment firm, and that the instruments provide the appropriate collateral and that the client monitors the continued appropriateness of such collateral; (b) the client has given his prior express consent to the use of the instruments on specified terms, as clearly evidenced in writing and affirmatively accepted by the investment firm, and the client monitors the continued appropriateness of such collateral and takes the necessary steps to ensure the continued appropriateness of such collateral; and (c) the client has given his consent, so as to enable the correct allocation of any loss.

2. Member States shall not allow investment firms to enter into arrangements for securities financing transactions in respect of financial instruments held by them on behalf of a client, or otherwise use such financial instruments for their own account or the account of any other person unless, in addition to the conditions set out in paragraph 1, at least one of the following conditions is met: (a) the client has given his prior express consent to the use of the instruments on specified terms, as clearly evidenced in writing and affirmatively accepted by the investment firm, and that the instruments provide the appropriate collateral and that the client monitors the continued appropriateness of such collateral; (b) the client has given his prior express consent to the use of the instruments on specified terms, as clearly evidenced in writing and affirmatively accepted by the investment firm, and the client monitors the continued appropriateness of such collateral and takes the necessary steps to ensure the continued appropriateness of such collateral; and (c) the client has given his consent, so as to enable the correct allocation of any loss.

2. Member States shall not allow investment firms to enter into arrangements for securities financing transactions in respect of financial instruments held by them on behalf of a client, or otherwise use such financial instruments for their own account or the account of any other person unless, in addition to the conditions set out in paragraph 1, at least one of the following conditions is met: (a) the client has given his prior express consent to the use of the instruments on specified terms, as clearly evidenced in writing and affirmatively accepted by the investment firm, and that the instruments provide the appropriate collateral and that the client monitors the continued appropriateness of such collateral; (b) the client has given his prior express consent to the use of the instruments on specified terms, as clearly evidenced in writing and affirmatively accepted by the investment firm, and the client monitors the continued appropriateness of such collateral and takes the necessary steps to ensure the continued appropriateness of such collateral; and (c) the client has given his consent, so as to enable the correct allocation of any loss.
Article 6 Commission Delegated Directive

1. Member States shall require that investment firms properly consider and be able to demonstrate that they have done so, the use of title transfer collateral arrangements in the context of the relationship between the client's obligation to the firm and the client assets subjected to title transfer collateral arrangements for exceeds the client's obligation, or is even unlimited if the client has any obligation at all to the firm, and (c) whether all client's financial instruments or funds are made subject to title transfer collateral arrangements, without consideration of what obligations each has to the firm. Where using title transfer collateral arrangements, investment firms shall highlight to professional clients and eligible counterparties the risks involved and the effect of any title transfer collateral arrangement on the client's financial instruments or funds.

(1) A firm must ensure that any TTCA is the subject of a written agreement made on a durable medium between the firm and the client.
(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.

Para. 5 Schedule 3 of MiFID Regulations

Inappropriate use of title transfer collateral arrangements

5. (1) Investment firms shall properly consider, and be able to demonstrate that they have done so, the use of title transfer collateral arrangements in the context of the relationship between the client's obligation to the firm and the client assets subjected to title transfer collateral arrangements by the firm.
(2) When considering, and documenting, the appropriateness of the use of title transfer collateral arrangements in the context of:
(a) the relationship between the client's obligation to the firm, and (b) the safe custody assets subject to TTCA by the firm.
(3) A firm must be able to demonstrate that it has complied with the requirement under (1).
(4) Which concerning, and documenting, the appropriateness of the use of TTCA in a context of:
(a) either the client's full-ownership of the safe custody asset to the firm, and (b) the safe custody asset subject to TTCA by the firm.
### Article 6 Commission Delegated Directive

#### Article 6 Inappropriate use of title transfer collateral arrangements

1. Member States shall require that investment firms properly consider, and are able to demonstrate that they have done so, the use of title transfer collateral arrangements in the context of the relationship between the client's obligation to the firm and the client assets subjected to title transfer collateral arrangements by the firm.

2. When considering, and documenting, the appropriateness of the use of title transfer collateral arrangements, investment firms shall take into account all of the following factors:
   - Whether there is only a very weak connection between the client's obligation to the firm and the use of title transfer collateral arrangements, including whether the likelihood of a client's liability to the firm is low or negligible;
   - Whether the amount of client funds or financial instruments subject to title transfer collateral arrangements far exceeds the client's obligation, or is even unlimited if the client has any obligation at all to the firm; and
   - Whether all clients' financial instruments or funds are made subject to title transfer collateral arrangements, without consideration of what obligation each client has to the firm.

3. Where using title transfer collateral arrangements, investment firms shall highlight to professional clients and eligible counterparties the risks involved and the effect of any title transfer collateral arrangement on the client's financial instruments and funds.

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### Remarks

- **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
- Whether all the client's safe custody assets are made subject to TTCA, whether the client has any obligations at all to the firm; and
- Whether all clients' financial instruments or funds are made subject to title transfer collateral arrangements, without consideration of what obligation each client has to the firm.

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### 221.

- A firm may choose to combine its client communication under CASS 6.1.6.4DR(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).

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### 222.

- 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.

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### 223.

Termination of title transfer collateral arrangements

1. 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.

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The UK rules are comparably more prescriptive than those EU and Irish rules, despite common principles being applied in a similar vein as to what the UK rules sets in compliance objectives.
(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 made to a client under (3) for a period of five years, starting from the date the notification was made.

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. Same comment as Row 221.

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 reasonably required 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). Same comment as Row 221.

If a TTCA is terminated, then the exemption at CASS 6.1.6R(4) no longer applies. Same comment as Row 221.

(1) Following the termination of a TTCA, where a firm does not immediately return the safe custody asset to the client the firm should consider whether the custody rules apply in respect of the safe custody asset pursuant to CASS 6.1.1R.

(2) Where the custody rules apply to a firm for safe custody assets in those 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 6.6.54R (in each case as appropriate). Same comment as Row 221.

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. Same comment as Row 221.

Prime brokerage agreements

A prime brokerage firm is reminded of the additional obligations in CASS 9.3.1R which apply to prime brokerage agreements. Same comment as Row 221.

Affiliated companies - MiFID business

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. Same comment as Row 221.

Affiliated companies - non-MiFID business

In respect of a firm's business falling under CASS 5.1.1R(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.

Delivery versus payment transaction exemption

(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 fulfillment 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 client within one business day following the client's fulfillment of its payment obligation to the firm.

(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 in compliance 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 asset under (3) it must also:
   - 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);
   - 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
   - update the record made under (5)(b) when the transaction in question has settled and the firm has re-appropriated the money.

233.

6.1.12AG

(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:
   - review the value of the safe custody asset in question in line with (1); and
   - 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.

Same comment as Row 221.

234.

6.1.12BR

A firm cannot, in respect of a particular delivery versus payment transaction, make use of the exemption under CASS 6.1.12R 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.

Same comment as Row 221.

235.

6.1.12CG

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.

Same comment as Row 221.

236.

6.1.12DG

(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 6.1.12R (1A) to CASS 6.1.12R (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:­

Same comment as Row 221.
(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
(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.

Same comment as Row 221.

6.1.14G
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. Where a firm temporarily handles safe custody assets, it is still obliged to comply with Principle 10 (Clients’ assets).  

Same comment as Row 221.

6.1.16B
(1) The custody rules do not apply to a firm that is managing an AIF or managing a 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 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 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)).

Same comment as Row 221.

6.1.16C
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) keeps a record, which must then be retained for a period of 5 years after the record is made, of all the designated investments held in accordance with (1) and (2) together with the details of the clients concerned and of any action the firm has taken.

UK jurisdiction-specific rules.
243. **6.1.16DG**

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.

244. **Trustees and depositaries (except depositaries of AIFs and UCITS)**

- **6.1.16ER**
  - 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 trust in the course of MiFID business.

245. **Trustees and depositaries**

- **6.1.16FR**
  - 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 UCIT), 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.

<table>
<thead>
<tr>
<th>Reference</th>
<th>Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td>CASS 6.1.1 R to CASS 6.1.9 G and CASS 6.1.15 G to CASS 6.1.16C R</td>
<td>Trustees and depositaries</td>
</tr>
<tr>
<td>CASS 6.1.16G R to CASS 6.1.16I G</td>
<td>General purpose</td>
</tr>
<tr>
<td>CASS 6.1.17 to CASS 6.2.2 R</td>
<td>Protection of clients' safe custody assets</td>
</tr>
<tr>
<td>CASS 6.3.1 R and CASS 6.3.4B G</td>
<td>Distribution and recording of legal title</td>
</tr>
<tr>
<td>CASS 6.4.1 R and CASS 6.4.2 G</td>
<td>Depositing safe custody assets with third parties</td>
</tr>
<tr>
<td>CASS 6.5.1 R and CASS 6.5.2B G</td>
<td>Safe custody assets</td>
</tr>
<tr>
<td>CASS 6.6</td>
<td>Records, accounts and reconciliations</td>
</tr>
</tbody>
</table>

246. **6.1.16GG**

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

247. **Depositaries of AIFs**

- **6.1.16IAR**
  - Subject to (2), when a firm is acting as trustee or depositary of an AIF the firm need comply only with the custody rules in the table below.

<table>
<thead>
<tr>
<th>Reference</th>
<th>Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td>CASS 6.1.1 R, CASS 6.1.9 G, CASS 6.1.15 G and CASS 6.1.16IB G</td>
<td>Application</td>
</tr>
<tr>
<td>CASS 6.1.16I R to CASS 6.1.16I G</td>
<td>General purpose</td>
</tr>
<tr>
<td>CASS 6.1.17 to CASS 6.2.2 R</td>
<td>Protection of clients' safe custody assets</td>
</tr>
<tr>
<td>CASS 6.3.1 R and CASS 6.3.4B G</td>
<td>Distribution and recording of legal title</td>
</tr>
<tr>
<td>CASS 6.4.1 R and CASS 6.4.2 G</td>
<td>Depositing safe custody assets with third parties</td>
</tr>
<tr>
<td>CASS 6.5.1 R and CASS 6.5.2B G</td>
<td>Safe custody assets</td>
</tr>
<tr>
<td>CASS 6.6</td>
<td>Records, accounts and reconciliations</td>
</tr>
</tbody>
</table>

248. **6.1.16J**

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

249. **6.1.16K**

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

250. **6.1.16L**

- **Depositories of AIFs**
  - Subject to (2), when a firm is acting as trustee or depositary of an AIF the firm need comply only with the custody rules in the table below.

<table>
<thead>
<tr>
<th>Reference</th>
<th>Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td>CASS 6.1.1 R, CASS 6.1.9 G, CASS 6.1.15 G and CASS 6.1.16IB G</td>
<td>Application</td>
</tr>
<tr>
<td>CASS 6.1.16I R to CASS 6.1.16I G</td>
<td>General purpose</td>
</tr>
<tr>
<td>CASS 6.1.17 to CASS 6.2.2 R</td>
<td>Protection of clients' safe custody assets</td>
</tr>
<tr>
<td>CASS 6.3.1 R and CASS 6.3.4B G</td>
<td>Distribution and recording of legal title</td>
</tr>
</tbody>
</table>

UK jurisdiction-specific rules.
Records, accounts and reconciliations

(2) When a firm is acting as trustee or depositary 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:

<table>
<thead>
<tr>
<th>Reference</th>
<th>Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td>CASS 6.1.1R (2)</td>
<td>Application</td>
</tr>
<tr>
<td>CASS 6.1.1R (3)</td>
<td>General purpose</td>
</tr>
<tr>
<td>CASS 6.1.2R</td>
<td>Holding of client assets</td>
</tr>
<tr>
<td>CASS 6.1.2R</td>
<td>Records, accounts and reconciliations</td>
</tr>
</tbody>
</table>

UK jurisdiction-specific rules.

253.

(1) A firm (Firm A) to which another firm acting as trustee or depositary of a 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 UCITS for that UCITS scheme. CASS 6.1.16IDR will not apply to Firm A for that UCITS scheme.

UK jurisdiction-specific rules.
However, Firm A may be safeguarding and administering investments in respect of that UCITS scheme.

Arrangers

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

<table>
<thead>
<tr>
<th>Reference</th>
<th>Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td>CASS 6.1.1 R to CASS 6.1.9 G and CASS 6.1.15 G to CASS 6.1.108 R</td>
<td>Application</td>
</tr>
<tr>
<td>CASS 6.1.16J R</td>
<td>Arrangers</td>
</tr>
<tr>
<td>CASS 6.1.16K R</td>
<td>Records</td>
</tr>
<tr>
<td>CASS 6.1.22 G to CASS 6.1.24 G</td>
<td>General purpose</td>
</tr>
<tr>
<td>CASS 6.3.4A R and CASS 6.3.4B G</td>
<td>Third-party custody agreements</td>
</tr>
</tbody>
</table>

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.

6.1.24G

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

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.

The custody rules also, where relevant, implement the provisions of MiFID which regulate the obligations of a firm when it holds financial instruments belonging to a client in the course of its MiFID business.

An investment firm shall, when holding financial instruments belonging to a client, make adequate arrangements as to safeguard the ownership rights of clients, especially in the event of the investment firm's insolvency, and to prevent the use of a client's financial instruments on own account except with the client's express consent.

Regulation 23(1)(k) MiFID Regulations

(ii) the use of a client's financial instruments on own account, except with the client's express consent,

Regulation 23(1)(l) MiFID Regulations

(ii) prevent the use of client funds for the firm's own account, except in the case of credit institutions, prevent the use of client funds for the firm's own account.

A firm must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client safe custody assets, or of rights in connection with those assets, as a result of misuse.

Requirement to have adequate organisational arrangements

1. Member States shall require that investment firms comply with the following requirements:

(i) they must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client safe custody assets, or of rights in connection with those assets, as a result of misuse.

[Note: article 2(1)(f) of the MiFID Delighted Directive]
261. Registration and recording of legal title

6.2 IR

Subject to CASS 6.2.5A IR, a firm must effect appropriate registration or recording of legal title to a safe custody asset belonging to a client in the name of:

(a) 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;

(b) a nominee company which is controlled by:

(i) a firm;

(ii) an affiliated company;

(iii) a recognised investment exchange; or

(iv) a third party with whom financial instruments are deposited under CASS 6.5 (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

(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 in writing;

(4) the firm if:

(a) the firm is not a trust 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 in writing;

(5) the firm if:

(a) the firm 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 in writing;

(6) the firm if:

(a) the firm 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 in writing;

(7) the firm if:

(a) the firm 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 in writing;

(8) the firm if:

(a) the firm 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 in writing;

(9) the firm if:

(a) the firm 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 in writing;
asset account in respect of any sum owed to it by any person, including any other account of the investment firm,

(a) the third party will provide the investment firm with a statement or other form of confirmation as often as is required to enable the investment firm comply with Regulations 75(1) to 75(2) and such statement shall specify all client funds deposited with the third party for the investment firm, and

(b) the third party shall not make withdrawals from the third party client asset account other than by instruction received from an authorised person of the investment firm.

(2) In advance of opening a third party client asset account, an investment firm shall enter into an agreement with the third party (in this Part to be known as a "Financial Instruments Facilities Agreement") and the terms of such Financial Instruments Facilities Agreement shall be that—

(a) the investment firm and the third party acknowledge that client financial instruments in the third party client asset account are held by the investment firm in trust for the relevant clients,

(b) the third party shall hold and record client financial instruments separate from the investment firm’s own financial instruments and financial instruments of the third party,

(c) the third party will designate the name of the third party client asset account in its records in such a way as to make clear that the client financial instruments do not belong to the investment firm,

(d) the third party shall not permit the third party client asset account to be combined with any other account or to exercise any right of set-off or counterclaim against client financial instruments in that third party client asset account in respect of any sum owed to it by any person, except—

(i) to the extent of any charges relating to the administration or safekeeping of that client’s financial instruments, or

(ii) where that client of the investment firm has failed to settle a transaction by its due settlement date,

(e) the third party shall provide the investment firm with a statement or other form of confirmation as often as is required to enable the investment firm to comply with Regulations 95(3) and such statement shall specify all client financial instruments held and a description and the amount of all client financial instruments held in the third party client asset accounts.

262. 6.2.3A

A firm need not comply with CASS 6.2.3 R for any safe custody asset.

UK rules, while following the spirit of the purpose of the EU law is more prescriptive (including when compared to the Irish rules).
<table>
<thead>
<tr>
<th>Section</th>
<th>Text</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.2.3AR</td>
<td>(1) 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 arrangement 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.</td>
</tr>
<tr>
<td>6.2.6.2AR</td>
<td>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.</td>
</tr>
<tr>
<td>6.2.6.2BG</td>
<td>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.</td>
</tr>
<tr>
<td>6.2.6.3R</td>
<td>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.</td>
</tr>
<tr>
<td>6.2.6.4R</td>
<td>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.</td>
</tr>
<tr>
<td>6.2.6.5R</td>
<td>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.</td>
</tr>
<tr>
<td>6.2.6.6G</td>
<td>(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. Examples of where the conditions under CASS 6.2.5 R (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 any 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.</td>
</tr>
<tr>
<td>6.2.7AR</td>
<td>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.</td>
</tr>
</tbody>
</table>
CASS 6.2.8G to CASS 6.2.16G do not apply to a firm following its failure.

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.

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.

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 the 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.

Taking reasonable steps in CASS 6.2.10 R includes following this course of conduct:

- determining, as far as reasonably possible, the correct contact details for the relevant client;
- writing to the client at the last known address either by post or by electronic mail to inform it:
  - of the name of the firm with which the client first deposited the safe custody asset in question;
  - 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;
  - if 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;
- 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 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
  - 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;
- 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);
- 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:
  - if 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
  - an undertaking will be provided by the firm or a member of its group in writing 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;
  - 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);
- 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 utilized, the communication is unlikely to reach the client, the firm does not have to comply with (d); and
- waiting a further 28 days following the most recent communication before deciding to divest itself of the safe custody asset under CASS 6.2.10 R.

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

UK rules, while following the spirit of the purpose of the EU law is more prescriptive (including when compared to the Irish rules).
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.

(Please check specific sections for further details related to the provisions mentioned.)
investment firms should, as part of their due diligence, also take into account the expertise and market reputation of the other third parties to which the initial third party, with whom they might deposit financial instruments, may have delegated functions concerning the holding and safeguarding of financial instruments.

Recital 12 Commission Delegated Directive

Where investment firms place client funds with a third party, the investment firm should exercise all due skill, care and diligence in the selection, appointment and periodic review of the third party and of the arrangements for holding and safeguarding client funds, and should consider the need for diversification and mitigation of risks, where appropriate, by placing client funds with more than one third party in order to safeguard clients’ rights and minimise the risk of loss and misuse. Investment firms should not circumvent their duty to consider diversification by requiring clients to waive protection. Diversification requirement should apply to client funds deposited in accordance with Article 4 of this Directive. Diversification requirements should not apply to client funds placed with the third party merely for the purpose of executing a transaction for the client. Therefore where an investment firm has transferred client funds to a transaction account in order to make a specific transaction for the client, such funds should not be subject to a requirement to diversify, for example where a firm has transferred funds to a central counterparty (CCP) or exchange in order to pay a margin call.

Article 3(1) Commission Delegated Directive

Article 3 Depositing client financial instruments

1. Member States shall allow investment firms to deposit financial instruments held by them on behalf of their clients into an account or accounts opened with a third party provided that the firms exercise 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 safeguarding of those financial instruments.

6.3.2

In discharging its obligations under CASR 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;
(3) market practices related to the holding of the safe custody asset that could adversely affect clients’ rights;
(4) current industry standards reports, for example “Assurance reports on the services of third parties in relation to investment services” made in line with Technical Release AAR 01/06 of The Institute of Chartered Accountants in England and Wales or equivalent;
(5) the capital or financial resources of the third party;
(6) the credit-worthiness of the third party;
(7) any other activities undertaken by the third party and, if relevant, any affiliated company; and
(8) whether the third party has the appropriate regulatory permissions.

6.3.3

A firm shall, in its due diligence, take into account the expertise and market reputation of the third party and of the arrangements for the holding and safeguarding of financial instruments that could adversely affect clients’ rights.

(1) Where an investment firm proposes to deposit client financial instruments with a third party, the investment firm shall only deposit financial instruments with a third party in a jurisdiction where the safeguarding of financial instruments for the account of another person is subject to specific regulation and supervision and that third party is subject to this specific regulation and supervision.

(2) Investment firms shall not deposit financial instruments held on behalf of clients with a third party in a third country that does not regulate the holding and safeguarding of financial instruments for the account of another person unless one of the following conditions is met:

(a) the nature of the financial instruments or of the investment services connected with those instruments requires them to be deposited with a third party in that third country;
(b) the financial instruments are held on behalf of a professional client, that client requests the firm in writing to deposit them with a third party in that third country;
(c) the financial instruments are held on behalf of another person unless one of the following conditions is met:

(3) Investment firms shall take into account the expertise, market reputation and any specific regulation and supervision if the third party has delegated any of its functions concerning the holding and safeguarding of financial instruments to another third party.

(4) Investment firms shall take into account the expertise, market reputation of the third party as well as any legal requirements related to the holding of those financial instruments that could adversely affect clients’ rights.

(5) Where an investment firm proposes to deposit client financial instruments with a third party, the investment firm shall only deposit financial instruments with a third party in a jurisdiction where the safeguarding of financial instruments is subject to specific regulation and supervision and that third party is subject to this specific regulation and supervision.

The verification process should be followed by the firm each time a third party collection account is opened and not each time investor money is deposited in that particular third party collection account. Arising from Regulation 75(2), the third service provider has up to three working days after the initial deposit of the money to withdraw the money if the third party collection account is not correctly designated. This process of designation verification is a separate process to what is required under Regulation 75(2), which relates to ensuring that the third party collection account is set up in accordance with the provisions of the Investor Money Facilities Agreement.

Article 3

Depositing client financial instruments

2. Where an investment firm proposes to deposit client financial instruments with a third party, Member States shall ensure that this investment firm only deposits financial instruments with a third party in a jurisdiction where the safekeeping of financial instruments for the account of another person is subject to specific regulation and supervision and that third party is subject to this specific regulation and supervision.

3. Member States shall ensure that investment firms do not deposit financial instruments held on behalf of clients with a third party in a third country that does not regulate the holding and safekeeping of financial instruments for the account of another person unless one of the following conditions is met:

(a) the nature of the financial instruments or of the investment services connected with those instruments requires them to be deposited with a third party in that third country;

(b) where the financial instruments are held on behalf of a professional client, that client requests the firm in writing to deposit them with a third party in that third country.

4. Member States shall ensure that investment firms comply with the following requirements:

(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;

(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.

5. Member States shall ensure the requirements under paragraph 2 and 3 shall 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.

6.3.4A(4) 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.


1. Member States shall ensure that investment firms comply with the following requirements:

(a) they must take the necessary steps to ensure that any client financial instruments deposited with a third party, in accordance with Article 3, are identifiable separately from the financial instruments belonging to the investment firm and from financial instruments belonging to the 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.

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 conclusions and conclusions. The firm must make the record of 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.

6.3.4A A firm must have entered into a written agreement with any person to whom it deposits client's safe custody assets under CASS 5.1 R, or with whom it arranges safeguarding and administration of assets.

3. An investment firm shall not place in a third party client asset account any asset other than a client asset.

4. Member States shall ensure that investment firms do in relation to depositing client funds with a third party:

Broadly, conceptually equivalent provisions across the relevant rules.


1. Member States shall ensure that investment firms comply with the following requirements:

(a) they must take the necessary steps to ensure that any client financial instruments deposited with a third party, in accordance with Article 3, are identifiable separately from the financial instruments belonging to the investment firm and from financial instruments belonging to the 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.

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 conclusions and conclusions. The firm must make the record of 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.

3. An investment firm shall not place in a third party client asset account any asset other than a client asset.

4. Member States shall ensure that investment firms do in relation to depositing client funds with a third party:

Broadly, conceptually equivalent provisions across the relevant rules.

286. Third-party custody agreements

1. A firm must have entered into a written agreement with any person to whom it deposits client's safe custody assets under CASS 5.1 R, or with whom it arranges safeguarding and administration of assets.

2. Member States shall ensure that investment firms do in relation to depositing client funds with a third party:

Broadly, conceptually equivalent provisions across the relevant rules.

What should an investment firm do in relation to depositing client funds with a third party?
which are client’s 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 services(s) to which the third party is contracted to provide.

Except in accordance with Regulations 49(5), 49(7) or Regulation 78(3).

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) that 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;
7) the restrictions over the circumstances in which the third party may withdraw assets from the account;
8) the procedures and authorities for the passing of instructions to, or by, the firm;
9) the procedures for the claiming and receiving of dividends, interest payments and other entitlements accruing to the firm’s client; and
10) 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.

Funds facilities agreement and financial instruments facilities agreement:

55. In advance of opening a third party client asset account, an investment firm shall enter into an agreement with the third party (in this Part to be known as a “Funds Facilities Agreement”) and the terms of such Funds Facilities Agreement shall be that—

(a) the investment firm and the third party acknowledge that the client funds in the third party client asset account are held by the investment firm in trust for the relevant clients;
(b) the third party shall maintain a record of the client funds in the third party client asset account separate from the investment firm’s own funds and the funds of the third party;
(c) the third party will designate the name of the third party client asset account in its records in such a way as to make it clear that the client funds do not belong to the third party;
(d) the third party is not entitled to combine the third party client asset account with any other account and the third party is not entitled to exercise any right of set-off or connection against client funds in that third party client asset account in respect of any sum owed to it by any person, including any other account of the investment firm;
(e) the third party will provide the investment firm with a statement or other form of confirmation as often as is required to enable the investment firm to comply with Regulations 57(1) to 57(12) and such statement shall specify all client funds deposited with the third party for the investment firm, and
(f) the third party will not make withdrawals from the third party client asset account other than by instruction received from an authorised person of the investment firm.

In advance of opening a third party client asset account, an investment firm shall enter into an agreement with the third party (in this Part to be known as a “Financial Instruments Facilities Agreement”) and the terms of such Financial Instruments Facilities Agreement shall be that—

(a) the investment firm and the third party acknowledge that client financial instruments in the third party client asset account are held by the investment firm in trust for the relevant clients;
(b) the third party shall hold and record client financial instruments separate from the investment firm’s own

6.3.4BG

The Central Bank expects an investment firm to clearly document in its CAMP the procedures it would follow to carry out the reviews required by Regulations 5(14), 5(15), 5(17) and 5(18). The investment firm should clearly explain to the client, that the third party in question does not meet the investment firm’s internal assessment. If the client wishes to continue, the client’s written consent should be obtained prior to depositing the client’s assets with that specific third party (refer to Regulation 7(14)).

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Broadly, conceptually equivalent provisions across the relevant rules.
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:

(ii) the security interest, lien or right of set-off is granted by applicable law in a third country jurisdiction in which the safe custody assets are held;

(iii) the firm has taken reasonable steps to determine that holding safe custody assets is in the best interests of the firm; or

(iv) the client has failed to settle a transaction by its due settlement date, and

(v) the third party will provide the investment firm with a statement or other form of confirmation as often as is required to enable the investment firm to comply with Regulation 57(3) and such statement shall specify all client financial instruments held and a description and the amount of all client financial instruments held in the third party client asset accounts.

Member States shall ensure that security interests, liens or rights of set-off over client financial instruments or funds enabling a third party to dispose of or recover debts or charges which are not client’s debts or charges, investment firms should be able to agree to security interests, liens or rights of set-off over client assets only where this is required by the applicable law in a third country. Sufficiently tailored risk disclosures should be made to clients in order to alert them to the specific risks they face in such cases.

Broadly, conceptually equivalent provisions across the relevant rules save for UK specific application to security interests – see comments in Annex 2 on the UK-specific concepts in the UK FCARs.
| 291. | 11 | Under CASS 6.5.6AR(2) a security interest, lien or right of set-off may be regarded as being required by applicable law in a third country for example when: (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) these 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 6.5.6AR(1)(ii) that is wider than that under CASS 6.5.6AR(1)(i) where another person in a third country simply requests or demands this as a condition of business. | 292. | 6.19. | CASS 6.5.6AR 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) paragraphs (d) of CASS 7 Annex 2R; or (2) paragraphs (e) or (f) of CASS 7 Annex 3R; or (3) paragraph (c) of CASS 7 Annex 4B. | 293. | Recital 8 Commission Delegated Directive | (1) The written terms of the 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) 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. | 6.4.1R. | (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 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. [Note: article 5(1) and (2) of the MiFID Delegated Directive] | Regulation 62 EIR 2017 | Client consent requirements | 62. (1) An investment firm shall obtain the prior written consent of a client in the following circumstances, as applicable: (a) where granting to another person a lien, security interest and/or right of set-off over client assets; (b) with respect to the arrangements for the giving and receiving of instructions by, or on behalf of, the client and any limitations to that authority, in respect of the provision of safekeeping services which it provides; (c) where client assets are deposited with a third party outside the firm; (d) when a client instructs an investment firm to deposit client assets with a specific third party that does not meet the investment firm’s internal risk assessment; (e) where client assets are to be held in a pooled account with a third party; (f) where interest earned on client funds in a third party client asset account is to be retained by the investment firm; (g) where client financial instruments are to be deposited with a third party.
consented to use of their securities. When an investment firm is acting on a client instruction to lend financial instruments and where this constitutes consent to entering into the transaction, the investment firms should hold evidence to demonstrate this.

**Article 5(1) and (2) Commission Delegated Directive**

**Article 5**

**Use of client financial instruments**

1. Member States shall not allow investment firms to enter into arrangements for securities financing transactions in respect of financial instruments held by them on behalf of a client, or otherwise use such financial instruments for their own account or the account of any other person or client of the firm, unless both of the following conditions are met:

   (a) the client has given his prior express consent to the use of the instruments on specified terms, as clearly evidenced in writing and affirmatively executed by signature or equivalent, and

   (b) the use of that client's financial instruments is restricted to the specified terms to which the client consents.

2. Member States shall not allow investment firms to enter into arrangements for securities financing transactions in respect of financial instruments which are held on behalf of a client in an omnibus account maintained by a third party, or otherwise use financial instruments held in such an account for their own account or for the account of any other person unless, in addition to the conditions set out in paragraph 1, at least one of the following conditions is met:

   (a) each client whose financial instruments are held together in an omnibus account must have given prior express consent in accordance with point (a) of paragraph 1;

   (b) the investment firm must have in place systems and controls which ensure that only financial instruments belonging to clients who have given prior express consent in accordance with point (a) of paragraph 1 are so used.

The records of the investment firm shall include details of the client on whose instructions the use of the financial instruments has been effected, as well as the number of financial instruments used belonging to each client who has given his consent, so as to enable the correct allocation of any loss.

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<tr>
<th>Paragraph</th>
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<tbody>
<tr>
<td>1a</td>
<td>The client has given prior express consent to the use of the instruments on specified terms, as clearly evidenced in writing and affirmatively executed by signature or equivalent.</td>
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<tr>
<td>1b</td>
<td>The use of the client's financial instruments is restricted to the specified terms to which the client consents.</td>
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<tr>
<td>2a</td>
<td>Each client whose financial instruments are held together in an omnibus account must have given prior express consent in accordance with point (a) of paragraph 1.</td>
</tr>
<tr>
<td>2b</td>
<td>The investment firm must have in place systems and controls which ensure that only financial instruments belonging to clients who have given prior express consent in accordance with point (a) of paragraph 1 are so used.</td>
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**Recital of Commission Delegated Directive**

Prior express consent by clients should be given and recorded by investment firms in order to allow the investment firm to demonstrate clearly what the client agreed to and to help clarify the status of client assets. However, no legal requirement should be set out in respect of the

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</tr>
<tr>
<td>1b</td>
<td>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.</td>
</tr>
</tbody>
</table>
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:

(a) the conclusion of agreements with clients on measures to be taken by the investment 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;
(b) the close monitoring by the investment firm of its projected ability to deliver on the settlement date; and
(c) 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]

Member States shall ensure that investment firms take appropriate measures to prevent the unauthorised use of client financial instruments for their own account or the account of any other person such as:

(a) the conclusion of agreements with clients on measures to be taken by the investment 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;
(b) the close monitoring by the investment firm of its projected ability to deliver on the settlement date; and
(c) the close monitoring and prompt requesting of undelivered securities outstanding on the settlement day and beyond.

[Note: recital 10 to the MiFID Delegated Directive]

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

P.4.1DG

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.

[Note: paragraph 1(1) of Regulation 11 IMR 2017 – Client Borrowing]

11. (1) An investment business firm shall not provide credit to a client except where the provision of credit is in accordance with the investment business firm’s credit policy and is for the purpose of—

(a) settling a securities transaction on a regulated market in the event of default or late payment by the client, or
(b) paying an amount to cover a margin call made on a collateral margined transaction on behalf of an officer or employee of the investment business firm.

Where a situation referred to paragraph (1) occurs, the investment business firm shall, in accordance with its terms of business or the relevant investment management agreement, close out the relevant position as soon as possible.

(2) Before entering into a collateral margined transaction on behalf of a client, an investment business firm shall—

(a) take account of—
(i) the financial resources available to the client, and
(ii) whether the client would be in a position to meet margin calls and fund a loss on the transaction.

(3) Where an investment business firm enters into a collateral margined transaction on behalf of an officer or employee of the investment business firm and such a position is outstanding and shows a loss, the investment business firm shall—

Broadly, conceptually equivalent provisions across the relevant rules.
Article 6.4 Commission Delegated Directive

Member States shall ensure that investment firms 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 client instruments.

6.4.2AR
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 9(6) of the MiFID Delegated Directive]

6.4.2BG
Broadly, conceptually equivalent provisions across the relevant rules.

Collateral margined transactions
6.4.3R
(1) With respect to collateral margined transactions, an investment firm, in advance of depositing collateral with, or pledging, charging or granting a security arrangement over the collateral to, a relevant party or eligible custodian, shall—
(a) verify the creditworthiness of the relevant party or eligible custodian that the investment firm—
(i) is under an obligation to keep the collateral separate from the investment firm’s collateral, and
(ii) that the relevant party or eligible custodian must not claim any lien or right of retention or sale over the collateral except to cover the obligations to the relevant party or eligible custodian which gave rise to that deposit, pledge, charge or security arrangement, or any charges relating to the administration or safekeeping of the collateral,
(b) instruct the relevant party or eligible custodian that—
(i) the value of the collateral passed by the investment firm on behalf of clients must be credited to the investment firm’s third party client asset account with the relevant party or eligible custodian, (ii) where collateral has been passed and the initial margin has been liquidated to satisfy margin requirements, any balance of the sale proceeds that is not a margin requirement must be paid into a third party client asset account without delay; and
(iii) where collateral is passed to an exchange or clearing house, any balance of the sale proceeds that is not a margin requirement must be dealt with in accordance with the rules of the relevant exchange or clearing house.
(c) ensure that a client’s fully paid (non-collateral) financial instruments and a client’s margin financial instruments will be held in separate third party client asset accounts with the relevant party or eligible custodian and that no right of set-off will apply to either of these accounts.

(2) An investment firm shall not use one client’s collateral to secure the obligations of another client or another person, unless legally enforceable agreements to do so are in place.

300. Recital 9 Commission Delegated Directive
In order to ensure appropriate protection for clients in relation to securities financing transactions (SFTs), investment firms should adopt specific arrangements to ensure that the borrower of client assets provides the appropriate collateral and that the firm monitors the continued appropriateness of such collateral. Investment firms’ duty to monitor collateral should apply where they are party to an SFT agreement, including where acting as an agent for the conclusion of a securities financing transaction, including when acting as an agent for the conclusion of a securities financing transaction in the case of a tripartite transaction between a borrower, a client and the firm.

[Note: recital 9 to the MiFID Delegated Directive]

Collateral margined transactions
55. (1) With respect to collateral margined transactions, an investment firm, in advance of depositing collateral with, or pledging, charging or granting a security arrangement over the collateral to, a relevant party or eligible custodian, shall—
(a) verify the creditworthiness of the relevant party or eligible custodian that the investment firm—
(i) is under an obligation to keep the collateral separate from the investment firm’s collateral, and
(ii) that the relevant party or eligible custodian must not claim any lien or right of retention or sale over the collateral except to cover the obligations to the relevant party or eligible custodian which gave rise to that deposit, pledge, charge or security arrangement, or any charges relating to the administration or safekeeping of the collateral,
(b) instruct the relevant party or eligible custodian that—
(i) the value of the collateral passed by the investment firm on behalf of clients must be credited to the investment firm’s third party client asset account with the relevant party or eligible custodian, (ii) where collateral has been passed and the initial margin has been liquidated to satisfy margin requirements, any balance of the sale proceeds that is not a margin requirement must be paid into a third party client asset account without delay; and
(iii) where collateral is passed to an exchange or clearing house, any balance of the sale proceeds that is not a margin requirement must be dealt with in accordance with the rules of the relevant exchange or clearing house.
(c) ensure that a client’s fully paid (non-collateral) financial instruments and a client’s margin financial instruments will be held in separate third party client asset accounts with the relevant party or eligible custodian and that no right of set-off will apply to either of these accounts.

(2) An investment firm shall not use one client’s collateral to secure the obligations of another client or another person, unless legally enforceable agreements to do so are in place.

301. Article 5(2) second subparagraph Commission Delegated Directive
The records of the investment firm shall include details of the client on whose instructions the use of the safe custody assets has been effected, as well as the number of financial instruments used belonging to each client who has given his

5.4.1R
Broadly, conceptually equivalent provisions across the relevant rules.
6.6.5G A firm must maintain a client safe custody asset record.

Section 6.6.4R of the CASS 6.6.4G specifies that a firm must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the financial instruments and funds held for clients and that they may be used as an audit trail.

Para. 6.6.3G Schedule 3 MiFID Regulations

Section 6.6.2G of the CASS 6.6.2G sets out the requirements that a firm must meet when keeping records and accounts of the safe custody assets it holds for clients. These requirements should be kept separate from the firm's own assets and should be recorded in a way that enables the correct allocation of any loss.

Para. 1(c) Schedule 3 MIID Regulations

Section 6.6.1G of the CASS 6.6.1G sets the requirements a firm must meet when keeping records and accounts of the safe custody assets it holds for clients. These requirements should be kept separate from the firm's own assets and should be recorded in a way that enables the correct allocation of any loss.

Section 6.6.3G of the CASS 6.6.3G states that a firm must keep such records and accounts as necessary to enable it to identify at any time and without delay any safe custody assets held for one client from assets held for any other client and from those of any third parties by whom those assets are held.
may have deposited, or through whom it may have registered legal title to, clients' safe custody assets.

(2) 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

6.6.6R
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

6.6.7R
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.

CASS 6.6.8R
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 was carried out; and

(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

6.6.9G
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

6.6.10G
(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.

Impaired by: Article 23 (1)(a) MiFID II Regulations

23. (1) An investment firm shall—

(a) establish adequate policies and procedures sufficient to ensure compliance of the investment firm and the persons who are its managers, employees and tied agents with—

(i) the investment firm's obligations under these Regulations, and

(ii) the appropriate rules governing personal transactions by such persons (that is to say, the arrangements required under Article 29 of Commission Delegated Regulation 2017/535 to be established, implemented and maintained),

(b) have adequate policies and procedures to ensure compliance of the firm with its obligations under this Directive as well as appropriate rules governing personal transactions by such persons,

(c) maintain adequate policies and procedures to ensure compliance of the firm with the requirements of the Directive and the associated regulations,

(d) maintain sufficient policies and procedures to ensure that it is able to identify, mitigate and manage shortfalls in the firm's arrangements in compliance with the relevant provisions of this Directive and the associated regulations,

(e) maintain adequate policies and procedures to ensure that it is able to identify, mitigate and manage shortfalls in the firm's arrangements in compliance with the relevant provisions of the Directive and the associated regulations, and

(f) have adequate policies and procedures to ensure compliance of the firm with the requirements of the Directive and the associated regulations.

Conceptual divergence exists in that the UK regime is much more focused on applying the obligation to establish, implement and maintain adequate policies to that as it applies to client asset and custody reconciliations and the identification, mitigation and management of shortfalls.

6.6.10AR
CASS 6.6.11R does not apply to a firm following its failure.

Same comment as in Row 309.

6.6.10BG
CASS 6.6.46AR (Frequency of checks and reconciliations after failure) applies to a firm following its failure.

Same comment as in Row 309.

6.6.11R
(1) A firm must perform an internal custody record check.

Same comment as in Row 309.
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| 314. | **6.6.11G**
|   | 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. |
|   |   | Same comment as in Row 309. |
| 315. | **6.6.12R**
|   | 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. |
|   |   | Same comment as in Row 309. |
| 316. | **6.6.13R**
|   | A firm must only use its internal records (for example its deposit and client-specific ledgers for safe custody assets or other internal accounting records) in order to perform an internal custody record check. |
|   |   | Same comment as in Row 309. |
| 317. | **6.6.14G**
|   | 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. |
|   |   | Same comment as in Row 309. |
| 318. | **6.6.15R**
|   | The internal custody reconciliation method for internal custody record checks. |
|   |   | Same comment as in Row 309. |
| 319. | **6.6.16G**
|   | 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. |
|   |   | Same comment as in Row 309. |
| 320. | **6.6.17G**
|   | The internal system evaluation method for internal custody record checks. |
|   |   | Same comment as in Row 309. |
| 321. | **6.6.18G**
<p>|   | 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 all accounts and controls correctly identify and resolve all discrepancies in its internal records and accounts of safe custody assets held by the firm for clients. |
|   |   | Same comment as in Row 309. |</p>
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<tr>
<td>322.</td>
<td>(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. Same comment as in Row 309.</td>
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<td>322.</td>
<td>6.6.22G</td>
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<td>323.</td>
<td>6.6.20G</td>
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<td>324.</td>
<td>6.6.21G</td>
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<td>325.</td>
<td>6.6.22R</td>
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<td>326.</td>
<td>6.6.44 R</td>
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<td>327.</td>
<td>6.6.45 R</td>
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<td>328.</td>
<td>6.6.46 R</td>
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<td>329.</td>
<td>6.6.47 R</td>
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<tr>
<td>330.</td>
<td>6.6.48 R</td>
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6.6.24R
(1) 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 total count method for that physical asset reconciliation.

6.6.28R
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.

6.6.29G
(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.

6.6.30R
(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.

6.6.31G
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 "bumping and larding" in respect of all the physical safe custody assets held by the firm for clients and across all the firm's business lines.

6.6.32G
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).

6.6.33G
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.

6.6.34R
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.

Article 2(1)(c) Commission Delegated Directive
1. Member States shall require that investment firms comply with the following requirements:
   (c) they must conduct, on a regular basis, reconciliations between their internal accounts and records and those of any third parties by whom those assets are held;
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 in 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.

A fund service provider should reconcile each third party collection account in the currency of denomination; dormant accounts should also be included.

Examples of the sorts of third parties referred to at CASS 6.6.35 R (2)(a) include central securities depositaries, operators of collective investment schemes, and administrators of offshore funds.

CASS 6.6.35R does not apply to a firm following its failure.

CASS 6.6.46AR (Frequency of checks and reconciliations after failure) applies to a firm following its failure.

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.

A firm holds clients’ safe custody assets electronically with a central securities depositary 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 these assets.
6.6.41G If a firm acting as trustee or depositary 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.

Same comment as in Row 369.

6.6.41AG If a firm acting as trustee or depositary of a 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.

Same comment as in Row 369.

6.6.42G 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, other than of the safe custody assets themselves, will not satisfy the requirement under CASS 6.6.34 R.

Same comment as in Row 369.

6.6.43G 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.

Same comment as in Row 369.

6.6.44R When determining the frequency at which it will undertake its internal custody record checks under CASS 6.6.11R, 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.

Same comment as in Row 369.

6.6.45R 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.

Same comment as in Row 369.

6.6.46R When determining the frequency at which it will undertake its internal custody record checks under CASS 6.6.11R, 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.

Same comment as in Row 369.
6.6.45R
(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.
(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.

Same comment as in Row 309.

6.6.46R
(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.

Same comment as in Row 309.

6.6.46AR
(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) regularly as is necessary to ensure that the firm remains in compliance with CASS 6.6.11 R, CASS 6.6.22 R and CASS 6.6.37 R (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.

Same comment as in Row 309.

6.6.46BG
(1) The reference point for the internal custody record check and physical asset reconciliation under CASS 6.6.46AR(2) and the external custody reconciliation under 6.6.46AR(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 6.6.46AR(2) and any further external custody reconciliations under 6.6.46AR(3)(a) can be determined by the firm.

Same comment as in Row 309.

6.6.47G
(1) Independence of person performing checks and reconciliations

Same comment as in Row 309.
<table>
<thead>
<tr>
<th>Section</th>
<th>Text</th>
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<tr>
<td>358.</td>
<td><strong>Resolution of discrepancies</strong> 6.6.49G</td>
<td>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).</td>
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<tr>
<td>360.</td>
<td>6.6.49R</td>
<td>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.</td>
</tr>
<tr>
<td>361.</td>
<td>6.6.50G</td>
<td>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.</td>
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<tr>
<td>362.</td>
<td>6.6.50R</td>
<td>When 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 recurrence 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).</td>
</tr>
<tr>
<td>363.</td>
<td>6.6.52G</td>
<td>Items recorded or held within a suspense or error account fall within the scope of discrepancies in this section.</td>
</tr>
<tr>
<td>364.</td>
<td>6.6.53G</td>
<td>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.</td>
</tr>
<tr>
<td>365.</td>
<td><strong>Treatment of shortfalls</strong> 6.6.54R</td>
<td>(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; (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 clients 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 and hold it for the relevant clients as client money under the client money rules and, in doing so.</td>
</tr>
</tbody>
</table>
(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.

6.6.56G

In considering whether it should notify affected clients under CASS 6.6.54R (5), 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).

6.6.57G

(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 it relates to a particular safe custody asset not 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.

6.6.58G

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

6.6.59G

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) its a firm acting as trustee or depositary of a UCITS and has not complied with, or is materially unable to comply with:
(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

Same comment as in Row 309.
6.7.4E Para. 7 of Schedule 3 of MiFID Regulations

Same comment as in Row 580.

6.7 Treatment of custody assets after a failure

Application

6.7.1B This section applies to a firm following its failure.

Same comment as in Row 580.

6.7.2E Disposal of safe custody assets

6.7.2R (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 22B of the RBSA Regulations to set a “hard bar date” by giving a “hard bar date notice”, or using another similar procedure in accordance with the legal procedure for the firm’s failure.

Same comment as in Row 580.

6.7.4E (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 22B of the RBSA Regulations to set a “hard bar date” by giving a “hard bar date notice”, or using another similar procedure in accordance with the legal procedure for the firm’s failure.

Same comment as in Row 580.

6.7.7E (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 22B of the RBSA Regulations to set a “hard bar date” by giving a “hard bar date notice”, or using another similar procedure in accordance with the legal procedure for the firm’s failure.

Same comment as in Row 580.

6.7.9E (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 22B of the RBSA Regulations to set a “hard bar date” by giving a “hard bar date notice”, or using another similar procedure in accordance with the legal procedure for the firm’s failure.

Same comment as in Row 580.

6.7.11E (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 22B of the RBSA Regulations to set a “hard bar date” by giving a “hard bar date notice”, or using another similar procedure in accordance with the legal procedure for the firm’s failure.

Same comment as in Row 580.
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).

6.7.4H
For the purposes of CASS 6.7.4H(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.

6.7.4I
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).

6.7.5G
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.

6.7.6R
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).

6.7.7R
(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:
(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 6.7.4E(1)(a), 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.

6.7.8R
(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.

6.7.9G
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.

6.7.10
Same comment as in Row 309.

6.7.11
Same comment as in Row 309.

6.7.12
Same comment as in Row 309.

Chapter 7
Same comment as in Row 309.
Client money rules

7.10 Application and purpose

7.10.1R This chapter applies to a firm that receives money from or holds money for, or on behalf of, a client in the course of, or in connection with, its:

(1) MiFID business; and/or
(2) designated investment business; and/or
(3) stocks and shares ISA business; and/or
(4) innovative finance ISA business; and/or
(5) lifetime ISA business, unless otherwise specified in this section.

7.10.2G A firm is reminded that when CASS 7.10.1 R applies it should treat client money in an appropriate manner so that, for example:

(1) if it holds client money in a client bank account that account is held in the firm’s name in accordance with CASS 7.13.13 R;
(2) if it allows another person to hold client money this is effected under CASS 7.14; and
(3) its internal client money reconciliation takes into account any client equity balance relating to its margined transaction requirements.

Opt-in to the client money rules

7.10.3R (1) A firm that receives or holds money to which this chapter applies in relation to:

(a) its MiFID business; or
(b) its MiFID business and its designated investment business which is not MiFID business;

and holds money in respect of which CASS 5 applies, may elect to comply with the provisions of this chapter in respect of all such money and if it does so, this chapter applies as if all such money were money that the firm receives and holds in the course of, or in connection with, its MiFID business.

(2) A firm that receives or holds money to which this chapter applies solely in relation to its designated investment business which is not MiFID business and receives or holds money in respect of which the insurance client money chapter applies, may elect to comply with the provisions of this chapter in respect of all such money and if it does so, this chapter applies as if all such money were money that the firm receives and holds in the course of, or in connection with, its designated investment business.

(2A) (a) A firm may elect to comply with all the provisions of this chapter for money that it receives or holds in respect of an ISA that only contain a cash deposit ISA.

(b) Where a firm makes an election under (a), this chapter applies to it in the same way that it applies to a firm who receives and holds money in the course of, or in connection with, its MiFID business.

(3) A firm must make and retain a written record of any election it makes under this rule, including the date from which the election is to be effective. The firm must make the record on the date it makes the election and must keep it for a period of five years after ceasing to use it.

(4) This rule is subject to CASS 1.2.11 R.

7.10.4G Firms are reminded that, under CASS 1.2.11 R, they must not keep money in respect of which the client money chapter applies in the same client bank account or client transaction account for money for which the insurance client money chapter applies.

Opt-in to the client money rules

7.10.3AR Where a firm opts into this chapter under CASS 7.10.3 R it must notify clients for whom it holds the opt-in money that it is holding their money in accordance with the client money rules.

7.10.5G The opt-in to the client money rules under CASS 7.10.3R does not apply in respect of money that a firm holds outside of either the (1) scope of the insurance client money chapter; or (2) relevant cash deposit ISA wrapper.
If a firm has opted to comply with this chapter under CASS 7.10.3R, the insurance client money chapter will have no application to the activities to which the election applies.

A firm that is only subject to the insurance client money chapter may not opt to comply with this chapter under either or both CASS 7.10.3R(1) and CASS 7.10.3R(2).

Under CASS 7.10.3R(2A), a firm may opt to comply with this chapter regardless of whether it is otherwise subject to the client money rules.

(1) If both the conditions in (a) and (b) below are met in respect of a firm, or the firm reasonably expects that they will all be met in the future, then the firm has the option to elect to comply with this chapter for all of the money described in those conditions:
(a) the firm receives or holds money for one or more persons in the course of, or in connection with, the firm’s activity of operating an electronic system in relation to non-P2P agreements; and
(b) those persons are customers of the firm in their capacity as lenders under non-P2P agreements or prospective lenders under non-P2P agreements.

(2) A firm can only make the election under (1) by informing the FCA in writing of the election at least one month before the date on which it intends to start holding the money in accordance with the client money rules (“the effective date”).

(3) The communication in (2) must specify the effective date.

(4) The firm may change the effective date after it has made the communication in (2) provided that:
(a) it informs the FCA in writing before the new effective date; and
(b) the new effective date is not less than one month after the date of the communication in (2).

When a firm makes an election under CASS 7.10.7AR it must write to any customer (“C”) with whom it has agreed to provide relevant electronic lending services in C’s capacity as a lender or prospective lender, informing C at least one month before it will start to hold the money in accordance with the client money rules:
(a) that all the money it holds in the course of, or in connection with, operating an electronic system in relation to non-P2P agreements for lenders and prospective lenders under non-P2P agreements will be treated in accordance with the client money rules; and
(b) of the date on which this will start.

The firm must also write to any customer (“C”) with whom, following the firm’s election, it agrees to provide relevant electronic lending services in C’s capacity as a lender or prospective lender:
(a) the firm must make this communication in advance of it receiving any money from or on behalf of C; and
(b) the communication must inform C that all the money the firm holds in the course of, or in connection with, operating an electronic system in relation to non-P2P agreements for lenders and prospective lenders under non-P2P agreements will be treated in accordance with the client money rules from the date specified under (1)(b) or, if that date has passed, that this will be the case from the time of the communication onwards.

Once an election made by a firm under CASS 7.10.7AR becomes effective, and until it ceases to be effective:
(1) the firm must treat all the money referred to under CASS 7.10.7AR in accordance with the election; and
(2) for the purposes of (1), this chapter applies to the firm in the same way that it applies to a firm that receives and holds money in the course of or in connection with its designated investment business, except that:
(a) CASS 7.10.10R will not apply to the money referred to under CASS 7.10.7AR(1); and
(b) “client” for the purposes of CASS and rules and guidance related to CASS and their application to the firm includes customers of the firm in their capacity as lenders or prospective lenders under non-P2P agreements.
7.10.7DR
If a firm that has made an election under CASS 7.10.7AR subsequently decides to cancel that election:
(1) it can only do so by writing to the FCA, at least one month before the date the election ceases to be effective;
(2) it must write to any customer with whom, as at the time of the cancellation, it has agreed to operate an electronic system in relation to non-P2P agreements in their capacity as a lender or prospective lender, informing them at least one month before the date the election ceases to be effective:
   (a) of the extent to which it will cease to hold their money in accordance with the client money rules; and
   (b) of the date from which those changes will take effect; and
(3) it must write to any customer ("C") with whom, following the firm's decision to cancel the election but before the election ceases to be effective, it agrees to operate an electronic system in relation to non-P2P agreements in C's capacity as a lender or prospective lender, in advance of the firm receiving any money from them or on their behalf, informing them:
   (a) of the period during which it will continue to hold all the money of lenders and prospective lenders under non-P2P agreements in accordance with the client money rules;
   (b) of the extent to which it will subsequently cease to hold their money in accordance with the client money rules; and
   (c) of the date from which those changes will take effect.

7.10.7ER
(1) A firm must make and retain a written record of any election it makes under CASS 7.10.7AR including:
   (a) the date from which the election is to be effective; and
   (b) if it cancels the election, the date from which the election is to cease to be effective.
(2) The firm must:
   (a) make the record on the date it makes the election;
   (b) update the record if it decides to cancel the election or change the effective date; and
   (c) keep the record for a period of five years after ceasing to use the election.

7.10.8R
CASS 7.10.9 G to CASS 7.10.15 G do not apply to a firm in relation to money held in connection with its MiFID business to which this chapter applies or in relation to money for which the firm has made an election under CASS 7.10.3 R(1) or CASS 7.10.7AR.

7.10.9G
Same comment as in Row 387.

Professional client opt-out
7.10.9G
Same comment as in Row 387.
The 'opt out' provisions provide a firm with the option of allowing a professional client to choose whether their money is subject to the client money rules (unless the firm is conducting insurance distribution activity).

| 395. | 7.10.1R | Subject to CASS 7.10.12 R, money is not client money when a firm (other than a sole trader) holds that money on behalf of, or receives it from, a professional client, other than in the course of insurance distribution activity, and the firm has obtained written acknowledgement from the professional client that:

1. money will not be subject to the protections conferred by the client money rules;
2. as a consequence, this money will not be segregated from the money of the firm in accordance with the client money rules and will be used by the firm in the course of its own business; and
3. the professional client will rank only as a general creditor of the firm. |

Same comment as in Row 387.

| 395. | Opt out for non-MiFID business |

| 7.10.1G | For a firm whose business is not governed by the IDD, it is possible to 'opt out' on a one-way basis. However, in order to maintain a comparable regime to that applying to MiFID business, all MiFID type business undertaken outside the scope of MiFID should comply with the client money rules or be 'opted out' on a two-way basis. |

Same comment as in Row 387.

| 396. | 7.10.1R | Money is not client money if a firm, in respect of designated investment business which is not an investment service or activity, an ancillary service, a listed activity or insurance distribution activity:

1. holds it on behalf of or receives it from a professional client who is not an authorised person; and
2. has sent a separate written notice to the professional client stating the matter set out in CASS 7.10.10 R (1) to CASS 7.10.10 R (3). |

Same comment as in Row 387.

| 396. | 7.10.1G | When a firm undertakes a range of business for a professional client and has separate agreements for each type of business undertaken, the firm may treat client money held on behalf of the client differently for different types of business: for example, a firm may, under CASS 7.10.10 R or CASS 7.10.12 R, elect to segregate client money in connection with securities transactions and not segregate (by complying with CASS 7.10.10 R or CASS 7.10.12 R) money in connection with contingent liability investments for the same client. |

Same comment as in Row 387.

| 397. | 7.10.1R | When a firm transfers client money to another person, the firm must not enter into an agreement under CASS 7.10.10 R or CASS 7.10.12 R with that other person in relation to that client money or represent to that other person that the money is not client money. |

Same comment as in Row 387.

| 397. | 7.10.1G | Accordingly, when a firm receives client money from another person for a professional client, it must:

1. either:
   a. ensure that money received is client money; and
   b. if it is not client money, take reasonable care to ensure that it is:
      i. identified as client money;
      ii. segregated from the firm’s own money; and
      iii. if necessary, transferred to another person in accordance with the client money rules.

2. as a consequence, this money will not be segregated from the money of the firm in accordance with the client money rules; and
3. the professional client will rank only as a general creditor of the firm. |

Same comment as in Row 387.

| 400. | | 

| Article 15 MiFID II | Organisational requirements

9. An investment firm shall, when holding funds belonging to clients, make adequate arrangements to safeguard the rights of clients and, except in the case of credit institutions, prevent the use of client funds for its own account.

Recital 13 Commission Delegated Directive

In order to ensure that client funds are adequately protected, as required by Article 16(5) of Directive 2014/65/EU, it is necessary to set a specific limit on the percentage of client funds that can be deposited at an intra-group credit institution. This should significantly reduce any potential conflicts with the due diligence requirements and address the contagion risk.

Credit institutions and approved banks

7.10 HR

In relation to the application of the client money rules (and any other rules to the firms referred to in (1) and (2)), the following is not client money:

1. any deposits within the meaning of the CRD held by a CRD credit institution; and
2. any money held by an approved bank that is not a CRD credit institution in an account with itself in relation to designated investment business carried on for its clients.

Para. 3 of Schedule 3 of MiFID Regulations

Dealing in client funds

5. (1) Investment firms are required, on receiving any client funds, promptly to place those funds into one or more accounts opened with any of the following:

(a) a Central Bank;
(b) a credit institution authorised in accordance with Directive 2013/36/EU; or
(c) a bank authorised in a third country;
(d) a qualifying money market fund.

(2) Subparagraph (1) shall not apply to a credit institution authorised in accordance with Directive 2013/36/EU.
inherent in depositing all client funds with a credit institution in the same group as the investment firm. While in certain circumstances it may be proportionate and appropriate for investment firms to deposit, after proper consideration, client funds with entities within their own group, national authorities should closely monitor the reasons for not diversifying client funds outside of the investment firm’s group in order to avoid creating loopholes where the general intragroup limit is applied.

Article 4 Commission Delegated Directive Depositing client funds

1. Member States shall require investment firms, on receiving any client funds, promptly to place those funds into one or more accounts opened with any of the following:
   (a) a central bank;
   (b) a credit institution authorised in accordance with Directive 2013/36/EU of the European Parliament and of the Council (7);
   (c) a bank authorised in a third country;
   (d) a qualifying money market fund.

The first subparagraph shall not apply to a credit institution authorised under Directive 2013/36/EU in relation to deposits within the meaning of that Directive held by that institution.

(3) Where investment firms do not deposit client funds with a central bank, they shall exercise all due skill, care and diligence in the selection, appointment and periodic review of the credit institution, bank or money market fund where the funds are placed and the arrangements for the holding of those funds and they consider the need for diversification of those funds as part of their due diligence.

(4) In particular, investment firms shall take into account the expertise and market reputation of such institutions or money market funds with a view to ensuring the protection of clients’ rights as well as any legal or regulatory requirements or market practices related to the holding of client funds that could adversely affect clients’ rights.

(5) Investment firms shall ensure that clients give their explicit consent to the placement of their funds in a qualifying money market fund. In order to ensure that this right to consent is effective, investment firms shall inform clients that funds placed with a qualifying money market fund will not be held in accordance with the requirements for safeguarding client funds set out in this Schedule.

(6) Where investment firms deposit client funds with a credit institution, bank or money market fund of the same group as the investment firm, they shall limit the funds that they deposit with any such group entity so that funds do not exceed 20% of all such funds.

(7) An investment firm is not required to comply with the foregoing limit where it is able to demonstrate to the Bank that, in view of the nature, scale and complexity of its business, and also the safety offered by the third parties considered in the preceding subparagraph, and including in any case the small balance of client funds the investment firm holds the requirement under the preceding subparagraph is not proportionate. Investment firms shall periodically review the assessment made in accordance with this subparagraph and shall notify their initial and reviewed assessments to the Central Bank of Ireland.

402. 7.10.13G
A firm referred to in CASS 7.10.16 R must comply, as relevant, with CASS 7.10.18 G to CASS 7.10.24 R.

Same comment as in Row 401.

403. 7.10.13G
The effect of CASS 7.10.16 R is that, unless notified otherwise in accordance with CASS 7.10.20 R or CASS 7.10.22 R, clients of CRD credit institutions or approved banks that are not CRD credit institutions should expect that where they pass money to such firms in connection with designated investment business these sums will not be held as client money.

Same comment as in Row 401.

404. 7.10.16R
A firm holding money in either of the ways described in CASS 7.10.16 R must: before providing designated investment business services to the client in respect of those sums, notify the client that:

(1) the money held for that client is held by the firm as banker and not as a trustee under the client money rules; and

(2) if the firm fails, the client money distribution and transfer rules will not apply to those sums and so the client will not be entitled to share in any distribution under the client money distribution and transfer rules.

Same comment as in Row 401.

405. 7.10.18R
A firm holding money in either of the ways described in CASS 7.10.16 R in respect of a client and providing the services to it referred to in CASS 7.10.19 R may:

(1) explain to its clients the circumstances, if any, under which it will cease to hold any money in respect of those services as banker and

Same comment as in Row 401.
406. **7.10.11G**

Where a firm receives money that would otherwise be held as client money but for CASS 7.10.16 R:

1. it should be able to account to all of its clients for sums held for them at all times; and
2. that money should, pursuant to Principle 10, be allocated to the relevant client promptly. This should be done no later than ten business days after the firm has received the money.

Same comment as in Row 401.

407. **7.10.12R**

1. a CRD credit institution or an approved bank that is not a CRD credit institution wishes to hold client money for a client rather than hold the money in either of the ways described in CASS 7.10.16 R it must, before providing designated investment business services to the client, disclose the following information to the client:
   a. that the money held for that client in the course of or in connection with the business described under (2) is being held by the firm as client money under the client money rules;
   b. a description of the relevant business carried on with the client in respect of which the client money rules apply to the firm; and
   c. that, if the firm fails, the client money distribution and transfer rules will apply to money held in relation to the business in question.

Same comment as in Row 401.

408. **7.10.22R**

A CRD credit institution or an approved bank that is not a CRD credit institution must, in respect of any client money held in relation to its designated investment business that is not MiFID business, comply with the obligations referred to in COBS 6.1.16 R (Compensation Information).

Same comment as in Row 401.

409. **7.10.23G**

Firms carrying on MiFID business are reminded of their obligation to supply investor compensation scheme information to clients under COBS 6.1.16 R or COBS 6.1ZA.22R (Compensation Information).

Same comment as in Row 401.

410. **Affiliated companies: MiFID business**

A firm that holds money on behalf of, or receives money from, an affiliated company in respect of MiFID business must treat the affiliated company as any other client of the firm for the purposes of this chapter.

UK jurisdiction-specific rules.

411. **Affiliated companies: non-MiFID business**

A non-MiFID firm that holds money on behalf of, or receives money from, an affiliated company in respect of designated investment business which is not MiFID business must not treat the money as client money unless:

1. the firm has been notified by the affiliated company that the money belongs to a client of the affiliated company; or
2. the affiliated company is a client dealt with at arm's length; or
3. the affiliated company is a manager of an occupational pension scheme or is an overseas company; and
4. the money is given to the firm in order to carry on designated investment business for or on behalf of the clients of the affiliated company; and
5. the firm has been notified by the affiliated company that the money is to be treated as client money.

UK jurisdiction-specific rules.

412. **Coins**

The client money rules do not apply with respect to coins held on behalf of a client if the firm and the client have agreed that the money (or money of that type) is to be held by the firm for the intrinsic value of the metal which constitutes the coin.

UK jurisdiction-specific rules.

413. **MiFID Client money (minimum implementing) rules**

Solicitors

1. An authorised professional firm regulated by the Law Society (of England and Wales), the Law Society of Scotland or the Law Society of Northern Ireland.

UK jurisdiction-specific rules.
of Northern Ireland that, with respect to its regulated activities, is subject to the following rules of its designated professional body, must comply with those rules and, where relevant paragraph (3), and if it does so, it will be deemed to comply with the client money rules.

(2) The relevant rules are:
   (a) if the firm is regulated by the Law Society (of England and Wales), the SRA Accounts Rules 2011;
   (b) if the firm is regulated by the Law Society of Scotland, the Law Society of Scotland Practice Rules 2011; and
   (c) if the firm is regulated by the Law Society of Northern Ireland, the Solicitors’ Accounts Regulations 1998.

(3) If the firm in (1) is a MiFID investment firm that receives or holds money for, or on behalf of a client in the course of, or in connection with its MiFID business, it must also comply with the MiFID client money (minimum implementing) rules in relation to that business.

414. **Long term insurers and friendly societies**

This chapter does not apply to the permitted activities of a long-term insurer or a friendly society, unless it is a MiFID investment firm that receives money from or holds money for or on behalf of a client in the course of, or in connection with, its MiFID business.

415. **Contracts of insurance**

Provided it complies with CASS 1.2.11 R, a firm that receives or holds client money in relation to contracts of insurance may elect to comply with the provisions of the insurance client money chapter, instead of this chapter, in respect of all such money.

416. **Life assurance business**

A firm must make and retain a written record of any election which it makes under CASS 7.10.30 H.

417. **Trustee firms**

A trustee firm which holds money in relation to its designated investment business which is not MiFID business to which this chapter applies, must hold any such client money separate from its own money at all times.

### Table: Reference and Rule

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UK jurisdiction-specific rules.
Requirement 420.

7.10.35R
(1) A trustee firm to which CASS 7.10.34 R applies may, in addition to the client money rules set out at CASS 7.10.34 R, also elect to comply with:

(a) all the client money rules in CASS 7.13 (Segregation of client money);
(b) CASS 7.14 (Client money held by a third party);
(c) all the client money rules in CASS 7.15 (Records, accounts and reconciliations); or
(d) CASS 7.18 (Acknowledgement letters).

(2) A trustee firm must make a written record of any election it makes under this rule, including the date from which the election is to be effective. The firm must make the record on the date it makes the election and must keep it for a period of five years after ceasing to use it.

(3) Where a trustee firm has made an election under (1) which it subsequently decides to cease to use, it must make a written record of this decision, including the date from which the decision is to be effective, and keep that record from the date the decision is made for a period of five years after the date it is to be effective.

UK jurisdiction—specific rules.

421.

7.10.36R
A trustee firm to which CASS 7.10.34 R applies and which is otherwise subject to the client money rules must ensure that any client money it holds other than in its capacity as trustee firm is segregated from client money it holds as a trustee firm.

UK jurisdiction—specific rules.

422.

7.10.37G
A trustee firm to which CASS 7.10.34 R applies and which is otherwise subject to the client money rules should ensure that in designing its systems and controls it:

(1) takes into account that the client money distribution rules will only apply in relation to any client money that the firm holds other than in its capacity as trustee firm; and
(2) has regard to other legislation that may be applicable.

UK jurisdiction—specific rules.

423.

7.10.38R
(1) A trustee firm to which CASS 7.10.34 R applies may elect that:

(a) the applicable provisions of CASS 7.13 (Segregation of client money) and CASS 7.15 (Records, accounts and reconciliations) under CASS 7.10.34 R; and

(b) any further provisions it elects to comply with under CASS 7.10.35 R (1);

will apply separately and concurrently for each distinct trust that the trustee firm acts for.

(2) A trustee firm must make a written record of any election it makes under this rule, including the date from which the election is to be effective. The firm must make the record on the date it makes the election and must keep it for a period of five years after ceasing to use it.

UK jurisdiction—specific rules.
(1) Where a trustee firm has made an election under (1) which it subsequently decides to cease to use, it must make a written record of this decision, including the date from which the decision is to be effective, and must keep that record from the date the decision is made for a period of five years after the date it is to be effective.

3.10.49 G  
A trustee firm may wish to make an election under CASS 7.10.38 R to, for example, act for a number of distinct trusts which it wishes, is required, to keep operationally separate. If a firm makes such an election then it should:
(1) establish and maintain adequate internal systems and controls to effectively segregate client money held for one trust from client money held for another trust, and
(2) conduct internal client money reconciliations as set out in CASS 7.16 and external client money reconciliations under CASS 7.15.20 R for each trust.

3.10.49 G  
The provisions in CASS 7.10.38 R to 7.10.39 G do not affect the general application of the client money rules regarding money that is held by a firm other than in its capacity as a trustee firm.

UK jurisdiction-specific rules.

General purpose  
7.10.41 G  
(1) Principle 10 (Clients' assets) requires a firm to arrange adequate protection for clients' assets when the firm is responsible for them. An essential part of that protection is the proper accounting and treatment of client money. The client money rules provide requirements for firms that receive or hold client money, in whatever form.
(2) The client money rules also, where relevant, implement the provisions of MiFID which regulate the obligations of a firm when it holds client money in the course of its MiFID business.

UK jurisdiction-specific rules.

Article 16(10) MiFID; Article 5(5)  
An investment firm shall not conclude title transfer collateral arrangements with retail clients for the purpose of securing or covering present or future, actual or contingent or prospective obligations of clients.

Recital 52 MiFID
The requirements concerning the protection of client assets are a crucial tool for the protection of clients in the provision of services and activities. These requirements can be excluded when full ownership of funds and financial instrument is transferred to an investment firm to cover any prospective obligations. That broad possibility may create uncertainty and jeopardise the effectiveness of the requirements concerning the safeguard of client assets. Thus, at least when retail client assets are involved, it is appropriate to limit the possibility of investment firms to conclude title transfer financial collateral arrangements as defined under Directive 2004/39/EC of the European Parliament and of the Council (24), for the purpose of securing or otherwise covering their obligations.

7.11.7 R  
(1) A firm must ensure that any TTCA is the subject of a written agreement made on a durable medium between the firm and the client.
(2) Regardless of the form of the written agreement in (1) (which may have additional commercial purposes), it must cover the client's agreement:
(a) the terms for the arrangement relating to the transfer of the client's full ownership of money to the firm;
(b) any terms under which the ownership of money is to transfer from the firm back to the client; and
(c) in the event 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.

UK jurisdiction-specific rules.

7.11 R  
The terms referred to in CASS 7.11.3 R (2)(b) may include, for example, terms under which the arrangement relating to the transfer of full ownership of money to the firm is not in effect from time to time, or is contingent on some other condition.

UK jurisdiction-specific rules.
Article 6 Commission Delegated Directive

Article 6

Inappropriate use of title transfer collateral arrangements

1. Member States shall require that investment firms properly consider, and are able to demonstrate that they have done so, the use of title transfer collateral arrangements in the context of the relationship between the client's obligation to the firm and the client assets subject to title transfer collateral arrangements by the firm.

2. When considering, and documenting, the appropriateness of the use of title transfer collateral arrangements, investment firms shall take into account all of the following factors:
   (a) whether there is only a very weak connection between the client's obligation to the firm and the use of title transfer collateral arrangements, including whether the likelihood of a client's liability to the firm is low or negligible;
   (b) whether the amount of client funds or financial instruments subject to title transfer collateral arrangements far exceeds the client's obligation, or is even unlimited if the client has any obligation at all to the firm; and
   (c) whether all client's financial instruments or funds are made subject to title transfer collateral arrangements, without consideration of what obligation each client has to the firm.

3. Where using title transfer collateral arrangements, investment firms shall highlight to professional clients and eligible counterparties the risks involved and the effect of any title transfer collateral arrangement on the client's financial instruments and funds.

7.11.4AR
(1) A firm must properly consider and document the use of TTCAs in the context of the relationship between the client’s obligation to the firm and the money 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 liability arising is low or negligible;
   (b) the extent by which the amount of money subject to a TTCA is in excess of the client’s obligations (including where the TTCA applies to all money from the point of receipt by the firm and whether the client might have no obligation at all to the firm; and
   (c) whether all the client’s money is made subject to TTCAs, without consideration of whether the client has any obligation 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 money.

[Note: article 6 of the MiFID Delegated Directive]

UK jurisdiction-specific rules.

7.11.6G
Where a firm has received full title or full ownership to money under a collateral arrangement, the fact that it has also granted a security interest to its client to secure its obligation to repay that money to the client would not result in the money being client money. This can be compared to a situation in which a firm takes a charge or other security interest over money held in a client bank account, where that money would still be client money as there would be no absolute transfer of title to the firm. However, where a firm has received client money under a collateral arrangement which includes a "right to use arrangement", under which the client agrees to transfer all of its rights to money in that account to the firm upon the exercise of the right to use, the money may cease to be client money, but only once the right to use is exercised and the money is transferred out of the client bank account to the firm.

UK jurisdiction-specific rules.

7.11.7G
Firms are reminded of the client's best interest rule, which requires a firm to act honestly, fairly and professionally in accordance with the best interests of its clients when structuring its business particularly in respect of the effect of that structure on firms’ obligations under the client money rules.

UK jurisdiction-specific rules.

7.11.9R
(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.

Broadly conceptually equivalent across all rules.
(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 money will be treated as client money 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.

434. 7.11.14G
CASS 7.11.9 R (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.

435. 7.11.11G
When a firm notifies a client under CASS 7.11.9 R (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 money to the client, or to update its records under CASS 7.15 (Records, accounts and reconciliations) and to segregate the money as client money under CASS 7.13 (Segregation of client money).

436. 7.11.12R
(1) If a TTCA is terminated then, unless otherwise permitted under the client money rules and notified to the client under CASS 7.11.12 R, the firm must treat that money as client money from the start of the next business day following the date of termination as set out in the firm’s notifications under CASS 7.11.9 R (3)(a).

(2) Where the firm’s notification under CASS 7.11.9 R (3)(a) does not state when the termination of the arrangement will take effect, the firm must treat that money as client money from the start of the next business day following the date on which the firm’s notification is made.

437. 7.11.13G
A firm to which CASS 7.11.12 R applies should, for example, update its records under CASS 7.15 (Records, accounts and reconciliations) and segregate the money as client money under CASS 7.13 (Segregation of client money), from the relevant time at which the firm is required to treat the money as client money.

438. 7.11.14R
Delivery versus payment transaction exemption

(1) Subject to (2) and CASS 7.11.16 R and with the agreement of the relevant client, money need not be treated as client money 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 money from the client to be due to it within one business day following the firm’s fulfillment of its delivery obligation to the client; or

(b) in respect of a client’s sale, the firm intends for the money in question to be due to the client within one business day following the client’s fulfillment of its delivery obligation to the firm.

(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 the firm makes use of the exemption under (1), the firm must stop using that exemption for the transaction.

439. 7.11.15G
The exclusion from the client money rules for delivery versus payment transactions under CASS 7.11.14 R is an example of an exclusion from the client money rules which is permissible by virtue of recital 51 to MiFID.

440. 7.11.16R
A firm cannot, in respect of a particular delivery versus payment transaction, make use of the exemption under CASS 7.11.14 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

(2) 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.

441. 7.11.19R

Where a firm does not meet the requirements in CASS 7.11.14 R or CASS 7.11.16 R for the use of the exemption in CASS 7.11.14 R, the firm is subject to the client money rules in respect of any money it holds in connection with the delivery versus payment transaction in question.

442. 7.11.18G

(1) In line with CASS 7.11.14 R, where a firm receives money from the client in fulfilment of the client's payment obligation in respect of a delivery versus payment transaction the firm is carrying out through a commercial settlement system in respect of a client's purchase, and the firm has not fulfilled its delivery obligation to the client by close of business on the third business day following the date of the client's fulfilment of its payment obligation to the firm, the firm must treat the client money in accordance with the client money rules until delivery by the firm to the client occurs.
(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 7.11.14 R (2)), 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.

443. 7.11.19R

A firm will not be in breach of the requirement under CASS 7.13.6 R to receive client money directly into a client bank account if it:
(1) receives the money in question:
(a) in accordance with CASS 7.11.14 R (1)(a) but it is subsequently required under CASS 7.11.14 R (2) to hold that money in accordance with the client money rules; or
(b) in the circumstances referred to in CASS 7.11.18 G (2)(b); and
(2) pays the money in question into a client bank account promptly, and in any event by close of business on the business day following:
(a) the expiration of the relevant period referred to in CASS 7.11.14 R (2); or
(b) receipt of the money in the circumstances referred to in CASS 7.11.18 G (2)(b).

444. 7.11.20R

(1) If a firm makes use of the exemption under CASS 7.11.14 R, it must obtain the client's written agreement to the firm's use of the exemption.
(2) In respect of each client, the record created in (1) must be retained during the time that the firm makes use, or intends to make use, of the exemption under CASS 7.11.14 R in respect of that client's monies.

445. 7.11.21R

(1) Subject to (2)(a), money need not be treated as client money:
(a) in respect of a delivery versus payment transaction for the purpose of settling a transaction in relation to units in a regulated collective investment scheme in either of the following circumstances:
(i) the authorised fund manager receives the money from a client in relation to the authorised fund manager's obligation to issue units, in an AUT or ACS, or to arrange for the issue of units in an ICVC, in accordance with COLL; or
(ii) the money is held in the course of redeeming units where the proceeds of that redemption are paid to a client within the time specified in COLL.
(b) Where, in respect of money received in any of the circumstances set out in (1), the authorised fund manager has not, by close of business on the business day following the date of receipt of the money, paid this money to the depositary of an AUT or ACS, the ICVC or the client, as the case may be, the authorised fund manager must stop using the exemption under (1) for that transaction.
(2) Paragraph (2)(a) does not prevent a firm transferring client money segregated under (2)(a) into the firm's own account, provided this is done only for the purpose of making a payment on the same day from.
that account in accordance with CASS 7.11.33R(1) to CASS 7.11.34R(3) (Discharge of fiduciary duty).

446. An authorised fund manager will not be in breach of the requirement under CASS 7.13.6R to receive client money directly into a client bank account if it received the money in accordance with CASS 7.11.21 R (1) and is subsequently required under CASS 7.11.21 R (2) to hold that money in accordance with the client money rules.

Broadly conceptually equivalent across all rules save that UK rules are more prescriptive.

447. Where proceeds of redemption paid to the client in accordance with CASS 7.11.21 R (1)(a)(ii) are paid by cheque, the cheque should be issued from the relevant client bank account.

Broadly conceptually equivalent across all rules save that UK rules are more prescriptive.

448. If a firm makes use of the exemption under CASS 7.11.21 R, it must obtain the client's written agreement to the firm's use of the exemption. In respect of each client, the record created in (1) must be retained for the duration of the time that the firm makes use of the exemption under CASS 7.11.21 R in respect of that client's money.

Broadly conceptually equivalent across all rules save that UK rules are more prescriptive.

449. Money due and payable to the firm
(1) Money is not client money when it becomes properly due and payable to the firm for its own account.
(2) For these purposes, if a firm makes a payment to, or on the instructions of, a client, from an account other than a client bank account, until that payment has cleared, no equivalent sum from a client bank account for reimbursement will become due and payable to the firm.

Broadly conceptually equivalent across all rules save that UK rules are more prescriptive.

450. Money held as client money becomes due and payable to the firm or for the firm's own account, for example, because the firm acted as principal in the contract or the firm, acting as agent, has paid for securities in advance of receiving the purchase money from its client. The circumstances in which it is due and payable will depend on the contractual arrangement between the firm and the client.

Broadly conceptually equivalent across all rules save that UK rules are more prescriptive.

451. Firms are reminded that, notwithstanding that money may be due and payable to them, they have a continuing obligation to segregate client money in accordance with the client money rules. In particular, in accordance with CASS 7.15.2 R, firms must ensure the accuracy of their records and accounts and are reminded of the requirement to carry out internal client money reconciliations either in accordance with the standard methods of internal client money reconciliation or the requirements for a non-standard method of internal client money reconciliation.

Broadly conceptually equivalent across all rules save that UK rules are more prescriptive.

452. When a client's obligation or liability, which is secured by that client's asset, crystallises, and the firm realises the asset in accordance with an agreement entered into between the client and the firm, the part of the proceeds of the asset to cover such liability that is due and payable to the firm is not client money. However, any proceeds of sale in excess of the amount owed by the client to the firm should be paid over to the client immediately or be held in accordance with the client money rules.

Broadly conceptually equivalent across all rules save that UK rules are more prescriptive.

453. Commission rebate
When a firm has entered into an arrangement under which commission is rebated to a client, those rebates need not be treated as client money until they become due and payable to the client in accordance with the terms of the contractual arrangements between the parties.

UK jurisdiction-specific rules.
When commission rebate becomes due and payable to the client, the firm should:

1. treat it as client money; or
2. pay it out in accordance with the rules regarding the discharge of a firm's fiduciary duty to the client (see CASS 7.11.34 R), unless the firm and the client have entered into an arrangement under which the client has agreed to transfer full ownership of this money to the firm as collateral against payment of future professional fees (see CASS 7.11 (Title transfer collateral arrangements)).

Interest

A firm must pay a retail client any interest earned on client money held for that client unless it has otherwise notified him in writing.

Discharge of fiduciary duty

Money ceases to be client money (having regard to CASS 7.11.40 R where applicable) if:

1. it is paid to the client, or a duly authorised representative of the client; or
2. it is:
   a. paid to a third party on the instruction of, or with the specific consent of, the client unless it is transferred to a third party in the course of effecting a transaction under CASS 7.14.2 R (Transfer of client money to a third party); or
   b. paid to a third party pursuant to an obligation on the firm where:
      i. the obligation arises under an enactment; and
      ii. the obligation under that enactment in applicable to the firm as a result of the nature of the business being undertaken by the firm for its client; or
   c. transferred in accordance with CASS 7.11.42 R; or
   d. transferred in accordance with CASS 7.11.44 R; or
   e. transferred in accordance with CASS 7A.2.4R(4); or
   f. paid into a bank account of the client (not being an account which is also in the name of the firm); or
   g. due and payable to the client in accordance with CASS 7.11.25 R (Money due and payable to the firm); or
   h. paid to charity under CASS 7.11.50 R or CASS 7.11.57 R.
7.11.35R
Client money which the firm places at an authorised central counterparty in connection with a regulated clearing arrangement ceases to be client money for that firm if, as part of the default management process of that authorised central counterparty in respect of a default by the firm, it is ported by the authorised central counterparty in accordance with article 48 of EMIR.

UK jurisdiction-specific rules.

7.11.36R
Client money which the firm places at an authorised central counterparty in connection with a regulated clearing arrangement ceases to be client money if, as part of the default management process of that authorised central counterparty in respect of a default by the firm, it is paid directly to the client by the authorised central counterparty in accordance with the procedure described in article 48(7) of EMIR.

UK jurisdiction-specific rules.

7.11.37R
Client money received or held by the firm and transferred to a clearing member who facilitates indirect clearing through a regulated clearing arrangement ceases to be client money for that firm and, if applicable, the clearing member, if the clearing member in accordance with the EMIR indirect clearing default management obligations or the MiFIR indirect clearing default management obligations (as applicable):

1. remits payment to another firm or to another clearing member; or
2. remits payment to the indirect clients of the firm.

UK jurisdiction-specific rules.

7.11.38R
Client money received or held by the firm for a sub-pool ceases to be client money for that firm to the extent that such client money is transferred by the firm to an authorised central counterparty or a clearing member as a result of porting.

UK jurisdiction-specific rules.

7.11.39R
A firm must not pay client money into a bank account of the client that has been opened without the consent of that client.

UK jurisdiction-specific rules.

7.11.40R
When a firm draws a cheque or other payable order to discharge its fiduciary duty to the client, it must continue to treat the sum concerned as client money until the cheque or order is presented and paid by the bank.

UK jurisdiction-specific rules.

7.11.40AR
CASS 7.11.41G to CASS 7.11.47R do not apply to a firm following a primary pooling event.

UK jurisdiction-specific rules.

7.11.40BG
CASS 7A.2.4R(4) (Pooling and distribution or transfer) applies to a firm in respect of transfers of client money to another person following a primary pooling event.

UK jurisdiction-specific rules.

7.11.41G
A firm may transfer client money to a third party as part of transferring all or part of its business if, in respect of each client with an interest in the client money that is sought to be transferred, it:

1. obtains the consent or instruction of that client at the time of the transfer of business (see CASS 7.11.4R(2)(a); or
2. complies with CASS 7.11.42R (see CASS 7.11.34R (2)(c); or
3. complies with CASS 7.11.44R (see CASS 7.11.34R (2)(d).

UK jurisdiction-specific rules.

7.11.42R
Subject to CASS 7.11.44R, money ceases to be client money for a firm if:

1. it is transferred by the firm to another person as part of a transfer of business to that person where the client money relates to the business being transferred; and
2. it is transferred to another person which requires the other person to return a client’s transferred sums to the client as soon as practicable at the client’s request.

UK jurisdiction-specific rules.
(3) A written agreement between the firm and the relevant client provides that:
(a) the firm may transfer the client's client money to another person; and
(b) (i) the same transferred will be held by the person to whom they are transferred in accordance with the client money rules for the clients; or
(ii) not held in accordance with (i), the firm will exercise all due skill, care and diligence in assessing whether the person to whom the client money is transferred will apply adequate measures to protect those sums; and
(c) the firm complies with the requirements in (3)(b)(ii) (if applicable).

470. 7.11.43G
In considering how and whether to introduce the written agreement referred to in CASS 7.11.42 R (3), firms should have regard to any relevant obligations to clients, including requirements under the Unfair Terms Regulations.

471. Transfer of business: de minimis sums
7.11.44R
(1) Client money belonging to those categories of clients set out in (2) and in respect of those amounts set out in (2) ceases to be client money of the firm if it is transferred by the firm to another person:
(a) as part of a transfer of business to that other person where these sums relate to the business being transferred; and
(b) on terms which require the other person to return a client's transferred sums as soon as practicable at the client's request.

(2) (a) For retail clients the amount is £25.
(b) For all other clients the amount is £100.

472. Transfer of business: client notifications
7.11.46R
Where a firm transfers client money belonging to its clients under either or both of CASS 7.11.42 R and CASS 7.11.44 R it must ensure that those clients are notified no later than seven days after the transfer taking place:
(1) whether or not the sums will be held by the person to whom they have been transferred in accordance with the client money rules and if not how the sums will be held by that person;
(2) the extent to which the sums transferred will be protected under a compensation scheme; and
(3) that the client may opt to have the client's transferred sums returned to it as soon as practicable at the client's request.

473. The firm must notify the FCA of its intention to effect any transfer of client money under either or both of CASS 7.11.42 R and CASS 7.11.44 R at least seven days before it transfers the client money in question.

474. Allocated but unclaimed client money
7.11.47AR
CASS 7.11.48G to CASS 7.11.58G do not apply to a firm following a primary pooling event.

7.11.48G
The purpose of CASS 7.11.50 R is to set out the requirements firms must comply with in order to cease to treat as client money any unclaimed balance which is allocated to an individual client.
Before acting in accordance with CASS 7.11.50 R to CASS 7.11.58 G, a firm should consider whether its actions are permitted by law and consistent with the arrangements under which the client money is held. For the avoidance of doubt, these provisions relate to a firm’s obligations as an authorised person and to the treatment of client money under the client money rules.

479. 7.11.50R
A firm may pay away to a registered charity of its choice a client money balance which is allocated to a client and if it does so, the released balance will cease to be client money under CASS 7.11.34 R (10), provided:

(1) this is permitted by law and consistent with the arrangements under which the client money is held;
(2) the firm held the balance concerned for at least six years following the last movement on the client’s account (disregarding any payment or receipt of interest, charges or similar items);
(3) it can demonstrate that it has taken reasonable steps to trace the client concerned and to return the balance; and
(4) the firm complies with CASS 7.11.54 R.

480. 7.11.51G
Where the client money balance held by a firm is, in aggregate, £100 or less for a client other than a retail client or, for a retail client, £25 or less, the firm may comply with CASS 7.11.57 R instead of CASS 7.11.50 R.

481. 7.11.52E
(1) Taking reasonable steps in CASS 7.11.50 R (3) 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 of the firm’s intention to no longer treat the client money balance as client money and to pay the sums concerned to charity if the firm 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 (a) and (c), 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 did not receive a claim for the relevant client money balance, it will in 28 days pay the balance to a registered charity; 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 balance paid away to charity in the event of the client seeking to claim the balance 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 held 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 paying the balance to a registered charity.
(2) Compliance with (1) may be relied on as tending to establish compliance with CASS 7.11.50 R.
(3) Contravention of (1) may be relied on as tending to establish contravention of CASS 7.11.50 R.

482. 7.11.53G
For the purpose of CASS 7.11.52 E (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.

483. 7.11.54R
UK jurisdiction-specific rules.
(1) Where a firm wishes to release a balance allocated to an individual client under CASS 7.11.50 R it must comply with either (a) or (b) and, in either case, (2):
(a) the firm must unconditionally undertake to pay to the client concerned a sum equal to the balance paid away to charity in the event of the client seeking to claim the balance in future; or
(b) the firm must ensure that an unconditional undertaking in the terms set out in (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) The undertakings in this rule must be:
(a) authorised by the firm's governing body where (1)(a) applies or by the governing body of the group member where (1)(b) applies;
(b) legally enforceable by any person who had a legally enforceable claim to the balance in question at the time it was released 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.

7.11.55R
(1) If a firm pays away client money under CASS 7.11.50 R (4) it must make and retain, or where the firm already has such records, retain:
(a) records of all balances released from client bank accounts under CASS 7.11.50 R (including details of the amounts and the identity of the client to whom the money 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 7.11.50 R (3).
(2) The records in (1) must be retained indefinitely.
(3) If a member of the firm's group has provided an undertaking under CASS 7.11.54 R (2) then the records in (1) must be readily accessible to that group member.

7.11.56G
The purpose of CASS 7.11.57 R is to allow a firm to pay away to charity client money balances of (i) £25 or less for retail clients or (ii) £100 or less for other clients when those balances remain unclaimed.

7.11.57R
A firm may pay away to a registered charity of its choice a client money balance which is allocated to a client and if it does so the released balance will cease to be client money under CASS 7.11.34 R (10):
(1) the balance in question is (i) for a retail client, in aggregate, £25 or less, or (ii) for a professional client, in aggregate, £100 or less;
(2) the firm held the balance concerned for at least six years following the last movement on the client's account (disregarding any payment or receipt of interest, charges or similar items);
(3) the firm has made at least one attempt to contact the client to return the balance using the most up-to-date contact details the firm has for the client, and the client has not responded to such communication within 28 days of the communication having been made; and
(4) the firm makes and/or retains records of all balances released from client bank accounts in accordance with this rule. Such records must include the information in CASS 7.11.55 R (1)(a) and CASS 7.11.55 R (1)(b).

7.11.58R
Any costs associated with the firm ceasing to treat unclaimed client money balances as client money pursuant to CASS 7.11.50 R to CASS 7.11.57 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 7.11.50 R (3), CASS 7.11.51 G or CASS 7.11.57 R (3); 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 client money paid away.
4.8.1 Article 16(9) MiFID II
An investment firm shall, when holding funds belonging to clients, make adequate arrangements to safeguard the rights of clients and, except in the case of credit institutions, prevent the use of client funds for its own account.

4.8.2 Article 16(2) to 10 MiFID II

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

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<td>(2) Without prejudice to the generality of paragraph (1), an investment business firm shall have—</td>
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<td>(d) robust governance arrangements, which include a clear organisational structure with well defined, transparent and clearly identifiable lines of reporting.</td>
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An investment firm shall, when holding funds belonging to clients, make adequate arrangements to safeguard the rights of clients and, except in the case of credit institutions, prevent the use of client funds for its own account.

[Note: article 16(9) of MiFID]
Article 2(1)(f) Commission Delegated Directive

Member States shall require that investment firms comply with the following requirements:

(f) 

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

490. 7.12 Se

The risk of loss or diminution of rights in connection with client money can arise where a firm's organisational arrangements give rise to the possibility that client money held by the firm may be paid for the account of a client whose money is yet to be received by the firm. Consistent with the requirement to hold client money as trustee (see CASS 7.17.5 G), a firm should ensure its organisational arrangements are adequate to minimise such a risk. This may include, for example, allowing for sufficient periods of time for payments of client money to be become available for use (including automated payments, credit card payments and payments by cheque), and setting up safeguards to ensure that payments out of client bank accounts do not take effect before the relevant amount of client money has become available for use by the firm.

491. 7.13 Segregation of client money

- Application and purpose
  - CASS 7.13.1G 05/06/2015 RP
  - The segregation of client money from a firm's own money is an important safeguard for its protection.


- Depositing client funds
  - 1. Member States shall require investment firms, on receiving any client funds, promptly to place those funds into one or more accounts opened with any of the following:
    - (a) a central bank;
    - (b) a credit institution authorised in accordance with Directive 2013/36/EU of the European Parliament and of the Council (7);
    - (c) a bank authorised in a third country;
    - (d) a qualifying money market fund.

- Paying client money
  - 7.13.3R
  - A firm, on receiving any client money, must promptly place this money into one or more accounts opened with any of the following:
    - (1) a central bank;
    - (2) a CRD credit institution;
    - (3) a bank authorised in a third country;
    - (4) a qualifying money market fund.

- Note: article 4(1) of the MiFID Delegated Directive

493. Article 4.1 Commission Delegated Directive

Depositing client money

- 7.13.4R

A firm should ensure that any money other than client money that is deposited into a client bank account is promptly paid out of that account unless such money is a minimum sum required to open the account, or to keep the account open.
The two approaches that a firm can adopt in discharging its obligations under this section are:

1. The ‘normal approach’; or
2. The ‘alternative approach’ (see CASS 7.13.9G to CASS 7.13.69 G).

**The normal approach**

When a firm makes the selection, appointment and conducts the periodic review of a third party, the investment firm must take into account:

1. The expertise and market reputation of the third party with a view to ensuring the protection of clients’ rights.
2. Any legal or regulatory requirements or market practices related to the holding of client funds that could adversely affect clients’ rights.

**The alternative approach**

Firms should ensure that clients and third parties make transfers and payments of any money which will be client money directly into the firm’s own account and then segregated.

Firms should ensure that clients and third parties make transfers and payments of any money which will be client money directly into the firm’s own account and then segregated.

**Selection, appointment and review of third parties**

1. A firm that does not deposit client money with a central bank must exercise all due skill, care and diligence in the selection, appointment and periodic review of the credit institutions, bank or money market fund where the funds are placed and the arrangements for the holding of those funds and they consider the need for diversification of those funds as part of their due diligence.

2. The firm must consider the need for diversification as part of its due diligence under (1).

**Approaches for the segregation of client money**

1. **The normal approach**;
   - A firm that does not deposit client money with a central bank must exercise all due skill, care and diligence in the selection, appointment and periodic review of a third party with a view to ensuring the protection of clients’ rights; and
   - The expertise and market reputation of the third party with a view to ensuring the protection of clients’ rights, as well as any legal or regulatory requirements or market practices related to the holding of client funds that could adversely affect clients’ rights.

2. The ‘alternative approach’ (see CASS 7.13.9G to CASS 7.13.69 G).

**Segregation**

1. In this Regulation “instruction” includes—
   - A written confirmation or recorded telephone confirmation by which a client has instructed the investment firm to transfer its client assets, or
   - A written agreement by which a client has instructed the investment firm to manage its client assets on a discretionary basis.

2. An investment firm shall take all steps as may be necessary to ensure that any client asset is held by it in trust for the benefit of the client on behalf of whom such client asset is being held.

3. An investment firm shall not place in a third party client asset account any asset other than a client asset except in accordance with Regulations 48(6), 49(7) or Regulation 78(3).

4. Except in accordance with a legally enforceable agreement, an investment firm shall not use the assets of a client for any purpose other than for the sole account of that client.

5. Without prejudice to Regulations 48(3), 49(6) and 49(7), an investment firm is not required to pay into a third party client asset account such client assets that it receives on behalf of a client where to do so would result in the investment firm breaching any law or order of any court of competent jurisdiction.

6. Where, in accordance with an instruction from a client, a client asset is transferred to a third party, the investment firm shall ensure that such transfer is overseen and approved, prior to or at the time of transfer, by a relevant person other than the relevant person who is conducting the transfer.

**Selection, appointment and review of third parties**

1. A firm that does not deposit client money with a central bank must exercise all due skill, care and diligence in the selection, appointment and periodic review of the credit institution, bank or qualifying money market fund where the money is deposited and the arrangements for the holding of this money.

2. The firm must consider the need for diversification of these funds as part of their due diligence.

3. When a firm makes the selection, appointment and conducts the periodic review of a CRD credit institution, bank or qualifying money market fund where the funds are placed and the arrangements for the holding of this money, it must take into account:
   - The expertise and market reputation of the third party with a view to ensuring the protection of clients’ rights; and
   - Any legal or regulatory requirements or market practices related to the holding of client money that could adversely affect clients’ rights.

4. Firms should ensure that clients and third parties make transfers and payments of any money which will be client money directly into the firm’s own account and then segregated.

5. Firms should ensure that clients and third parties make transfers and payments of any money which will be client money directly into the firm’s own account and then segregated.

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9. Firms should ensure that clients and third parties make transfers and payments of any money which will be client money directly into the firm’s own account and then segregated.

**Approaches for the segregation of client money**

1. A firm that does not deposit client money with a central bank must exercise all due skill, care and diligence in the selection, appointment and periodic review of a CRD credit institution, bank or qualifying money market fund where the money is deposited and the arrangements for the holding of this money.

2. The firm must consider the need for diversification of these funds as part of their due diligence.
7.5.1.1 HR

For the purposes of this Part, an investment firm which is not a regulated financial firm shall be deemed to hold client funds where—

(a) it is holding money where

(1) the capital of the CRD credit institution or bank,

(2) the amount of client money placed, as a proportion of the CRD credit institution or bank’s capital and reserves, and, in the case of a qualifying money market fund, compared to any limit the fund may place on the volume of redemptions in any period;

(3) the extent to which client money that the firm deposits or holds with any CRD credit institution or bank incorporated outside the UK would be protected under a deposit protection scheme in the relevant jurisdiction;

(4) the credit-worthiness of the CRD credit institution or bank, and

(5) the extent that the information is available, the level of risk in the investment and loan activities undertaken by the CRD credit institution or bank and affiliated companies.

Broadly conceptually equivalent across all rules.

7.5.2 Article 2(1)(c) Commission Delegated Directive

Member States shall require that investment firms comply with the following requirements:

(a) they must take the necessary steps to ensure that client funds deposited, in accordance with Article 4 (of the Commission Delegated Directive), in a central bank, a credit institution or a bank authorised in a third country or a qualifying money market fund are held in an account or accounts identified separately from any accounts used to hold funds belonging to the investment firm.

(b) the investment firm has the capacity to effect transfers out of, or withdraw, from the third party client asset account.

(b) the investment firm has the capacity to effect transactions on that third party client asset account.

(c) the extent to which client money that the firm deposits or holds with any CRD credit institution or bank incorporated outside the UK would be protected under a deposit protection scheme in the relevant jurisdiction.

(1) To the extent that client money which the firm deposits or holds with any CRD credit institution or bank incorporated outside the UK would be protected under a deposit protection scheme in the relevant jurisdiction, the client financial instruments and any other money used to hold those client funds

(b) the investment firm has the capacity to effect transactions on that third party client asset account.

(2) For the purposes of this Part, an investment firm is deemed to hold client funds where—

(a) the funds have been deposited on behalf of a client of the investment firm in a third party client asset account with a third party or a relevant party in the name of the investment firm or of a nominee, and

(b) the investment firm has the capacity to effect transactions on the third party client asset account.

(3) Client funds received from, or on behalf of, a client shall be held as client funds in accordance with this Part unless such money relates exclusively to an activity of the investment firm which is not a regulated financial service.

(4) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(5) Where an investment firm receives client funds from, or on behalf of, a client for storage in a third party client asset account, the investment firm shall, as soon as practicable after receiving those client funds, send to the client a receipt in writing for those client funds, except where the client funds are received by electronic means.

(6) Where an investment firm receives client funds from, or on behalf of, a client, the investment firm shall, as soon as practicable after receiving those client funds, send to the client a receipt in writing for those client funds, except where the client funds are received by electronic means.

(7) In respect of the matters:

(8) Where an investment firm receives client funds from, or on behalf of, a client, the investment firm shall, as soon as practicable after receiving those client funds, send to the client a receipt in writing for those client funds, except where the client funds are received by electronic means.

(b) the investment firm has the capacity to effect transactions on that third party client asset account.

(3) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(4) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(5) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(b) the investment firm has the capacity to effect transactions on that third party client asset account.

(3) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(4) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(b) the investment firm has the capacity to effect transactions on that third party client asset account.

(3) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

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(b) the investment firm has the capacity to effect transactions on that third party client asset account.

(3) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(4) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(b) the investment firm has the capacity to effect transactions on that third party client asset account.

(3) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(4) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(b) the investment firm has the capacity to effect transactions on that third party client asset account.

(3) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(4) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(b) the investment firm has the capacity to effect transactions on that third party client asset account.

(3) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(4) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(b) the investment firm has the capacity to effect transactions on that third party client asset account.

(3) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(4) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(b) the investment firm has the capacity to effect transactions on that third party client asset account.

(3) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(4) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(b) the investment firm has the capacity to effect transactions on that third party client asset account.

(3) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.

(4) Where an investment firm deposits client funds with a qualifying money market fund, the units in that qualifying money market fund shall be held in accordance with the requirements for holding and depositing client financial instruments.
<table>
<thead>
<tr>
<th>604</th>
<th>7.13.13BR</th>
<th>A firm may only use one or more client bank accounts under CASS 7.13.13R(3A)(b) if:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1) prior to using any such client bank accounts, it:</td>
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<td></td>
<td>(a) produces a written policy that sets out:</td>
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<td></td>
<td>(i) for each of its business lines, the minimum proportion of the client money held by the firm that the firm considers would be appropriate to hold in such client bank accounts having regard to the need to manage the risk of the firm being unable to access client money when required;</td>
<td></td>
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<tr>
<td></td>
<td>(ii) the measures that it will put in place to comply with sub-paragraph (2)(a) of this rule, having regard to CASS 7.13.14CE; and</td>
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<tr>
<td></td>
<td>(b) provides each of its clients with a written explanation of the risks that arise as a result of the longer notice period for withdrawals that:</td>
<td></td>
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<td></td>
<td>(i) is clear, fair and not misleading; and</td>
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<td></td>
<td>(ii) in respect of the medium of the explanation, satisfies whichever of COBS 6.1.3R (Medium of disclosure) or COBS 8.12A.19EU (Medium of disclosure) applies to the firm in respect of its obligations to provide information to the client; and</td>
<td></td>
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<tr>
<td></td>
<td>(2) while the firm uses any such client bank accounts, it:</td>
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<tr>
<td></td>
<td>(a) takes appropriate measures to manage the risk of the firm being unable to access client money when required;</td>
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<tr>
<td></td>
<td>(b) keeps its written policy under sub-paragraph (1)(a) under review, amending it where necessary; and</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(c) provides any of its clients to whom it has not previously provided the explanation under sub-paragraph (1)(b) with such a written explanation before it starts to hold or receive client money for them.</td>
<td></td>
</tr>
</tbody>
</table>
10. the days on which the firm ceased to use client bank accounts under CASS 7.13.13R(3A)(b).

507. 7.13.13CE

(1) Appropriate measures under CASS 7.13.13AR(2)(a) include the firm considering the need to make, and making where appropriate, quarterly or more frequent adjustments to the amount of client money held in client bank accounts under CASS 7.13.13R(3A)(b), taking into consideration the following factors:
(a) historic and expected firm client money receipts and payments;
(b) the firm’s own analysis of its exposure to the risk of being unable to meet instructions from its clients in relation to client money that it holds, applying an appropriate set of time horizons and stress scenarios; and
(c) the content of the firm’s written policy under CASS 7.13.13AR(1)(a)(iii) and (iv).
(2) Compliance with (1) may be relied on as tending to establish compliance with CASS 7.13.13AR(2)(a).
(3) Contravention of (1) may be relied on as tending to establish contravention of CASS 7.13.13AR(2)(a).

508. 7.13.14CE

(1) Appropriate measures under CASS 7.13.14AR(2)(a) include the firm considering the need to make, and making where appropriate, quarterly or more frequent adjustments to the amount of client money held in client bank accounts under CASS 7.13.13R(3A)(b), taking into consideration the following factors:
(a) historic and expected future client money receipts and payments;
(b) the firm’s own analysis of its exposure to the risk of being unable to meet instructions from its clients in relation to client money that it holds, applying an appropriate set of time horizons and stress scenarios; and
(c) the content of the firm’s written policy under CASS 7.13.14AR(1)(a)(i) and (ii).
(2) Compliance with (1) may be relied on as tending to establish compliance with CASS 7.13.14AR(2)(a).
(3) Contravention of (1) may be relied on as tending to establish contravention of CASS 7.13.14AR(2)(a).

509. 7.13.14DG

(1) Under CASS 7.13.14AR(2)(b) a firm should consider whether amendments to its written policy under CASS 7.13.14AR(1)(a) are needed for any reason, including in light of the firm’s analysis in the course of its measures under CASS 7.13.14AR(2)(a).
(2) Each time a firm amends its written policy under CASS 7.13.14AR(1)(a) it should also update the rationale for the amended policy under CASS 7.13.14AR(1)(a)(ii).
(3) The stress scenarios under CASS 7.13.14CE(1)(b) should include a variety of severe yet plausible institution-specific and market-wide liquidity shocks.

510. 7.13.14EG

(1) If a fixed term or notice period for a withdrawal from a client bank account is scheduled to expire on a day on which a firm would expect to be unable to make the withdrawal, and the result is that the total period for which the withdrawal is prevented is longer than that permitted under CASS 7.13.13R(3A)(a) or (b), then the firm would be in breach of that rule.
(2) Such a situation could arise because the fixed term or notice period expires on a day which is not a business day for the relevant bank.
(3) Firms should therefore schedule their withdrawals from client bank accounts under CASS 7.13.13R(3A)(a) and (b) to avoid such breaches.

511. 7.13.14FG

Firms that hold client money using a client bank account under CASS 7.13.13R(3A)(b) and to which SUP 16.14 (Client money and asset return) applies may need to fill in their CMARs in the way set out at SUP 16.14.7R (Reporting of ‘unbreakable’ client money deposits).

512. 7.13.15G

A firm may open one or more client bank accounts in the form of a general client bank account, a designated client bank account or a designated client fund account (see CASS 7A.2.1 G (Failure of the authorised firm: primary pooling event)). The requirements of CASS 7.13.13 R (2) and CASS 7.13.13 R (3) apply for each type of client bank account.

513. 7.13.16G

A designated client bank account may be used for a client only where that client has consented to the use of that account. If a firm deposits client money into a designated client bank account then, in the event...
A designated client fund account may be used for a client only where that client has consented to the use of that account and all other designated client fund accounts which may be pooled with it. For example, a client who consents to the use of bank A and bank B should have his money held in a different designated client fund account at bank B from a client who has consented to the use of banks B and C. If a firm deposits client money into a designated client fund account then, in the event of a secondary pooling event in respect of the relevant bank, the account will not be pooled with any general client bank account or designated client bank account.

Diversification of client money
7.13.20R
(1) In CASS 7.13.20R to CASS 7.13.25R client money means money deposited under CASS 7.13.3R and therefore includes money deposited under CASS 7.13.3R:
(a) in an account opened with a qualifying money market fund; or
(b) invested in units or shares of a qualifying money market fund.
(2) But client money held under CASS 7.14.2R does not fall within the scope of the diversification provisions at CASS 7.13.20R to CASS 7.13.25R.

Broadly conceptually equivalent across all rules.

Article 4(3) first sub-paragraph Commission Delegated Directive
Member States shall require that, where investment firms deposit client funds with a credit institution, bank or money market fund of the same group as the investment firm, they limit the funds that they deposit with any such group entity or combination of any such group entities so that funds do not exceed 20% of all such funds.

Broadly conceptually equivalent across all rules.

Article 4(3) first sub-paragraph Commission Delegated Directive
Member States shall require that, where investment firms deposit client funds with a credit institution, bank or money market fund of the same group as the investment firm, they limit the funds that they deposit with any such group entity or combination of any such group entities so that funds do not exceed 20% of all such funds.

Broadly conceptually equivalent across all rules.

Article 4(3) second sub-paragraph Commission Delegated Directive
An investment firm may not comply with this limit where it is able to demonstrate that, in view of the nature, scale and complexity of its business, and also the nature of the trades, the third parties considered in the previous subparagraph, and including in any case the small balance of client funds the investment firm holds the requirement under the previous paragraph is not proportionate. Investment firms shall periodically review the assessment made in accordance with this subparagraph and shall notify their initial and reviewed assessments to NCAs.

Broadly conceptually equivalent across all rules.
that it holds, to have difficulty in justifying using the approach in CASS 7.13.21 AR(1); 
(b) a firm should calculate its client money balance for these purposes in the same way required under CASS 1A.2.3R, and base its assessment under CASS 7.13.21 AR(1)(a) on either:
(1) the highest total amount of client money that it held during the year ending on the date of the assessment; or
(2) if it did not hold client money in the previous calendar year, the highest total amount of client money that the firm projects it will hold during the year starting on the date of the assessment; and
(c) this means that it may be possible for a CASS medium firm or a CASS large firm to justify using the approach in CASS 7.13.21 AR(1) on the basis of small client money balances; and
(d) in any case, a firm seeking to take that approach should also consider the points at CASS 7.13.21 AR(1)(b) and (c) as part of its assessment.

(2) In relation to the requirement under CASS 7.13.21 AR(2) to review the assessment under CASS 7.13.21 AR(1):
(a) a firm should undertake a review and, where appropriate, consider whether to cease to use the approach in CASS 7.13.21 AR(1) when it becomes aware of a change in the circumstances that might have led the firm to a different conclusion on its previous assessment; and
(b) in any case a firm should undertake a review at least one year after its previous assessment until it ceases to use the approach in CASS 7.13.21 AR(1).

(3) A firm may, subject to paragraph (2)(a), wish to perform the assessment and any periodic reviews under CASS 7.13.21 AR when the obligations under CASS 1A.2.9 R arise.

(4) Firms are reminded that, independent of CASS 7.13.21 AR, each firm is required by CASS 1A.2.2 R to determine once every year whether it is a CASS large firm, CASS medium firm or CASS small firm.

Where a firm decides following an assessment under CASS 7.13.21 AR(1) that it intends to use the approach under that rule, the firm must give the FCA notice of this upon reaching that decision and before it starts to use that approach.
Where, following a review under CASS 7.13.21 AR(2), a firm decides that it will either cease to use the approach under CASS 7.13.21 AR(1) or continue to use it, it must give the FCA notice of this upon reaching that decision.
7.13.25R
(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 bank or a qualifying money market fund under CASS 7.13.8 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 that particular person for the purposes of depositing client money under CASS 7.13.3 R.
(2) A firm must make a record of each periodic review of its selection and appointment of a bank or a qualifying money market fund that it conducts under CASS 7.13.8 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 that particular person for the purposes of depositing client money under CASS 7.13.3 R.
(3) A firm must make a record of each periodic review that it conducts under CASS 7.13.22 R, its considerations and conclusions. The firm must make the record on the date it completes the review and must keep it for five years from that date.

7.13.26R
Where an investment firm deposits funds it holds on behalf of a client with a qualifying money market fund, the units or shares in that money market fund should be held in accordance with the requirements for holding financial instruments belonging to clients. Clients should be required to explicitly consent to the depositing of those funds. When assessing the quality of money market instruments there should be no mechanistic reliance on external ratings. However a downgrade below the two highest short-term credit ratings by any agency registered and supervised by ESMA that has rated the instrument should lead the manager to undertake a new assessment of the credit quality of the money market instrument to ensure it continues to be of high quality.

7.13.27G
A firm that places client money in a qualifying money market fund should ensure that it has the permissions required to invest in and hold units or shares in that fund and must comply with the rules that are relevant for those activities.

7.13.28R
(1) A firm must inform a client that money placed with a qualifying money market fund will not be held in accordance with the requirements for safeguarding client money. 
(2) A firm must ensure that, having provided the information to the client under (1), the client gives its explicit consent to the placement of their money in a qualifying money market fund.

7.13.29AG
A firm may comply with CASS 7.13.28 R(1) by informing the client that the units or shares in the qualifying money market fund will be held as safe custody assets.

7.13.30R
A firm may segregate client money in a different currency from that in which it was received or in which the firm is liable to the relevant client. If it does so the firm must ensure that the amount held is adjusted each day to an amount at least equal to the original currency amount (or the currency in which the firm has its liability to its clients, if different), translated at the previous day's closing spot exchange rate.

7.13.31R
A firm may comply with CASS 7.13.28 R(1) by informing the client that the units or shares in the qualifying money market fund will be held in safe custody accounts.

7.13.32R
A firm may use a different currency for a different currency fund where it is reasonable to do so.

Mixed remittance
7.13.31R

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### Physical receipt of client money

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Text</th>
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<tbody>
<tr>
<td>7.13.32R</td>
<td>Where a firm receives client money in the form of cash, a cheque or other payable order, it must:</td>
</tr>
<tr>
<td>(1)</td>
<td>pay the money in accordance with CASS 7.13.6 R, promptly, and no later than on the business day after it receives the money into a client bank account, unless either:</td>
</tr>
<tr>
<td>(a) the money is received by a business line for which the firm uses the alternative approach, in which case the money must be paid into the firm’s own bank account promptly, and no later than on the business day after it receives the money; or</td>
<td></td>
</tr>
<tr>
<td>(b) the firm is unable to meet the requirement in (1) because of restrictions under the regulatory system or law regarding the receipt and processing of money, in which case the money must be paid in accordance with CASS 7.13.6 R as soon as possible;</td>
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<tr>
<td>(2)</td>
<td>hold it in a secure location in accordance with Principle 10; and</td>
</tr>
<tr>
<td>(3)</td>
<td>record the receipt of the money in the firm’s books and records in accordance with CASS 7.15 (Records, accounts and reconciliations).</td>
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</tbody>
</table>

### Appointed representatives, tied agents, field representatives and other agents

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Text</th>
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<tbody>
<tr>
<td>7.13.34R</td>
<td>A firm must ensure that client money received by its appointed representatives, tied agents, field representatives or other agents is:</td>
</tr>
<tr>
<td>(1)</td>
<td>received directly into a client bank account of the firm, where this would have been required if such client money had been received by the firm otherwise than through its appointed representatives, tied agents, field representatives or other agents (see CASS 7.13.6 R and CASS 7.13.7 G), or</td>
</tr>
<tr>
<td>(2)</td>
<td>forwarded to the firm or, in the case of a field representative, forwarded to a specified business address of the firm, to ensure that the money arrives at the specified business address promptly and, in any event, no later than the close of the third business day.</td>
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</table>

### Allocating client money receipts

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Text</th>
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<tbody>
<tr>
<td>7.13.36R</td>
<td>Under CASS 7.13.34 R (2)(b), client money received on business day one should be forwarded to the firm or specified business address of the firm promptly and, in any event, no later than the next business day after receipt (business day two) in order for it to reach that firm or specified business address by the close of the third business day. Procedures requiring the client money in the form of a cheque to be sent to the firm or specified business address of the firm by first class post and, in any event, no later than the next business day after receipt, would fulfill CASS 7.13.34 R (2)(b).</td>
</tr>
</tbody>
</table>

*Broadly conceptually equivalent across all rules.*
(1) A firm must allocate any client money it receives to an individual client promptly and, in any case, no later than ten business days following the receipt (or where subsequent to the receipt of money it has identified that the money, or part of it, is client money under CASS 7.13.37 R, no later than ten business days following that identification).

(2) Pending a firm's allocation of a client money receipt to an individual client under (1), it must record the received client money in its books and records as "unallocated client money".

537. If a firm receives money (either in a client bank account or an account of its own) which it is unable to immediately identify as client money or its own money, it must:

(1) take all necessary steps to identify the money as either client money or its own money;
(2) if it considers it reasonably prudent to do so, given the risk that client money may not be adequately protected if it is not treated as such, treat the entire balance of money as client money and record the money in its books and records as "unidentified client money" while it performs the necessary steps under (1).

Broadly conceptually equivalent across all rules save that UK rules are more prescriptive.

538. If a firm is unable to identify money that it has received as either client money or its own money under CASS 7.13.37 R, it should consider whether it would be appropriate to return the money to the person who sent it or to the source from where it was received (for example, the banking institution).

Broadly conceptually equivalent across all rules save that UK rules are more prescriptive.

539. Pursuant to the client money segregation requirements, a firm that is operating the normal approach and is liable to pay money to a client must promptly, and in any event no later than one business day after the money is due and payable, pay the money:

(1) to, or to the order of, the client;
(2) into a client bank account.

Broadly conceptually equivalent across all rules save that UK rules are more prescriptive.

540. Where the firm has payment instructions from the client the firm should pay the money to the order of the client, rather than into a client bank account.

Broadly conceptually equivalent across all rules save that UK rules are more prescriptive.

541. Subject to paragraph (2), CASS 7.13.41 R to CASS 7.13.49 R do not apply to a firm following a primary pooling event.

UK jurisdiction specific rule.

542. If it is prudent to do so to prevent a shortfall in client money on the occurrence of a primary pooling event, a firm may pay money of its own into a client bank account and subsequently retain that money in the client bank account (prudent segregation). Money that the firm retains in a client bank account under this rule is client money for the purposes of the client money rules and the client money distribution and transfer rules.

UK jurisdiction specific rule.

543. A firm must make and retain an up-to-date record of all payments made under CASS 7.13.41 R. (See further CASS 7.13.59 R to CASS 7.13.55 R: the prudent segregation record.)

UK jurisdiction specific rule.

544. UK jurisdiction specific rule.
If a firm intends to pay its own money into a client bank account under CASS 7.13.41 R it must establish a written policy that is approved by its governing body and retain such policy for a period of at least five years after the date it ceases to retain such money in a client bank account under CASS 7.13.41 R detailing:
1. the specific anticipated risks in relation to which it would be prudent for the firm to make such payments into a client bank account;
2. why the firm considers that the use of such a payment is a reasonable means of protecting client money against each of the risks set out in the policy; and
3. the method that the firm will use to calculate the amount required to address each risk set out in the policy.

The firm may amend its written policy to reflect changes in the specific anticipated risks in relation to which it would be prudent for the firm to make payments into a client bank account under CASS 7.13.41 R.

The firm’s written policy must not conflict with the client money rules or the client money distribution and transfer rules. If there is a conflict, the client money rules and the client money distribution and transfer rules will prevail.

Examples of the types of risks that a firm may wish to provide protection for under CASS 7.13.41 R include systems failures and business that is conducted on non-business days where the firm would be unable to pay any anticipated shortfall into its client bank account.

In the event the firm faces a risk not contemplated under its current policy it will not be prevented from prudently segregating money as client money in accordance with these rules but the policy must be created or amended, as applicable, as soon as reasonably practicable.

In the event the firm no longer considers it prudent to retain money in its client bank account pursuant to CASS 7.13.41 R in order to ensure that client money is protected, the firm may cease to treat that money as client money.

Any money that the firm cease to treat as client money pursuant to CASS 7.13.48 R must be withdrawn from its client bank account as an excess under CASS 7.15.29 R as part of its next reconciliation.

Account segregation record

Subject to paragraph (2), CASS 7.13.50R to CASS 7.13.52G do not apply to a firm following a primary pooling event.

Where a firm holds a prudent segregation record under CASS 7.13.53R following a primary pooling event, the prudent segregation record must continue to satisfy the requirements set out in CASS 7.13.51R.

The prudent segregation record must record:
1. the outcome of the firm’s calculation of its prudent segregation;
2. the amounts paid into or withdrawn from a client bank account pursuant to CASS 7.13.41 R or CASS 7.13.48 R;
3. why each payment or withdrawal is made;
4. the amounts paid into or withdrawn from a client bank account pursuant to CASS 7.13.41 R or CASS 7.13.48 R;
5. why each payment or withdrawal is made;
6. the method that the firm will use to calculate the amount required to address each risk set out in the policy.
(b) that the policy will be created or amended to include the reasons for this payment or withdrawal;
(5) that the money was paid by the firm in accordance with CASS 7.13.41 R or withdrawn by the firm in accordance with CASS 7.13.49 R; and
(6) the up-to-date total amount of client money held pursuant to CASS 7.13.41 R.

556. 7.13.51G
Firms are reminded that payments and records made in accordance with CASS 7.13.51 R should not be used as a substitute for a firm keeping accurate and timely records in accordance with CASS 7.15 (Records, accounts and reconciliations) and requirements under SYSC 4.1.1 R (General requirements) and SYSC 6.1.1 R (Compliance).

UK jurisdiction specific rule.

557. 7.13.52G
Firms are reminded that payments and records made in accordance with CASS 7.13.51 R should not be used as a substitute for a firm keeping accurate and timely records in accordance with CASS 7.15 (Records, accounts and reconciliations) and requirements under SYSC 4.1.1 R (General requirements) and SYSC 6.1.1 R (Compliance).

UK jurisdiction specific rule.

558. 7.13.53R
The prudent segregation record must be retained for five years after the firm ceases to retain money as client money pursuant to CASS 7.13.41 R.

UK jurisdiction specific rule.

559. 7.13.54G
(1) In certain circumstances, use of the normal approach for a particular business line of a firm could lead to significant operational risks to client money protection. These may include a business line under which client transactions are complex, numerous, closely related to the firm's proprietary business and involve a number of currencies and time zones. In such circumstances, subject to meeting the relevant criteria and fulfilling the relevant notification and audit requirements, a firm may use the alternative approach to segregating client money for that business line.
(2) Under the alternative approach, client money is received into and paid out of a firm's own bank account. A firm that adopts the alternative approach must also:
(1) Subject to paragraphs (2) and (3), CASS 7.13.62R(3), CASS 7.13.62R(4) and CASS 7.13.63R to CASS 7.13.67R do not apply to a firm following its failure.
(2) If, at the time of a primary pooling event, a firm has retained money in a client bank account for the purposes of alternative approach mandatory prudent segregation under CASS 7.13.65R, that money remains client money for the purposes of the client money rules and the client money distribution and transfer rules.
(3) When a firm holds an alternative approach mandatory prudent segregation record under CASS 7.13.68R following a primary pooling event, the alternative approach mandatory prudent segregation record must continue to satisfy the requirements set out in CASS 7.13.67R.

UK jurisdiction specific rule.

560. 7.13.55R
A firm that wishes to adopt the alternative approach for a particular business line must first establish, and document in writing, its reasons for concluding, that:
(1) adopting the normal approach would lead to greater operational risks to client money protection compared to the alternative approach; and
(2) adopting the alternative approach (including complying with the requirements for alternative approach mandatory prudent segregation under CASS 7.13.65R) would not result in undue operational risk to client money protection; and
(3) the firm has systems and controls that are adequate to enable it to operate the alternative approach effectively and in compliance with Principle 10 (Customer assets).

UK jurisdiction specific rule.
A firm must retain any documents created under CASS 7.13.55 R in relation to a particular business line for a period of at least five years after the date it ceases to use the alternative approach in connection with that business line.

7.13.55R
At least three months before adopting the alternative approach for a particular business line, a firm must:
1. inform the FCA in writing that it intends to adopt the alternative approach for that particular business line; and
2. if requested by the FCA, make any documents it created under CASS 7.13.55 R available to the FCA for inspection.

7.13.55R
At least three months before adopting the alternative approach for a particular business line, a firm must:
1. inform the FCA in writing that it intends to adopt the alternative approach for that particular business line; and
2. if requested by the FCA, make any documents it created under CASS 7.13.55 R available to the FCA for inspection.

7.13.57R
At least three months before adopting the alternative approach for a particular business line, a firm must:
1. inform the FCA in writing that it intends to adopt the alternative approach for that particular business line; and
2. if requested by the FCA, make any documents it created under CASS 7.13.55 R available to the FCA for inspection.

7.13.58R
In addition to the requirement under CASS 7.13.57 R, a firm must:
1. send a written report to the FCA prepared by an independent auditor of the firm in line with a reasonable assurance engagement, stating the matters set out in (2).
2. The written report in (1) must state whether, in the auditor's opinion:
   a. the firm's systems and controls are suitably designed to enable the firm to comply with CASS 7.13.62 R to CASS 7.13.65 R; and
   b. the firm's calculation of its alternative approach mandatory prudent segregation amount under CASS 7.13.65 R is suitably designed to enable the firm to comply with CASS 7.13.65 R.

7.13.59R
A firm that uses the alternative approach must review, at least on an annual basis and with no more than one year between each review, whether its reasons for adopting the alternative approach for a particular business line, as documented under CASS 7.13.55 R, continue to be valid.

7.13.60R
A firm that uses the alternative approach must not materially change how it will calculate and maintain the alternative approach mandatory prudent segregation amount under CASS 7.13.65 R unless:
1. an auditor of the firm has prepared a report that complies with the requirements in CASS 7.13.58 R (2)(b) in respect of the firm's proposed changes; and
2. the firm provides a copy of the report prepared by the auditor under (a) to the PCA before implementing the change.

7.13.61G
A firm is reminded that, under SUP 3.4.2 R, it must take reasonable steps to ensure that its auditor has the required skill, resources and experience to perform its function.

7.13.62R
A firm that uses the alternative approach for a particular business line must:
1. receive any money from and pay any money to (or, in either case, on behalf of) clients into and out of its own bank accounts;
2. perform the necessary reconciliations of records and accounts required under CASS 7.13.15 (Records, accounts and reconciliations);
3. adjust the balances held in its client bank account (by effecting transfers between its own bank account and its client bank account) to address any difference arising between its client money requirement and its client money resource at the close of business on the previous business day (T-1), so that the correct amount reflected in the reconciliations under (2) is segregated in its client bank account, and
4. subject to CASS 7.13.63R below, keep segregated in its client bank account the balance held under (3) until it has performed a reconciliation on the following business day (T+1) and as a result of that reconciliation undertakes further adjustments under (3).

7.13.63R
During the period between the adjustment in CASS 7.13.62 R (3) and the completion of the next reconciliations in CASS 7.13.62 R (2), a...
A firm that uses the alternative approach for a particular business line may:

1. Increase the balance held in its client bank account by making intra-day transfers (during T0) from its own bank account to its client bank account before the completion of the internal client money reconciliation under CASS 7.13.62 R (2) (that is expected sometime later on T0) only if:
   a. The firm reasonably expects that the client money requirement for the previous business day (T-1) will increase above the client money resource currently held in its client bank account; and
   b. Such reasonable expectations are based on the working calculation of the client money requirement relating to the previous business day (T-1) that the firm has already determined on that business day (during T0) as part of the process of completing its internal client money reconciliation.

2. Decrease the balance held in its client bank account by making intra-day transfers (during T0) from its client bank account to its own bank account before the completion of the internal client money reconciliation under CASS 7.13.62 R (2) (that is expected sometime later on T0) only if:
   a. The firm reasonably expects that the client money requirement for the previous business day (T-1) will decrease below the client money resource currently held in its client bank account; and
   b. Such reasonable expectations are based on the working calculation of the client money requirement relating to the previous business day (T-1) that the firm has already determined on that business day (during T0) as part of the process of completing its internal client money reconciliation.

However, in doing so, a firm must act prudently and should take appropriate steps to manage the risk of not having segregated an amount that appropriately reflects its actual client money requirement at any given time.

569. 7.13.64G

It is anticipated that CASS 7.13.63 R may be used by firms which maintain client bank accounts in a number of different time zones and making adjustments to the balances of these client bank accounts is dependent on meeting cut off times for money transfers in those time zones.

570. 7.13.65R

1. A firm that uses the alternative approach must, in addition to CASS 7.13.62 R, pay an amount (determined in accordance with this rule) of its own money into its client bank account and subsequently retain that money in its client bank account (alternative approach mandatory prudent segregation). The amount segregated by a firm in its client bank account under this rule is client money for the purposes of the client money rules and the client money distribution and transfer rules.

2. The amount required to be segregated under this rule must be an amount that a firm reasonably determines would be sufficient, at the time it makes the determination, to protect client money against the risk that at any time in the following three months the following categories of client money may not have been fully segregated in its client bank account or may not be (or become) available for pooling under CASS 7A.2.4R (1), were a primary pooling event to occur:
   a. Client money that is received and held by the firm in its own bank account during the period between:
      i. The firm's adjustment of client bank account balances under CASS 7.13.62 R (3) on a particular business day; and
      ii. The firm's subsequent adjustments under CASS 7.13.62 R (3) on the following business day;
   b. Money received and held by the firm in its own bank account which the firm does not initially identify as part of its client money requirement, but which subsequently becomes part of its client money requirement;
   c. With the effect that the firm's alternative approach mandatory prudent segregation under this rule will reduce, as far as possible, any shortfall that might have been produced as a result of (a) or (b) on the occurrence of a primary pooling event.

3. Subject to (c), in reaching its determination under (2) of the amount of money that would be sufficient to address the risks referred to in (2) for the forthcoming three months, a firm must take into account the following in respect of each business line for which it uses the alternative approach, and for at least the previous three months:

UK jurisdiction specific rule.
(i) the firm’s client money requirement over the course of that prior period (excluding any amount that was required to be segregated under this rule during that prior period for the purposes of alternative approach mandatory prudent segregation);
(ii) the daily adjustment payments that the firm made into its client bank account under CASS 7.13.62 R (3) during that prior period; and
(iii) the amount of money received by the firm in its own bank account which did not initially identify as part of its client money requirement, but which subsequently, and during that prior period, became part of its client money requirement as shown in its internal records.

(b) In reaching its determination under (2) a firm must also take into account, but at all times having regard to the requirement under (2), any impact that particular events, the seasonal nature of each relevant business line, or any other aspect of those business lines may have on:

(i) the firm’s client money requirement during the forthcoming three months for which the amount of alternative approach mandatory prudent segregation required under this rule is being determined;
(ii) the daily adjustment payments that the firm is likely to make into its client bank account under CASS 7.13.62 R (3) in that same period; and
(iii) the amount of unidentified receipts of money that the firm is likely to receive into its own bank account and which will subsequently, in that same period, become part of its client money requirement.

(c) If, at the time of its determination under (2), the firm has not been trading for three months in a business line for which it is using the alternative approach, then it must use the records that are available to it and must also factor in reasonable forecasts, as required under (b), to establish a three-month reference period.

(4)

(a) A firm must, at regular intervals that are at least quarterly, repeat and complete the combined process of:

(i) determining the amount that it is required to segregate for the purposes of alternative approach mandatory prudent segregation under (2) and (3);
(ii) making necessary adjustments to its records to reflect any changes to its client money requirement (in accordance with CASS 7.16.16 R (3) and CASS 7.16.17 R (2)); and
(iii) paying any additional amounts of its own money into its client bank account to increase the firm’s alternative approach mandatory prudent segregation or withdrawing any excess amounts from its client bank account to decrease the firm’s alternative approach mandatory prudent segregation after it has adjusted its records under (ii).

(b) The combined process of (a)(i) to (iii) must take no longer than ten business days.

(c) To the extent that a firm’s compliance with (a)(i) and (ii) results in there being an excess in the firm’s client bank account, the firm may cease to treat that money as client money.

(5) A firm must ensure that the individual responsible for CASS oversight under CASS 1A.3.1 R, CASS 1A.3.1A R or CASS 1A.3.1C R (as appropriate) reviews the adequacy of the amount of the firm’s alternative approach mandatory prudent segregation maintained under this rule at least annually.

<table>
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<tr>
<th>Rule</th>
<th>Text</th>
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| 7.13.66R | A firm must create and keep up-to-date records so that any amount of money that is, pursuant to CASS 7.13.65 R:
|   | (1) paid into a client bank account and retained as client money; or
|   | (2) withdrawn from a client bank account;
|   | can be easily ascertained (the alternative approach mandatory prudent segregation record). |
| 7.13.67R | The alternative approach mandatory prudent segregation record under CASS 7.13.66 R must record:
|   | (1) the date of the first determination under CASS 7.13.65 R (2) and each subsequent review undertaken under CASS 7.13.65 R (4), and the total amount that the firm determined was required to be segregated under CASS 7.13.65 R (2) or at that date;
|   | (2) the date of any payment of the firm’s own money into a client bank account, or withdrawal of any excess from a client bank account, which may cease to treat that money as client money; and
|   | (3) the fact that the money was paid or withdrawn by the firm in accordance with CASS 7.13.65 R (2), and |
| 571. | UK jurisdiction specific rule. |
| 572. | UK jurisdiction specific rule. |
(1) as at that date, the total amount actually segregated by the firm under CASS 7.13.65 R.

573. 7.13.68R
The alternative approach mandatory prudent segregation record must be retained for five years after the firm ceases to segregate any money in accordance with CASS 7.13.65 R.

574. 7.13.69G
Nothing in CASS 7.13.54 G to CASS 7.13.68 R prevents a firm from also making use of the prudent segregation rule in CASS 7.13.41 R.

575. Use of the normal approach in relation to certain regulated clearing arrangements:
CASS 7.13.72 R sets out the circumstances under which a firm, that would otherwise be required to comply with the requirement in CASS 7.13.6 R to receive client money directly into a client bank account, must receive (or is permitted to receive) client money into its own bank account.

576. 7.13.71R
A firm that is also a clearing member that is using the normal approach in connection with regulated clearing arrangements must use reasonable endeavours to ensure it is not required under its arrangements with an authorised central counterparty to receive mixed remittances from or pay mixed remittances to the authorised central counterparty through a single bank account.

577. 7.13.72R
(1) If, notwithstanding its reasonable endeavours in accordance with CASS 7.13.71 R, the firm is required under its arrangements with an authorised central counterparty to:
(a) receive mixed remittances from the authorised central counterparty into a single bank account and pay mixed remittances to the authorised central counterparty from that bank account, or
(b) pay mixed remittances to the authorised central counterparty using a single bank account;
then such arrangements for client money are permitted if the firm complies, as applicable, with (2) and CASS 7.13.73 R.

(2) (a) In either or both of the circumstances described in (1):
(i) the firm must pay any mixed remittances to the authorised central counterparty from its own bank account, and
(ii) the firm is permitted to pay any remittances to the authorised central counterparty that consist only of client money from that same bank account.

(b) Where the circumstances described in (1)(a) or (1)(b) are satisfied, the firm is permitted to receive any remittances that consist only of client money from the authorised central counterparty into its own account, if it complies with (2)(a), if it complies with (2)(b), and, in any event, no later than the next business day after receipt.

578. 7.13.73R
(1) Subject to paragraphs (2) and (3), CASS 7.13.72 R do not apply to a firm following a primary pooling event.

(2) If, at the time of a primary pooling event, a firm has received money in a client bank account for the purposes of clearing arrangement mandatory prudent segregation under CASS 7.13.72 R, that money remains client money for the purposes of the client money rules and the client money distribution and transfer rules.

(3) Where a firm holds a clearing arrangement mandatory prudent segregation record under CASS 7.13.72 R following a primary pooling event, the clearing arrangement mandatory prudent segregation record must continue to satisfy the requirements set out in CASS 7.13.72 R.

579. 7.13.74R
(1) Where the circumstances described in CASS 7.13.72 R (1)(a) apply to a firm, it must pay an amount (determined in accordance with this rule) of its own money into its client bank account and retain that money in its client bank account (clearing arrangement mandatory prudent segregation). The amount segregated by a firm in its client bank account under this rule will be client money for the purposes of
the client money rules and the client money distribution and transfer rules.

(2) The amount required to be segregated under this rule must be an amount that a firm reasonably determines would be sufficient, at the time it makes the determination, to protect client money against the risk that at any time in the following three months client money received from the authorised central counterparty and held by the firm in its own bank account following receipt of those monies and under CASS 7.13.72 R (2)(b) may not have been fully segregated in the client bank account or may not be (or become) available for pooling under CASS 7A.2.4R (1), were a primary pooling event to occur with the effect that the firm’s clearing arrangement mandatory prudent segregation under this rule will reduce, as far as possible, any shortfall that might have been produced as a result of this risk on the occurrence of a primary pooling event.

(3)

(a) Subject to (c), in reaching its determination under (2) of the amount of money that would be sufficient to address the risks referred to in (2) for the forthcoming three months, a firm must take into account the following for at least the previous three months:

(i) the firm’s client money requirement over the course of that prior period (excluding any amount that was required to be segregated under this rule during that prior period for the purposes of clearing arrangement mandatory prudent segregation); and

(ii) the payments that the firm made into its client bank account under CASS 7.13.72 R (2)(b) during that prior period, as shown in its internal records.

(b) In reaching its determination under (2) a firm must also take into account, at all times having regard to the requirement under (2), any impact that particular events, the seasonal nature of each relevant business line, or any other aspect of those business line(s) may have on:

(i) the firm’s client money requirement during the forthcoming three months for which the amount of clearing arrangement mandatory prudent segregation required under this rule is being determined; and

(ii) the payments that the firm is likely to make into its client bank account under CASS 7.13.72 R (2)(b).

(c) If, at the time of its determination under (2), a firm has been trading for three months in a business line for which it is using the normal approach in connection with regulated clearing arrangements, then it must use the records that are available to it and must also factor in reasonable forecasts, as required under (b), to make up a three-month reference period.

(4)

(a) A firm must, at regular intervals that are at least quarterly, repeat and complete the combined process of:

(i) determining the amount that it is required to segregate for the purposes of clearing arrangement mandatory prudent segregation under (2) and (3);

(ii) making necessary adjustments to its records to reflect any changes to its client money requirement in accordance with CASS 7.16.16 R (3) and CASS 7.16.17 R (1); and

(iii) paying any additional amounts of its own money into its client bank account to increase the firm’s clearing arrangement mandatory prudent segregation or withdrawing any excess amounts from its client bank account to decrease the firm’s clearing arrangement mandatory prudent segregation after it has adjusted its records under (ii).

(b) The combined process of (a)(i) to (iii) must take no longer than ten business days.

(c) To the extent that a firm’s compliance with (a)(i) and (ii) results in there being an excess in its client bank account, the firm may:

(i) retain the excess as client money; or

(ii) use the excess to increase the amount of the firm’s clearing arrangement mandatory prudent segregation maintained under this rule at least annually.

(5) A firm must ensure that the individual responsible for CASS oversight under CASS 1A.3.1 R, CASS 1A.3.1A R or CASS 1A.3.1C R (as appropriate) reviews the adequacy of the amount of the firm’s clearing arrangement mandatory prudent segregation maintained under this rule at least annually.

585.

Clearing arrangement mandatory prudent segregation record 7.13.74R

A firm must create and keep up-to-date records so that any amount of money that, pursuant to CASS 7.13.75 R:

(1) paid into a client bank account and retained as client money, or

(2) withdrawn from a client bank account,

can be easily ascertained (the clearing arrangement mandatory prudent segregation record).

UK jurisdiction specific rule.
The clearing arrangement mandatory prudent segregation record under CASS 7.13.74 R must record:
(1) the date of the first determination under CASS 7.13.73 R (2) and each subsequent review undertaken under CASS 7.13.73 R (4), and the total amount that the firm determined was segregated under CASS 7.13.73 R (2) or at that date;
(2) the date of any payment of the firm's own money into a client bank account, or withdrawal of any excess from a client bank account under CASS 7.13.73 R (4)(a)(iii), and for each such occasion:
(a) the amount of the payment or withdrawal;
(b) the fact that the money was paid or withdrawn by the firm in accordance with CASS 7.13.73 R; and
(c) at that date, the total amount actually segregated by the firm under CASS 7.13.73 R.

The clearing arrangement mandatory prudent segregation record must be retained for five years after the firm ceases to segregate any money in accordance with CASS 7.13.73 R.

Nothing in CASS 7.13.73 R to CASS 7.13.76 R prevents a firm from making use of the prudent segregation rule in CASS 7.13.41 R.

The obligation to use reasonable endeavours referred to in CASS 7.13.71 R is a continuing obligation. Firms should at least on an annual basis, whether it is possible for payments of client money between the firm and the authorised central counterparties to be made separately from house monies and for such payments to be incurred into and made from its client bank accounts.

A firm may allow another person, such as an exchange, a clearing house or an intermediate broker, to hold client money, but only if:
(1) the firm allows that person to hold the client money:
(a) for the purpose of one or more transactions for a client through or with that person; or
(b) to meet a client's obligation to provide collateral for a transaction (for example, an initial margin requirement for a contingent liability investment); and
(2) in the case of a retail client, that client has been notified that the firm may allow the other person to hold its client money.

This section sets out the requirements a firm must comply with when it allows another person to hold client money, other than under CASS 7.13.3 R, without discharging its fiduciary duty to that client. Such circumstances arise when, for example, a firm passes client money to a clearing house in the form of margin (or the firm's obligations to the clearing house that are referable to transactions undertaken by the firm for the relevant clients). They may also arise when a firm passes client money to an intermediate broker for contingent liability investment in the form of initial or variation margin on behalf of a client. In these circumstances, the firm remains responsible for that client equity balance held at the intermediate broker until the contract is terminated and all of that client's positions at that broker closed. Similarly, this section applies where a firm allows a broker to hold client money in respect of the firm's client's non-margined transactions, again without the firm discharging its fiduciary duty to that client. In all cases, if a firm wishes to discharge itself from its fiduciary duty, it should do so in accordance with the rule regarding the discharge of a firm's fiduciary duty to the client (CASS 7.11.34 R).

This section sets out the requirements a firm must comply with when it allows another person to hold client money, other than under CASS 7.13.3 R, without discharging its fiduciary duty to that client. Such circumstances arise when, for example, a firm passes client money to a clearing house in the form of margin (or the firm's obligations to the clearing house that are referable to transactions undertaken by the firm for the relevant clients). They may also arise when a firm passes client money to an intermediate broker for contingent liability investment in the form of initial or variation margin on behalf of a client. In these circumstances, the firm remains responsible for that client equity balance held at the intermediate broker until the contract is terminated and all of that client's positions at that broker closed. Similarly, this section applies where a firm allows a broker to hold client money in respect of the firm's client's non-margined transactions, again without the firm discharging its fiduciary duty to that client. In all cases, if a firm wishes to discharge itself from its fiduciary duty, it should do so in accordance with the rule regarding the discharge of a firm's fiduciary duty to the client (CASS 7.11.34 R).

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(1) the firm allows that person to hold the client money:
(a) for the purpose of one or more transactions for a client through or with that person; or
(b) to meet a client's obligation to provide collateral for a transaction (for example, an initial margin requirement for a contingent liability investment); and
(2) in the case of a retail client, that client has been notified that the firm may allow the other person to hold its client money.

This section sets out the requirements a firm must comply with when it allows another person to hold client money, other than under CASS 7.13.3 R, without discharging its fiduciary duty to that client. Such circumstances arise when, for example, a firm passes client money to a clearing house in the form of margin (or the firm's obligations to the clearing house that are referable to transactions undertaken by the firm for the relevant clients). They may also arise when a firm passes client money to an intermediate broker for contingent liability investment in the form of initial or variation margin on behalf of a client. In these circumstances, the firm remains responsible for that client equity balance held at the intermediate broker until the contract is terminated and all of that client's positions at that broker closed. Similarly, this section applies where a firm allows a broker to hold client money in respect of the firm's client's non-margined transactions, again without the firm discharging its fiduciary duty to that client. In all cases, if a firm wishes to discharge itself from its fiduciary duty, it should do so in accordance with the rule regarding the discharge of a firm's fiduciary duty to the client (CASS 7.11.34 R).
Client money that a firm allows another person to hold under CASS 7.14.2 R:
(1) should only be held for transactions which are likely to occur (and for which the other person needs to receive client money) or have recently settled (and such that the other person has received client money); and
(2) should be recorded in client transaction accounts by that other person.

588. 7.14.4G Apart from client money held by a firm in an individual client account or an omnibus client account at an authorised central counterparty, a firm should not hold excess client money in its client transaction accounts.

591. 7.14.6R If a firm has deposited safe custody assets with a third party under CASS 6.3 and client money arises from, or in connection with, those safe custody assets then the third party either deposits the money in a client bank account of the firm or records it in a client transaction account for the benefit of the firm clients as appropriate.

593. 7.14.8G If the third party holding the safe custody assets under CASS 7.14.6 R is a bank with which the firm is permitted to deposit client money under CASS 7.13.3 R, then the client bank account referred to in CASS 7.14.6 R may be an account with that bank.

594. 7.14.9G Firms are reminded of the requirements under CASS 7.18 for acknowledgement letters, which must be complied with before using client bank accounts and client transaction accounts.

595. 7.15 Records, accounts and reconciliations

596. Article 2(1)(a) Commission Delegated Directive

597. Article 2(1)(b) Commission Delegated Directive

598. Article 2(1)(a) Commission Delegated Directive

599. Article 2(1)(b) Commission Delegated Directive
<table>
<thead>
<tr>
<th>Section</th>
<th>Text</th>
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<tbody>
<tr>
<td>598.423</td>
<td>their correspondence to the financial instruments and funds held for clients and that they may be used as an audit trail.</td>
</tr>
<tr>
<td>599.7.15.4G</td>
<td>(1) The requirements in CASS 7.15.2R to CASS 7.15.3R are for a firm to keep internal records and accounts of client money. Therefore, any records falling under these 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 or through whom it may have deposited, or otherwise allowed to hold, client money. (2) Where a firm complies with CASS 7.15 as a whole (to the extent applicable to that firm) this will be sufficient to comply with the specific duty in CASS 7.15.3R to maintain its records and accounts in a way that ensures they can be used as an audit trail.</td>
</tr>
<tr>
<td>6. Where an internal audit function exists within an investment firm, or within a group of which the investment firm is a member, the investment firm shall provide the Bank, as soon as practicable, with a copy of any internal audit report which refers to the investment firm.</td>
<td></td>
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<tr>
<td>7.15.5R</td>
<td>(1) A firm must maintain records so that it is able to promptly determine the total amount of client money it should be holding for each of its clients. (2) A firm must ensure that its records are sufficient to show and explain its transactions and commitments for its client money. (3) Unless otherwise stated, a firm must ensure that any record made under this chapter is retained for a period of five years starting from the later of: (a) the date it was created; and (b) (if it has been modified since the date it was created), the date it was most recently modified.</td>
</tr>
<tr>
<td>Regulations 25(1) MiFID Regulations</td>
<td>An investment firm shall arrange for records to be kept of all services, activities and transactions undertaken by the investment firm and ensure that the records are sufficient to enable the Bank to fulfil its supervisory tasks and take enforcement action under these Regulations, Regulation (EU) No 596/2014, Regulation (EU) No 600/2014 and the European Union (Market Abuse) Regulations 2016 (S.I. No. 349 of 2016) and, in particular, to ascertain whether the firm has complied with all obligations including those with respect to clients or potential clients and to the integrity of the market. Para. 1(1) (a) and (b) of Schedule 3 MiFID Regulations</td>
</tr>
<tr>
<td>Safeguarding client financial instruments and funds</td>
<td>1. (1) Investment firms shall— (a) keep records and accounts enabling them at any time and without delay to distinguish assets held for one client from assets held for any other client and from their own assets, (b) maintain their records and accounts in a way that ensures their accuracy, and in particular their correspondence to the financial instruments and funds held for clients and that they may be used as an audit trail. General reporting requirements for investment firms</td>
</tr>
</tbody>
</table>
(b) on the Online Reporting System in respect of the MiFID investment firm.

(5) A MiFID investment firm which is subject to the CRD Regulations and is authorised for investment service 3 or investment service 6 and applies Article 96(1) of the Capital Requirement Regulation shall submit to the Bank all data items specified—

(a) in Part 4 of the Schedule, and

(b) on the Online Reporting System in respect of the MiFID investment firm.

(6) A MiFID investment firm which is subject to the CRD Regulations but not authorised for investment service 3 or investment service 6 shall submit to the Bank all data items specified—

(a) in Part 5 of the Schedule, and

(b) on the Online Reporting System in respect of the MiFID investment firm.

(7) A MiFID investment firm not subject to the CRD Regulations but authorised for investment service 2 or investment service 4 shall submit to the Bank all data items specified—

(a) in Part 6 of the Schedule, and

(b) on the Online Reporting System in respect of the MiFID investment firm.

(8) A MiFID investment firm not subject to the CRD Regulations but authorised only for investment service 1 or investment service 5, or both, shall submit to the Bank all data items specified—

(a) in Part 7 of the Schedule, and

(b) on the Online Reporting System in respect of the MiFID investment firm.

(9) An investment firm subject to reporting requirements under these Regulations shall—

(a) submit data items to the Bank—

(i) through the Online Reporting System,

(ii) in such form and manner as may be specified on the Online Reporting System from time to time,

(iii) as frequently as is specified in column 2 of the applicable Part of the Schedule, and

(iv) by—

(I) the day specified in column 3 of the Schedule, or

(II) where the day specified in column 3 of the Schedule is not a working day, the next working day, and

(b) ensure that data items submitted to the Bank pursuant to this Regulation are—

(i) complete, and

(ii) in the case of an estimate or a judgement, supported by adequate evidence which evidence includes documents or information—

(I) relied upon during the formulation of the estimate or judgement, and

(II) describing the manner in which the documents or information referred to in subclause (I) were applied or relied upon when formulating the estimate or judgement.

Regulation 67 IMR 2017

Record-keeping — general requirements

67. (1) An investment firm shall—

424
(a) keep an accurate record of each transaction on a client asset account in such a manner and form that:
   (i) the client or in respect of whom the transaction was conducted is identified, and
   (ii) the transaction is accounted for by the investment firm separate from all other transactions of the investment firm;
(b) keep the records required under paragraph (a) separate from records relating to transactions which are not related to the third party client asset account.

(2) An investment firm shall maintain the following, in a readily accessible form, for a period of at least 6 years:
(a) a record of the verification referred to in Regulation 54(3);
(b) every Funds Facilities Agreement and Financial Instruments Facilities Agreement between the investment firm and a third party;
   (i) a record of the date upon which—
      (ii) the reconciliation referred to in Regulation 57(5) was prepared, and
      (iii) the daily calculation, referred to in Regulation 58(5) was prepared;
   (ii) a record to evidence the review process referred to in Regulations 57(6) and 58(6);
   (iii) evidence of the review referred to in Regulation 59(2)(b);
   (iv) a record of each reconciliation required by Regulation 57 including—
      (i) the information upon which the reconciliation is based,
      (ii) the relevant person who carried out such reconciliation, and
      (iii) the relevant person who reviewed such reconciliation;
   (v) a record of each daily calculation required by Regulation 58 including—
      (i) the information upon which the daily calculation is based,
      (ii) the relevant person who carried out such daily calculation, and
      (iii) the relevant person who reviewed such daily calculation;
   (vi) a record of the client asset management plan review referred to in Regulation 64(3);
   (vii) all records required to demonstrate compliance with this Part.

(3) Where under or in relation to this Part, an investment firm holds or another party holds a record on behalf of an investment firm electronically, the investment firm shall ensure that it can produce these records without delay.

Regulation 12 IMR 2017
Books, records, financial control and management information

12. (1) An investment business firm shall maintain the following, in a readily accessible form, for a period of at least 6 years:
(a) a full record of each transaction entered into by it whether on its own behalf or on behalf of clients;
(b) a complete written record of all investment advice, including oral advice, given to clients;
(c) all records required to demonstrate compliance with these Regulations;
(d) details of all money received and expended by the investment business firm whether on its own behalf or on
behalf of clients, together with details of how such receipts and payments arose;
(e) a record of all assets and liabilities of the investment business firm including long and short positions, off-balance sheet items and any commitments or contingent liabilities;
(f) a record of all investment instruments or documents of title held by the investment business firm setting out—
(i) the physical or electronic location, 
(ii) the beneficial owner, 
(iii) the purpose for which they are held, and
(iv) whether they are subject to any charge;
(g) records that are adequate for the purposes of financial control and management information and which are maintained in such a manner which discloses or is capable of disclosing the financial and business information which will enable the investment business firm’s senior management to—
(i) identify, quantify, control and manage the risk exposures,
(ii) make timely and informed decisions, 
(iii) monitor the performance of all aspects of the business, 
(iv) maintain the asset quality, and
(v) safeguard the assets of the investment business firm, including any client assets and investor money;
(h) the records referred to in Regulations 44 to 46.
(2) An investment business firm shall have adequate procedures for the maintenance, security, privacy and preservation of records, working papers and documents of title held by the investment business firm, including the documents referred to in paragraph (1), so that they are reasonably safeguarded against loss, unauthorised access, alteration or destruction.
(3) Where an investment business firm contracts all or part of its recordkeeping activities to another person, it shall only do so in accordance with the provisions of a written agreement entered into with that other person.

600. 7.15.6G
Unless required sooner under another rule in this chapter, in complying with CASS 7.15.5 R (1)(a) a firm should ensure it is able to determine the total amount of client money it should be holding for each client within two business days of having taken a decision to do so or at the request of the FCA.

601. 7.15.7R
For each internal client money reconciliation and external client money reconciliation the firm conducts, it must ensure that it records:
(1) the date it carried out the relevant process;
(2) the actions the firm took in carrying out the relevant process; and
(3) the outcome of its calculation of its client money requirement and client money resource.

602. Policies and procedures
7.15.8G
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 under this chapter. This should include, for example, establishing and maintaining policies and procedures concerning—
(1) the frequency and method of the reconciliations the firm is required to carry out under this section;
(2) the resolution of reconciliation discrepancies under this section; and
(3) the frequency at which the firm is required to review its arrangements in compliance with this chapter.

603. Receipts of client money
7.15.9R

Irish rules diverge conceptually from EU and UK rules in being more prescriptive.
A firm must maintain appropriate records that account for all receipts of client money in the form of cash, cheque or other payable order that are not yet deposited in a client bank account (see CASS 7.13.32 R and CASS 7.13.33 R). Examples of circumstances in which money is investor money:

(i) Cheques, electronic transfers and other payable orders received from investors will be investor money from the time of receipt of the cheque or other payable order by the fund service provider. Money sent to an investor by way of, cheques, electronic transfers or other payable order does not cease to be investor money until the cheque, electronic transfer or other payable order is presented and paid by the third party (as defined in Part 7).

### 604.1.15 R

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Description</th>
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<tbody>
<tr>
<td>7.15.10G</td>
<td>Firms following one of the standard methods of internal client money reconciliation in CASS 7.16 are also reminded that they must, as part of their internal client money reconciliation, take into account all receipts of client money in the form of cash, cheque or other payable order that are not yet deposited in a client bank account (see CASS 7.13.32 R and CASS 7.13.33 R).</td>
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Broadly conceptually equivalent across relevant rules.

### 605.1.15 R

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Description</th>
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<tbody>
<tr>
<td>7.15.11R</td>
<td>If a firm draws a cheque, or other payable order, to discharge its fiduciary duty to its clients (see CASS 7.11.40 R), it must continue to record its obligation to its clients until the cheque, or other payable order, is presented and paid by the bank.</td>
</tr>
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</table>

Broadly conceptually equivalent across relevant rules.

### 606.1.15 R

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Description</th>
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<tbody>
<tr>
<td>7.15.12R</td>
<td>An internal client money reconciliation requires a firm to carry out a reconciliation of its internal records and accounts of the amount of client money that the firm holds for each client with its internal records and accounts of the client money the firm should hold in client bank accounts or has placed in client transaction accounts.</td>
</tr>
</tbody>
</table>

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

### 607.1.15 R

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Description</th>
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<tbody>
<tr>
<td>7.15.13R</td>
<td>In carrying out an internal client money reconciliation, a firm must use the values contained in its internal records and ledgers (for example, its cash book or other internal accounting records) rather than the values contained in the records it has obtained from banks and other third parties with whom it has placed client money (for example, bank statements).</td>
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</table>

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

### 608.1.15 R

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Description</th>
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</table>
| 7.15.14R | An internal client money reconciliation should:

1. be one of the steps a firm takes to arrange adequate protection for clients' assets when the firm is responsible for them (see Principle 10 ( Clients' assets), as it relates to client money);
2. be one of the steps a firm takes to satisfy its obligations under CASS 7.12.2 R and CASS 7.13.5 R and, where relevant, SYSC 4.1.1R (1) and SYSC 5.1.1 R, to ensure the accuracy of the firm's records and accounts;
3. be the normal approach to segregating client money (CASS 7.13.6 R), check whether the amount of client money recorded in the firm's records as being segregated in client bank accounts meets the firm's obligations to its clients under the client money rules on a daily basis; and
4. be the alternative approach to segregating client money (CASS 7.13.62 R); calculate the amount of client money to be segregated in client bank accounts which meets the firm's obligations to its clients under the client money rules on a daily basis. |

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

### 609.1.15 R

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Description</th>
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</table>
| 7.15.15G | (1) Subject to paragraph (4), a firm must perform an internal client money reconciliation:

(a) each business day; and
(b) based on the records of the firm as at the close of business on the previous business day.

(2) When performing an internal client money reconciliation, a firm must, subject to (5), follow one of the standard methods of internal client money reconciliation in CASS 7.16.

(3) A firm proposing to follow a non-standard method of internal client money reconciliation must comply with the requirements in CASS 7.13.37 R to CASS 7.13.40 G. |

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.
(4) Following a primary pooling event, and in addition to any obligations of a special administrator under regulation 10H of the IBSA Regulations:
(a) a firm must perform an internal client money reconciliation that relates to the time of the primary pooling event as soon as reasonably practicable after the primary pooling event; and
(b) the firm must perform further internal client money reconciliations as regularly as required under paragraph (5), based on the records of the firm as at the close of business on the business day before the day on which the reconciliation takes place.

(5) A firm must determine when and how often to perform an internal client money reconciliation under paragraph (4)(b) so as to ensure that:
(a) the firm remains in compliance with CASS 7.15.2R, CASS 7.15.3R and CASS 7.15.6R(1) and (2) (Record keeping); and
(b) the correct amounts of client money are returned to clients or transferred on behalf of clients under the client money distribution and transfer rules.

610.7.15.15AG
(1) The reference point for the internal client money reconciliation under CASS 7.15.15R(4)(a) should be the precise point in time at which the primary pooling event occurred.
(2) When a firm decides whether it is necessary at any particular point in time to perform an internal client money reconciliation under CASS 7.15.15R(4)(b), it should have particular regard to the need to maintain its books and accounts in order to ensure that:
(a) each notional pool of client money formed under CASS 7A.2.4R(1) and (1A) (Pooling and distribution or transfer) is correctly composed and maintained, and is treated separately;
(b) client money that is required under CASS 7A.2.4R(3) (Pooling and distribution or transfer) and CASS 7A.2.7AR (Client money received after a primary pooling event) to be treated as outside of any notional pool is treated accordingly; and
(c) where applicable, client's entitlements to their client money are calculated in accordance with CASS 7A.2.5R(2)(b) (Client money entitlements).
(4) Depending on the circumstances of the firm and the scale, frequency and nature of activity after a primary pooling event that affects client money, a firm may conclude that it is necessary to continue performing internal client money reconciliations each business day for a period of time after the primary pooling event.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

611.7.15.16R
(1) A firm which has adopted the normal approach to segregating client money (see CASS 7.13.6 R) must use the internal client money reconciliation to check whether its client money resource, as at the close of business on the previous business day, was equal to its client money requirement at the close of business on that previous day.
(2) A firm that adopts the alternative approach to segregating client money (see CASS 7.13.5R G) must use the internal client money reconciliation to ensure that its client money resource as at the close of business on any day it carries out an internal client money reconciliation is equal to its client money requirement at the close of business on the previous day.

Non-standard method of internal client money reconciliation

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

612.7.15.17R
A non-standard method of internal client money reconciliation is a method of internal client money reconciliation which does not meet the requirements in CASS 7.16 (The standard methods of internal client money reconciliation).

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

613.7.15.18R
(1) Before using a non-standard method of internal client money reconciliation, a firm must:
(a) establish and document in writing its reasons for concluding that the method of internal client money reconciliation it proposes to use will:
(i) (for the normal approach to segregating client money) check whether the amount of client money recorded in the firm's records as being segregated in client bank accounts meets the firm's obligation to its clients under the client money rules on a daily basis; or
(ii) (for the alternative approach to segregating client money) calculate the amount of client money to be segregated in client bank accounts which meets the firm's obligations to its clients under the client money rules on a daily basis;
(b) notify the FCA of its intention to use a non-standard method of internal client money reconciliation; and

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.
(1) send a written report to the FCA prepared by an independent auditor of the firm in line with a reasonable assurance engagement and stating the matters set out in (2).

(2) The written report in (1)(c) must state whether in the auditor's opinion:
   (a) the method of internal client money reconciliation which the firm will use is suitably designed to enable it to (as applicable):
      (i) (for the normal approach to segregating client money) check whether the amount of client money recorded in the firm's records as being segregated in client bank accounts meets the firm's obligation to its clients under the client money rules on a daily basis; or
      (ii) (for the alternative approach to segregating client money) calculate the amount of client money to be segregated in client bank accounts which meets the firm's obligations to its clients under the client money rules on a daily basis; and
   (b) the firm's systems and controls are suitably designed to enable it to carry out the method of internal client money reconciliation the firm will use.

(3) A firm using a non-standard method of internal client money reconciliation must not materially change its method of undertaking internal client money reconciliations unless:
   (a) the firm has established and documented in writing its reasons for concluding that the changed methodology will meet the requirements in (1)(a)(i) and (ii), as applicable;
   (b) an auditor of the firm has prepared a report that complies with the requirements in (1)(c) and (2) in respect of the firm's proposed changes; and
   (c) the firm provides a copy of the report prepared by the auditor under (2) to the FCA before implementing the change.
7.15.23R  
(1) A firm must make and retain records sufficient to show and explain any decision it has taken under CASS 7.15.23 R when determining the frequency of its external client money reconciliations. Subject to (2), any such records must be retained indefinitely.  
(2) If any decision under CASS 7.15.23 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.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

7.15.24R  
In most circumstances, firms which undertake transactions on a daily basis should conduct an external client money reconciliation each business day.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

7.15.26R  
(1) Subject to (3), a firm must review the frequency it conducts its external client money reconciliations at least annually to ensure that it continues to comply with CASS 7.15.22 R and has given due consideration to the matters in CASS 7.15.23 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 external client money reconciliations.  
(3) A firm need not carry out a review under (1) if it is conducting external client money reconciliations each business day.

Frequency of external reconciliations after a primary pooling event

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

7.15.26AR  
Following a primary pooling event, and in addition to any obligations of a special administrator under regulation 10H of the IBSA Regulations:

(1) a firm must perform an external client money reconciliation that relates to the time of the primary pooling event as soon as reasonably practicable after the primary pooling event, based on the next available statements or other form of confirmation after the primary pooling event from:
   (a) the banks with which the firm holds a client bank account; and  
   (b) the persons with which the firm holds a client transaction account; and  
(2) the firm must perform further external client money reconciliations on a regular basis:
   (a) with a suitable frequency to ensure that the correct amounts of client money are returned to clients or transferred on behalf of clients under the client money distribution and transfer rules; and  
   (b) as soon as reasonably practicable after the date to which the external client money reconciliation relates.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

7.15.26BG  
The reference point for the external client money reconciliation under CASS 7.15.26AR(1) should be the precise point in time at which the primary pooling event occurred.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

7.15.26CR  
When determining the frequency with which it will undertake external client money reconciliations under CASS 7.15.26AR(2) after a primary pooling event, a firm must have regard to:

(1) the frequency, number and value of transactions which the firm undertakes in respect of client money;  
(2) the risks to which the client money is exposed, such as the nature, volume and complexity of the firm’s business and where and with whom client money is held; and  
(3) the need to be able to verify that:
   (a) client money within each notional pool formed under CASS 7A.2.4R(1) and (1A) (Pooling and distribution or transfer), and client money that is required under CASS 7A.2.7R-AR-(Client money received after a primary pooling event) to be treated as outside of any notional pool, has not been incorrectly distributed, transferred or dissipated;  
   and  
   (b) the proceeds of any payments and transactions that settle after the primary pooling event and which involve client money, including interest payments and other amounts included in the client money resource, have been received accurately.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

7.15.27R  
Method of external client money reconciliations

An external client money reconciliation requires a firm to:

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.
(1) compare:
(a) the balance, currency by currency, on each client bank account recorded by the firm, as set out in the most recent statement or other form of confirmation issued by the bank with which those accounts are held; and
(b) the balance, currency by currency, on each client transaction account as recorded by the firm, as set out in the most recent statement or other form of confirmation issued by the person with whom the account is held; and
(2) promptly identify and resolve any discrepancies between those balances under CASS 7.15.31 R and CASS 7.15.32 R.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

628.

7.15.28R

A firm must ensure it includes the following items within its external client money reconciliation:

(1) any client's approved collateral a firm holds which secures an individual negative client equity balance (see CASS 7.16.32 R); and
(2) any of its own approved collateral a firm holds which is used to meet the total margin transaction requirement in CASS 7.16.33 R.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

629.

Reconciliation discrepancies

7.15.29R

When a discrepancy arises between a firm's client money resource and its client money requirement identified by a firm's internal client money reconciliations, the firm must determine the reason for the discrepancy and, subject to CASS 7.15.29AR, ensure that:

(1) any shortfall is paid into a client bank account by the close of business on the day that the reconciliation is performed; or
(2) any excess is withdrawn from a client bank account within the same time period.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

630.

7.15.29AR

A firm that has failed is not required to make a payment or withdrawal under CASS 7.15.29R(1) or CASS 7.15.29R(2) respectively so far as the legal procedure for the firm's failure restricts the firm from doing so.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

631.

7.15.30G

Where the discrepancy identified under CASS 7.15.29 R has arisen as a result of a breach of the client money segregation requirements, the firm should ensure it takes sufficient steps to avoid a recurrence of that breach (see Principle 10 (Chronic issues), as it relates to client money, CASS 7.15.5 R and, where relevant, SYSC 4.1.1R (1) and SYSC 6.1.1 R).

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

632.

7.15.31R

If any discrepancy is identified by an external client money reconciliation, the firm must investigate the reason for the discrepancy and take all reasonable steps to resolve it without undue delay, unless the discrepancy arises solely as a result of timing differences between the accounting systems of the party providing the statement or confirmation and that of the firm.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

633.

7.15.32R

While a firm is unable to immediately resolve a discrepancy identified by an external client money reconciliation, and one record or set of records examined by the firm during its external client money reconciliation indicates that there is a need to have a greater amount of client money or, if appropriate, approved collateral than is the case, the firm must assume, until the matter is finally resolved, that that record or set of records is accurate and, subject to CASS 7.15.32AR, pay its own money into a relevant account.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

634.

7.15.32AR

A firm that has failed is not required to pay its own money into a relevant account under CASS 7.15.32R in so far as the legal procedure for the firm's failure restricts the firm from doing so.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.

635.

7.15.32BG

(1) CASS 7.15.29AR and CASS 7.15.32AR recognise that a failed firm is required to investigate discrepancies, but the extent to which it is able to resolve discrepancies may be limited by insolvency law, for example.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive.
A firm must inform the FCA in writing without delay if:

1. its internal records and accounts of client money are materially out of date, inaccurate or invalid so that the firm is no longer able to comply with the requirements in CASS 7.15.2 R, CASS 7.15.3 R or CASS 7.15.5 R (1);
2. it will be unable to, or materially fails to, pay any shortfall into a client bank account or withdraw any excess from a client bank account so that the firm is unable to comply with CASS 7.15.29 R after having carried out an internal client money reconciliation;
3. it will be unable to, or materially fails to, identify and resolve any discrepancies under CASS 7.15.31 R as to CASS 7.15.32 R after having carried out an external client money reconciliation;
4. it will be unable to, or materially fails to, conduct an internal client money reconciliation in compliance with CASS 7.15.12 R and CASS 7.15.15 R;
5. it will be unable to, or materially fails to, conduct an external client money reconciliation in compliance with CASS 7.15.20 R to CASS 7.15.28 R;
6. it becomes aware that, at any time in the preceding 12 months, the amount of client money segregated in its client bank accounts materially differed from the total aggregate amount of client money the firm was required to segregate in client bank accounts under the client money segregation requirements.

Regulation 57 IMR 2017
Reconciliation
37. (1) In relation to third party client asset accounts, other than fixed term deposit accounts, which hold client funds, an investment firm shall reconcile daily, the balance of all client funds held, as recorded by the investment firm with the balance of all client funds deposited, as recorded by the third party as set out in a statement or other form of confirmation from the third party and such a reconciliation shall be carried out by the end of the working day immediately following the working day to which the reconciliation relates.
(2) In relation to third party client asset accounts which hold fixed term deposits, an investment firm shall reconcile, at least monthly, the balance of all client funds deposited, as recorded by the investment firm with the balance of all client funds held, as recorded by the third party as set out in a statement or other form of confirmation from the third party and such a reconciliation shall be carried out within 3 working days of the date to which the reconciliation relates.
(3) In relation to third party client asset accounts which hold client financial instruments, an investment firm shall reconcile, at least monthly, the balance of client financial instruments held, as recorded by the investment firm with the balance of all client financial instruments held, as recorded by the third party as set out in a statement or other form of confirmation from the third party and such a reconciliation shall be carried out within 10 working days of the date to which the reconciliation relates.

(c) CASS 7.15.29AR and CASS 7.15.32AR would not prevent a failed firm from making any transfers required under regulation 10H(3) or (4) of the IBSA Regulations.
(5) Each reconciliation shall be carried out by a relevant person who is independent of the production and maintenance of the records used for the purpose of carrying out the reconciliation.

(6) Each reconciliation shall be reviewed by a relevant person who is independent of the person who carried out the reconciliation and of the person who produced and maintained the records used for the purpose of carrying out the reconciliation.

(7) An investment firm shall—

(a) ensure that the reconciliations required pursuant to Regulations 57(1), 57(2) and 57(3) are performed using client asset records that are accurate and the reconciliation itself is performed accurately.

(b) investigate within one working day the cause of any reconciliation difference in the reconciliation required pursuant to Regulations 57(1), 57(2) and 57(3).

(c) identify the cause of any reconciliation difference identified in Regulation 57(7)(b) within 5 working days, and

(d) resolve any reconciliation difference identified in Regulation 57(7)(b) as soon as practicable.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive than EU and Irish rules.

7.16.3G

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).

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive than EU and Irish rules.

7.16.4G

Firms are reminded that the internal client money reconciliation should achieve the purpose set out in CASS 7.15.14 G.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive than EU and Irish rules.

7.16.5G

(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.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive than EU and Irish rules.

7.16.6G

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).

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive than EU and Irish rules.

7.16.7G

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 (e.g., 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 7.16.9 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).

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive than EU and Irish rules.
7.16.8G
(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.

7.16.10R
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).

Regulation 58 IMR 2017
Daily calculation
58. (1) An investment firm shall, each working day, ensure that the client funds resource as at the close of business on the previous working day is equal to the client funds requirement.
(2) For the purposes of Regulation 58(1), an investment firm shall use values in its own accounting records which may have been reconciled with statements from a third party rather than values contained in statements received from a third party.
(3) In the event of a shortfall of client funds, an investment firm shall deposit into a third party client asset account, without delay and in any event within one working day from the date to which the calculation relates, such money from the investment firm’s own assets as is necessary to ensure that the client funds resource is equal to the client funds requirement.
(4) In the event of an excess of client funds, an investment firm shall withdraw from a third party client asset account, without delay and in any event within one working day from the date to which the calculation relates, such money from a third party client asset account as is necessary to ensure that the client funds resource is equal to the client funds requirement.
(5) The daily calculation shall be carried out by a relevant person who is independent of the production and maintenance of the records used for the purpose of carrying out the daily calculation.
(6) The daily calculation shall be reviewed by a relevant person who is independent of the person who carried out the daily calculation and of the person who produced and maintained the records used for the purpose of carrying out the calculation.

7.16.11R
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.

7.16.12R
A CASS 7 loan-based crowdfunding firm may not use the individual client balance method under this section.

7.16.13R
(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.

651.

7.16.14G

(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 (i.e., across all its client bank accounts and business lines) 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 firm and, as a result, each firm will need to apply the calculation in a way which recognises the business model under which that firm operates.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive than EU and Irish rules.

652.

7.16.15G

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).

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive than EU and Irish rules.

653.

Client money requirement calculation: individual client balance method

7.16.16R

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:

(1) the individual client balances calculated under CASS 7.16.21 R, excluding:

(a) individual client balances which are negative (ie, debtors); and

(b) client equity balances;

(2) the total margined 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 7.16.32 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).

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive than EU and Irish rules.

654.

Client money requirement calculation: net negative add-back method

7.16.17R

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive than EU and Irish rules.
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.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive than EU and Irish rules.

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 in 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)).

For the purposes of CASS 7.16.17 R, a firm should be able to readily see 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.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive than EU and Irish rules.

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).

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive than EU and Irish rules.

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.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive than EU and Irish rules.

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.

Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive than EU and Irish rules.

A firm may calculate either:

1. one individual client balance for each client, based on the total of the firm's holdings for that client; or
2. 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 money (sums held for a client free of sale or purchase (eg, see 5.15E) and
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<thead>
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<th>free proceeds due to the client)</th>
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<td>(a) for principal deals when the client has delivered the designated investments and</td>
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<td>(b) for agency deals when</td>
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<tr>
<td>(c) the sale proceeds due to the firm have been invested by the firm and the client has delivered the</td>
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Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive than EU and Irish rules.
(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, unless it identifies it 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 settle under CASS 6.1.12R (2);
(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.

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.
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 (18), the result should be that the firm does not net client positions across all products and accounts.

662. Other requirements for calculating the client money requirement

7.16.22R

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

1. Include any unidentified 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.

UK jurisdiction-specific rules.

663. 7.16.25G

(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).

UK jurisdiction-specific rules.

664. 7.16.27G

(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:
(a) if it is using 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 these balances when calculating its client money requirement and CASS 7.16.25 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 its client’s individual client balance (eg, see CASS 7.16.22 R and items C1 and E2).
(b) Under (1) (a) 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).
(c) 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).

UK jurisdiction-specific rules.

665. Margined transactions (eg, derivatives): equity balances

7.16.28R

Subject to CASS 7.16.29 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) if the client were to exercise the right to reduce its margin account to zero.
firms 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.

666. 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 position the firm holds for clients and any margin the firm holds for clients in the relevant client transaction accounts.

667. 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.

668. The total margined transaction requirement is:

7.16.33G

The total margined transaction requirement is:

1. the sum of each of the clients' equity balances which are positive;
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 on client transaction accounts for customers with exchanges, clearing houses, intermediate brokers and OTC counterparties.

669. 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, UK jurisdiction-specific rules.

670. Broadly conceptually equivalent across relevant rules save that UK rules are more prescriptive than EU and Irish rules.
simultaneously reducing its overall client money requirement (i.e., the amount of money the firm is required to segregate in client bank accounts).

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.

BROADLY CONCEPTUALLY EQUIVALENT ACROSS RELEVANT RULES SAVE THAT UK RULES ARE MORE PREScriptive THAN EU AND IRLAND RULES.

LME bond arrangements

A firm with a Part 50 exemption order under which it 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 margined transaction requirement, to the extent those transactions are provided for by an LME bond arrangement (see CASS 12.2.3G).

UK jurisdiction-specific rules.

Reduced client money requirement option

(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.

UK jurisdiction-specific rules.

LME bond arrangements

7.16.35R

A firm with a Part 50 exemption order under which it 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 margined transaction requirement, to the extent those transactions are provided for by an LME bond arrangement (see CASS 12.2.3G).

UK jurisdiction-specific rules.

Reduced client money requirement option

7.16.36R

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 margined transaction requirement, to the extent those transactions are provided for by an LME bond arrangement (see CASS 12.2.3G).

UK jurisdiction-specific rules.

Reduced client money requirement option

7.16.36R

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.

UK jurisdiction-specific rules.

Requirement

7.16.36R

Subject to CASS 7.17.3 R in respect of a trustee firm, a firm receives and holds client money in trust on the following terms:
(1) for the purposes of, and on the terms of, the client money rules and the client money distribution and transfer rules;
(2) (a) where a firm maintains only a general pool of client money:
(b) where a firm has established one or more pools of client money, subject to (4): (i) the general pool is held for all the clients of the firm for whom the firm receives or holds client money (other than clients which are insurance undertakings when acting in regard to client money received during insurance distribution activity and that were opted in to this chapter) according to their respective interests; and (ii) each sub-pool is for the clients of the firm who are identified as beneficiaries of the sub-pool in question, in accordance with CASS 7.19.6 R (2), according to their respective interests; and (3) after all valid claims in (2) have been met, for clients which are insurance undertakings with respect of client money received in the course of insurance distribution activity according to their respective interests in it.

UK jurisdiction-specific rules.

Requirement

7.17.4G

Section 137B(1) of the Act (Miscellaneous ancillary matters) provides that rules may make provision which result in client money being held by a firm on trust (England and Wales and Northern Ireland) or as agent (Scotland only). This section creates a fiduciary relationship between the firm and its client under which client money is in the legal ownership of the firm but remains in the beneficial ownership of the client. In the event of failure of the firm, costs relating to the distribution of client money may have to be borne by the trust.

UK jurisdiction-specific rules.

Requirement

7.17.4G

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.

UK jurisdiction-specific rules.
(4) for the payment of the costs properly attributable to the distribution of the client money in (2) if such distribution takes place following the failure of the firm, and (5) after all valid claims and costs under (2) to (4) have been met, for the firm itself.

The remuneration under CASS 7.17.2 R does not permit a firm, in its capacity as trustee, to use client money to advance credit to the firm's clients, itself, or any other person. For example, if a firm wishes to undertake a transaction for a client in advance of receiving client money from that client to fund that transaction, it should not advance credit to that client or itself using other clients' client money (ie, it should not "pre-fund" the transaction using other clients' client money).

The main purposes of an acknowledgement letter are:

(1) to put the bank, exchange, clearing house, intermediate broker, OTC counterparty or other person (as the case may be) on notice of a firm's clients' interests in client money that has been deposited with, or has been allowed to be held by, such person;

(2) to ensure that the client bank account or client transaction account has been opened in the correct form(s), whether the client bank account is being correctly opened as a general client bank account, a designated client bank account or a designated client fund account, and is distinguished from any account containing money that belongs to the firm;

(3) to ensure that the bank, exchange, clearing house, intermediate broker, OTC counterparty or other person (as the case may be) understands and agrees that it will not have any recourse or right against money standing to the credit of the client bank account or client transaction account, in respect of any sum owed to such person or to any other third person, on any other account.

For each client bank account, a firm must, in accordance with CASS 7.18.6 R, complete and sign a client bank account acknowledgement letter clearly identifying the client bank account, and send it to the bank with whom the client bank account is, or will be, opened, requesting the bank to acknowledge and agree to the terms of the letter by countersigning it and returning it to the firm. Subject to CASS 7.18.14 R and CASS 7.18.15 R, a firm must not hold or receive any client money in or into a client bank account unless it has received a duly countersigned client bank account acknowledgement letter from the relevant bank that has not been inappropriately redrafted (see CASS 7.18.8 R) and clearly identifies the client bank account.

For each client transaction account, a firm must, in accordance with CASS 7.18.6 R, complete and sign a client transaction account acknowledgement letter clearly identifying the client transaction account, and send it to the person with whom the client transaction account is, or will be, opened, requesting such person to acknowledge and agree to the terms of the letter by countersigning it and returning it to the firm. Subject to CASS 7.18.14 R and CASS 7.18.15 R, a firm must not allow the relevant person to hold any client money in a client transaction account maintained by that person for the firm, unless the firm has received a duly countersigned client transaction account acknowledgement letter from the relevant person that has not been inappropriately redrafted.
inappropriately redrafted (see CASS 7.18.8 R) and that clearly
identifies the client transaction account.

684.

Authorised central counterparty acknowledgement letters

7.18.4R

(1) A firm which places client money at an authorised central
counterparty in connection with a regulated clearing arrangement
must, in accordance with CASS 7.18.6 R, complete and sign an
authorised central counterparty acknowledgement letter clearly
identifying the relevant client transaction account. That letter must be
sent to the authorised central counterparty with whom the client
transaction account is, or will be, opened, requesting such authorised
central counterparty to acknowledge receipt of the letter by
counter-signing it and returning it to the firm.
(2) A firm which has complied with CASS 7.18.4 R (1) may allow the
authorised central counterparty to hold client money on the relevant
client transaction account, whether or not the authorised central
counterparty has counter-signed and returned the authorised central
counterparty acknowledgement letter it received from the firm.

685.

Acknowledgement letters in general

7.18.5G

In drafting acknowledgement letters under CASS 7.18.2 R, CASS
7.18.3 R or CASS 7.18.4 R, a firm is required to use the relevant
template in CASS 7 Annex 2 R, CASS 7 Annex 3 R or CASS 7
Annex 4 R, respectively.

686.

7.18.6R

When completing an acknowledgement letter under CASS 7.18.2 R
(1), CASS 7.18.3 R (1) or CASS 7.18.4 R (1), a firm:
(1) must not amend any of the acknowledgement letter fixed text;
(2) subject to (3), must ensure the acknowledgement letter variable
text is removed, included or amended as appropriate; and
(3) must not amend any of the acknowledgement letter variable text in
a way that would alter or otherwise change the meaning of the
acknowledgement letter fixed text.

687.

7.18.7G

CASS 7 Annex 5 G contains guidance on using the template
acknowledgement letters, including when and how firms should amend
the acknowledgement letter variable text that is in square brackets.

688.

7.18.8R

(1) If, on counter-signing and retu
rning the acknowledgement letter to
a firm, the relevant person has also:
(a) made amendments to any of the acknowledgement letter fixed text;
or
(b) made amendments to any of the acknowledgement letter variable
text in a way that would alter or otherwise change the meaning of the
acknowledgement letter fixed text;
the acknowledgement letter will have been inappropriately redrafted
for the purposes of CASS 7.18.2 R (2) or CASS 7.18.3 R (3) (as
applicable).
(2) For the purposes of CASS 7.18.2 R (2) or CASS 7.18.3 R (3),
amendments made to the acknowledgement letter variable text in the
acknowledgement letter returned to a firm by the relevant person, will
not have the result that the letter has been inappropriately redrafted if
those amendments do not affect the meaning of the acknowledgment
letter fixed text, have been specifically agreed with the firm and do
not cause the acknowledgement letter to be inaccurate.

689.

7.18.9R

A firm must use reasonable endeavours to ensure that any individual
that has counter-signed an acknowledgement letter that has been
returned to the firm was authorised to counter-sign the letter on behalf
of the relevant person.

690.

7.18.10R

(1) A firm must retain each countersigned client bank account
acknowledgement letter and client transaction account
acknowledgement letter it receives, from the date of receipt until the
expiry of five years from the date on which the last client bank
account or client transaction account to which the acknowledgement
letter relates is closed.
(2) A firm must retain a copy of each authorised central counterparty
acknowledgement letter it sends to an authorised central counterparty
under CASS 7.18.4 R (1), from the date it was sent until the expiry of
UK jurisdiction-specific rules that are echoed but not mirrored by Irish
requirements.
A firm must retain any other documentation or evidence it believes is necessary to demonstrate that it has complied with each of the applicable requirements in this section such as any evidence it has obtained to ensure that the individual that has countersigned an acknowledgement letter retained to the firm was authorised to countersign the letter on behalf of the relevant person.

UK jurisdiction - specific rules that are echoed but not mirrored by Irish requirements.

A firm must also retain any other documentation or evidence it believes is necessary to demonstrate that it has complied with each of the applicable requirements in this section such as any evidence it has obtained to ensure that the individual that has countersigned an acknowledgement letter retained to the firm was authorised to countersign the letter on behalf of the relevant person.

UK jurisdiction - specific rules that are echoed but not mirrored by Irish requirements.

A firm must periodically (at least annually, and whenever it is aware that something referred to in an acknowledgement letter has changed) review each of its acknowledgement letters to ensure that they all remain accurate.

A firm must promptly draw up a replacement acknowledgement letter under CASS 7.18.2 R or CASS 7.18.3 R or CASS 7.18.4 R, as applicable, and, if it is an acknowledgement letter required to be sent under CASS 7.18.2 R, CASS 7.18.3 R, ensure that the new acknowledgement letter is duly countersigned and returned by the relevant person.

Broadly equivalent rules between UK and Irish rules.
(1) safeguard the assets of the investment business firm, including any client assets and investor money;

(2) the records referred to in Regulations 44 to 46.

(2) An investment business firm shall have adequate procedures for the maintenance, security, privacy and preservation of records, working papers and documents of title held by the investment business firm, including the documents referred to in paragraph (1), so that they are reasonably safeguarded against loss, unauthorised access, alteration or destruction.

(3) Where an investment business firm contracts all or part of its recordkeeping activity to another person, it shall only do so in accordance with the provisions of a written agreement entered into with that other person.

Regulation 67 IMR 2017

67. (1) An investment firm shall—

(a) keep an accurate record of each transaction on a client asset account in such a manner and form that:

(i) the client for or in respect of whom the transaction was conducted is identified, and

(ii) the transaction is accounted for by the investment firm separate from all other transactions of the investment firm;

(b) keep the records required under paragraph (a) separate from records relating to transactions which are not related to the third party client asset account.

(2) An investment firm shall maintain the following, in a readily accessible form, for a period of at least 6 years:

(a) a record of the verification referred to in Regulation 54(1);

(b) every Funds Facilities Agreement and Financial Instruments Facilities Agreement between the investment firm and a third party;

(c) a record of the date upon which—

(i) the reconciliation referred to in Regulation 57(5) was prepared, and

(ii) the daily calculation, referred to in Regulation 58(5) was prepared;

(d) a record to evidence the review process referred to in Regulations 57(6) and 58(6);

(e) evidence of the review referred to in Regulation 63(2)(b);

(f) a record of each reconciliation required by Regulation 57 including—

(i) the information upon which the reconciliation is based,

(ii) the relevant person who carried out such reconciliation, and

(iii) the relevant person who reviewed such reconciliation;

(g) a record of each daily calculation required by Regulation 58 including—

(i) the information upon which the daily calculation is based,

(ii) the relevant person who carried out such daily calculation, and

(iii) the relevant person who carried out such daily calculation, and
(iii) the relevant person who reviewed such daily calculation;

(h) a record of the client asset management plan review referred to in Regulation 64(2);

(i) all records required to demonstrate compliance with this Part.

(3) Where under or in relation to this Part, an investment firm holds or another party holds a record on behalf of an investment firm electronically, the investment firm shall ensure that it can produce these records without delay.

694. 7.18.14R

If a firm’s client bank account or client transaction account is transferred to another person, the firm must promptly draw up a new acknowledgement letter under CASS 7.18.2 R, CASS 7.18.3 R or CASS 7.18.4 R, as applicable, and, if it is an acknowledgement letter required to be sent under CASS 7.18.2 R or CASS 7.18.3 R, ensure that the new acknowledgement letter is duly countersigned and returned by the relevant person within 20 business days of the firm sending it to that person.

695. 7.18.15R

If a firm opens a client bank account after a primary pooling event, the firm must:

(1) promptly draw up and send out a new acknowledgement letter under CASS 7.18.2 R;

(2) not hold or receive any client money in or into the client bank account unless it has sent the acknowledgement letter to the relevant person; and

(3) if the firm has not received a duly countersigned acknowledgement letter that has not been inappropriately redrafted (see CASS 7.18.8 R) within 20 business days of the firm sending the acknowledgement letter, withdraw all money standing to the credit of the account and deposit it in a client bank account with another bank as soon as possible.

696. 7.19 Clearing member client money sub-pools

7.19.1G

(1) Under CASS 7.17.2R(2), a firm acts as trustee for all client money received or held by it for the benefit of the clients for whom that client money is held, according to their respective interests in it.

(2) A firm that is also a clearing member of an authorised central counterparty may wish to segregate client money specifically for the benefit of a group of clients who have chosen to clear positions through a net margined omnibus client account maintained by the firm with that authorised central counterparty, where that segregation might facilitate the porting of client positions recorded in that net margined omnibus client account. To segregate client money (that would otherwise be held in the general pool) for a specific group of clients clearing positions through a particular net margined omnibus client account, a clearing member firm may, in accordance with these rules, create a sub-pool of client money.

(3) Upon the occurrence of a primary pooling event, the client money for:

(a) the general pool, should be distributed in accordance with CASS 7.19A to the clients for whom the firm receives or holds client money in that general pool; and

(b) a sub-pool, should either be:

(i) transferred to facilitate porting; or

(ii) distributed to the client who are beneficiaries of that sub-pool, according to their respective interests under CASS 7.19A.2 R. (2)(a).

(4) All client money is received or held by the firm as trustee for the clients of the firm. However, a clearing member of an authorised central counterparty who clears client positions through a net margined omnibus client account may organise its affairs (with the consent of the relevant clients) in such a way that such clients need not share in the general pool of client money following a primary pooling event, save to the extent that such clients otherwise have an interest in the general pool.

697. 7.19.2R

Where a firm creates a sub-pool for a particular net margined omnibus client account, it must not clear positions through that omnibus client account for clients who are not beneficiaries of that sub-pool.

UK jurisdiction specific rules.
7.19.3R
A firm wishing to establish a sub-pool must establish and maintain adequate internal controls necessary to comply with the firm’s obligations under CASS 7 for the general pool and each sub-pool that it may establish.

UK jurisdiction specific rules.

7.19.4R
Where a firm establishes one or more sub-pools, CASS 7.15 (Records, accounts and reconciliations) shall be read as applying separately to the firm’s general pool and each sub-pool.

UK jurisdiction specific rules.

7.19.5G
A firm that establishes one or more sub-pools must establish and maintain adequate internal controls and records in accordance with CASS 7.15 (Records, accounts and reconciliations) to conduct internal and external reconciliations for each sub-pool and the general pool individually.

UK jurisdiction specific rules.

7.19.6R
(1) The records maintained for a sub-pool under CASS 7.19.4 R must identify all the client beneficiaries of that sub-pool.

(2) The beneficiaries of each sub-pool are those clients:

(a) from whom the firm has received a signed sub-pool disclosure document in accordance with CASS 7.19.11 R;

(b) for whom the firm maintains, previously maintained or is in the process of establishing a margined transaction(s) in the relevant net margined omnibus client account at the authorised central counterparty; and

(c) to whom any client equity balance or other client money is required to be segregated for the client by the firm in respect of the margined transactions under (2)(b) from that sub-pool.

UK jurisdiction specific rules.

7.19.7R
(1) For each sub-pool that the firm establishes, it must maintain a record of:

   (a) the name of the sub-pool;

   (b) the particular net margined omnibus client account at an authorised central counterparty to which the sub-pool relates;

   (c) each client bank account and each client transaction account (other than the net margined omnibus client account) maintained for the sub-pool, including the unique identifying reference or descriptor under CASS 7.19.13 R (2); and

   (d) the applicable sub-pool disclosure document for the sub-pool.

UK jurisdiction specific rules.

7.19.8R
The firm must maintain an up-to-date list of all the sub-pools it has created.

UK jurisdiction specific rules.

7.19.9R
(1) A firm wishing to establish a sub-pool must prepare a sub-pool disclosure document for each sub-pool.

(2) The sub-pool disclosure document for each sub-pool must:

   (a) identify the sub-pool by name, as stated in its records under CASS 7.19.7R, the net margined omnibus client account and the authorised central counterparty to which the sub-pool relates;

   (b) contain a statement that the client consents to the firm receiving and holding the client’s client money in the sub-pool;

   (c) contain a statement that, in the event of the failure of the firm, the firm is directed by the client to use any client money held by the firm in the sub-pool to facilitate the porting of the positions recorded in that net margined omnibus client account; and

   (d) a statement reminding the client that, in the event of the failure of the firm, if porting is not effected or if porting is effected but any money in the sub-pool is not used to facilitate porting, the client beneficiaries of the sub-pool will be entitled to a distribution of any client money held for that sub-pool in line with CASS 7A. However, the client beneficiaries will not have a claim on any other pool of client money, except to the extent that the client is a beneficiary of another pool.

UK jurisdiction specific rules.

7.19.10G
In preparing a sub-pool disclosure document under CASS 7.19.9 R (1), a firm may use the template in CASS 7 Annex 6.

UK jurisdiction specific rules.
7.19.13R
(1) A firm must not hold client money for a sub-pool in a client bank account or a client transaction account used for holding client money for any other sub-pool or the general pool.

(2) A firm that establishes a sub-pool must ensure that the name of each client bank account and each client transaction account (other than the net margined omnibus client account) maintained for that sub-pool includes a unique identifying reference or descriptor that enables the account to be identified with that sub-pool.

(3) Where a client of the firm is a beneficiary of the general pool and wishes to become a beneficiary of a sub-pool, the client acquisition shall become a beneficiary of the relevant sub-pool when:
   (a) the firm has obtained the signed sub-pool disclosure document from the client in accordance with CASS 7.19.11 R (1); and
   (b) the firm has either:
      (i) transferred the relevant amount of client money for that client from a client bank account maintained for the general pool to a client bank account maintained for the relevant sub-pool; or
      (ii) the firm is not making a transfer of client money from the general pool, when it has received that client's money in a client bank account maintained for the relevant sub-pool; and
      (iii) the firm has either:
         (a) transferred the amount owing to that client for all of the margined transactions cleared through the related net margined omnibus client account and no longer holds any client money for that client in that sub-pool, or the firm has notified the client under CASS 7.19.18 R (2) (c) no longer apply for that client; or
         (b) the firm has notified the client under CASS 7.19.18 R (2) (c) no longer apply for that client, or transferred client money from the general pool to a client bank account maintained for that sub-pool, unless the amount of client money held for the general pool is sufficient, immediately after that transfer, to satisfy the firm's client money obligations to the remaining beneficiaries of the general pool.

(4) Where a client of the firm is a beneficiary of the general pool and wishes to become a beneficiary of a sub-pool, when it has received that client's money in a client bank account maintained for the relevant sub-pool must ensure that the name of each client bank account and each client transaction account used for holding client money for any other sub-pool or the general pool.

(5) A client of the firm who is a beneficiary of a sub-pool, when it has received that client's money in a client bank account maintained for the relevant sub-pool or a client transaction account used for holding client money for any other sub-pool or the general pool, unless the amount of client money held for the general pool is sufficient, immediately after that transfer, to satisfy the firm's client money obligations to the remaining beneficiaries of the general pool.

(6) In relation to the transfer of client money under CASS 7.19.13 R (2)(c) no longer apply for that client; or
   (b) the firm has either:
      (i) transferred the relevant amount of client money for that client from a client bank account maintained for the general pool to a client bank account maintained for the relevant sub-pool; or
      (ii) the firm is not making a transfer of client money from the general pool when:
         (a) the firm has either:
            (i) the firm has received a written instruction from the client stating:
               (a) that the client no longer wishes to have its positions cleared through the net margined omnibus client account or its client money held in that sub-pool; or
               (b) the firm has received a written instruction from the client stating:
                  (i) that the client no longer wishes to have its positions cleared through the net margined omnibus client account or its client money held in that sub-pool; or
                  (ii) the firm has notified the client under CASS 7.19.18 R that it is making a material change to a sub-pool; or
                  (iii) the firm has notified the client under CASS 7.19.18 R that it is making a material change to a sub-pool; or
                  (iv) the firm has either:
                     (a) provided a copy of the sub-pool disclosure document applicable to that sub-pool, or
                     (b) obtained a signed copy of that sub-pool disclosure document from the client.

UK jurisdiction specific rules.
Save to the extent permitted under CASS 7.13.50 G, a firm that receives client money to be credited in part to the general pool or one sub-pool and in part to another sub-pool must:

1. Take the necessary steps to ensure that the full sum is paid directly into a client bank account maintained for the general pool; and
2. Promptly, and in any event no later than one business day after receipt, pay the money that is not client money for the general pool out of that client bank account and into a client bank account maintained for the appropriate sub-pool.

7.19.15G
(1) If a primary pooling event occurs before client money is transferred from a client bank account maintained for the general pool to a client bank account maintained for the appropriate sub-pool in accordance with CASS 7.19.14 R (2), the amount in question will not form part of that sub-pool, including for the purposes of CASS 7A.2.3R (1).
(2) If a primary pooling event occurs before client money is transferred from a client bank account maintained for a sub-pool to a client bank account maintained for the general pool or another sub-pool in accordance with CASS 7.19.13 R (5), the amount in question will not form part of the general pool or that other sub-pool, including for the purposes of CASS 7A.2.4R (1), but will remain part of the original sub-pool.

7.19.16R
A client for whom a firm receives or holds client money for a sub-pool has no claim to or interest in client money received or held for the general pool or any other sub-pool unless:

1. That client is a beneficiary of that other sub-pool; or
2. The firm receives or holds client money for that client for other business which does not relate to any sub-pool (and thus the client is a beneficiary of the firm's general pool).

7.19.17R
A client for whom a firm receives or holds client money in more than one pool as described in CASS 7.19.16 R (1) and/or CASS 7.19.16 R (2) has an interest in a distribution from each such pool, and each interest is separate and distinct.

7.19.18R
Before making a material change to a sub-pool, a firm must:

1. Notify the then current beneficiaries of that sub-pool in writing, not less than two months before the date on which the firm intends the change to take effect; and
2. Include in the notification an explanation of the consequences for the beneficiaries of the proposed change and the options available to them, such as the option of a beneficiary of the affected sub-pool to cease to be a beneficiary of that sub-pool and to become a beneficiary of the firm's general pool or, if applicable, another sub-pool.

7.19.19G
A firm should keep in mind its obligations under CASS 7.19.11 R (1)(b) (before receiving or holding client money for a client in a sub-pool, a firm must obtain a signed copy of the sub-pool disclosure document from the client when making a material change to a sub-pool). A firm is also reminded of the conditions under CASS 7.19.13 R (5)(b) (when a client of the firm who is a beneficiary of a sub-pool ceases to be a beneficiary of that sub-pool if a material change proposed to a sub-pool results in a client ceasing to be a beneficiary of that sub-pool).

7.19.20G
The FCA would normally consider the dissolution of a sub-pool, such that the firm no longer operates the sub-pool or no longer uses the relevant net margined omnibus client account or transfers the business to another authorized central counterparty, to be examples of material changes to a sub-pool.

7.19.21R
Before materially changing a sub-pool, a firm must provide a copy of the notice provided to clients under CASS 7.19.18 R to the FCA not less than two months before the date on which the firm intends the change to take place.
A firm that wishes to establish a sub-pool of client money must notify the FCA in writing not less than two months before the date on which the firm intends to receive or hold client money for that sub-pool.

Upon request, a firm must deliver to the FCA a copy of the sub-pool disclosure document for any sub-pool established by the firm.

A firm must inform the FCA in writing, without delay, if it has not complied, or is unable to comply with the requirements in CASS 7.19.11 R or the requirements in CASS 7.19.18 R.

The records maintained under this section, including the sub-pool disclosure documents, are a record of the firm that must be kept in a durable medium for at least five years following the date on which client money was last held by the firm for a sub-pool to which those records or the sub-pool disclosure document applied.

The client money distribution and transfer rules set out the required treatment of client money on the occurrence of a pooling event so that:

1) for example, a firm fails (but also in other situations where a primary pooling event occurs), the rules in CASS 7A.2 (Primary pooling events) facilitate the return or transfer of client money; and

2) a person at which the firm holds client money fails, the rules in CASS 7A.3 (Secondary pooling events) allocate any loss of client money among certain of the firm’s clients.

The client money distribution and transfer rules do not apply to any client money held by a trustee firm under CASS 7.10.34R to CASS 7.10.40G.

The client money distribution and transfer rules do apply to a firm for any client money that it holds other than in that capacity which is subject to the client money rules.

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The client money distribution and transfer rules do apply to a firm for any client money that it holds other than in that capacity which is subject to the client money rules.
725. **7A.2 Primary pooling events**

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

    7A.2.2R A primary pooling event occurs:
    
    (1) on the failure of the firm;
    
    (2) on the vesting of assets in a trustee in accordance with an 'assets requirement' imposed under section 55P(1)(b) or (c) (as the case may be) of the Act;
    
    (3) on the coming into force of a requirement or requirements which, either separately or in combination:
        
        (a) is or are for all client money held by the firm; and
        
        (b) require the firm to take steps to cease holding all client money; or
        
    (4) when the firm notifies the FCA, in accordance with CASS 7.15.33 R (Notification requirements), that it is unable correctly to identify and allocate in its records all valid claims arising as a result of a secondary pooling event.

726. **7A.2.3R**

    CASS 7A.2.2R (4) does not apply so long as:
    
    (1) the firm is taking steps, in consultation with the FCA, to establish those records; and
    
    (2) there are reasonable grounds to conclude that the records will be capable of rectification within a reasonable period.

727. **7A.2.4R**

    If a primary pooling event occurs in circumstances where the firm had, before the primary pooling event, reduced its margined transaction requirement by utilising approved collateral under CASS 7.16.33 R, it must immediately liquidate this approved collateral and place the proceeds in a client bank account that relates to the relevant notional pool under CASS 7A.2.4R(1) (Pooling and distribution or transfer).

728. **7A.2.5R**

    Client money reconciliations after a primary pooling event

    (1) If a special administrator has been appointed to the firm under the IBSA Regulations then they will be required to carry out a reconciliation under regulation 10H of the IBSA Regulations.
    
    (2) Notwithstanding regulation 10H of the IBSA Regulations, CASS 7.15 has application to a firm after a primary pooling event, meaning, for example, that ongoing compliant record-keeping is required (see CASS 7.15.15R(4) (Internal client money reconciliations) and CASS 7.15.26AR (Frequency of external reconciliations after a primary pooling event)).

729. **Pooling and distribution or transfer**

    7A.2.6R If a primary pooling event occurs, then:
    
    (1) (a) in respect of a sub-pool, the following is treated as a single notional pool of client money for the beneficiaries of that pool:
        
        (i) any client money held in a client bank account of the firm relating to that sub-pool; and
        
    (2) (a) any client money held in a client transaction account of the firm relating to that sub-pool, except for client money held in a client transaction account at an authorised central counterparty or a clearing member which is, in either case, held as part of a regulated clearing arrangement.
    
    (b) if at any time any client money held in a client transaction account of the firm relating to that sub-pool, except for client money held in a client transaction account at an authorised central counterparty or a clearing member which is, in either case, held as part of a regulated clearing arrangement.

    (b) if at any time any client money held in a client transaction account of the firm relating to that sub-pool, except for client money held in a client transaction account at an authorised central counterparty or a clearing member which is, in either case, held as part of a regulated clearing arrangement.

    (c) any client money held in a client transaction account of the firm relating to that sub-pool, except for client money held in a client transaction account at an authorised central counterparty or a clearing member which is, in either case, held as part of a regulated clearing arrangement.

    (d) any client money held in a client transaction account of the firm relating to that sub-pool, except for client money held in a client transaction account at an authorised central counterparty or a clearing member which is, in either case, held as part of a regulated clearing arrangement.

730. **Client money reconciliations after a primary pooling event**

    7A.2.7R

    If a primary pooling event occurs, then:
    
    (1) (a) in respect of a sub-pool, the following is treated as a single notional pool of client money for the beneficiaries of that pool:
        
        (i) any client money held in a client bank account of the firm relating to that sub-pool; and
        
        (ii) any client money held in a client transaction account of the firm relating to that sub-pool, except for client money held in a client transaction account at an authorised central counterparty or a clearing member which is, in either case, held as part of a regulated clearing arrangement.
    
    (b) if at any time any client money held in a client transaction account of the firm relating to that sub-pool, except for client money held in a client transaction account at an authorised central counterparty or a clearing member which is, in either case, held as part of a regulated clearing arrangement.

    (c) any client money held in a client transaction account of the firm relating to that sub-pool, except for client money held in a client transaction account at an authorised central counterparty or a clearing member which is, in either case, held as part of a regulated clearing arrangement.

    (d) any client money held in a client transaction account of the firm relating to that sub-pool, except for client money held in a client transaction account at an authorised central counterparty or a clearing member which is, in either case, held as part of a regulated clearing arrangement.

731. **Pooling and distribution or transfer**

    7A.2.8R If a primary pooling event occurs, then:
    
    (1) (a) in respect of a sub-pool, the following is treated as a single notional pool of client money for the beneficiaries of that pool:
        
        (i) any client money held in a client bank account of the firm relating to that sub-pool; and
        
        (ii) any client money held in a client transaction account of the firm relating to that sub-pool, except for client money held in a client transaction account at an authorised central counterparty or a clearing member which is, in either case, held as part of a regulated clearing arrangement.
    
    (b) if at any time any client money held in a client transaction account of the firm relating to that sub-pool, except for client money held in a client transaction account at an authorised central counterparty or a clearing member which is, in either case, held as part of a regulated clearing arrangement.

    (c) any client money held in a client transaction account of the firm relating to that sub-pool, except for client money held in a client transaction account at an authorised central counterparty or a clearing member which is, in either case, held as part of a regulated clearing arrangement.

    (d) any client money held in a client transaction account of the firm relating to that sub-pool, except for client money held in a client transaction account at an authorised central counterparty or a clearing member which is, in either case, held as part of a regulated clearing arrangement.
authorised central counterparty, or a clearing member which is, in either case, held as part of a regulated clearing arrangement; and
(iii) any client money identifiable in any other account held by the firm into which client money has been received; except, in each case, for client money relating to a sub-pool which falls under sub-paragraphs (1)(a)(i) or (a)(ii), and
(1A)
(a) a notional pool under paragraph (1) shall also include any client money that is:
(i) transferred by the firm under regulation 10H(3) of the IBSA Regulations to a client bank account that is included in that pool under paragraph (1);
(ii) paid under CASS 7A.2.3AR into a client bank account that is included in that pool under paragraph (1);
(iii) paid under CASS 7A.2.4R(3)(b) or CASS 7A.2.4R(3)(d) into a client bank account or client transaction account that is included in that pool under paragraph (1);
(iv) subject to sub-paragraph (b) otherwise received after the primary pooling event into a client transaction account that is included in that pool under paragraph (1) where the receipt is in relation to a margined transaction that the firm had entered into through the use of that client transaction account and which had not closed out before primary pooling event; and
(v) paid under CASS 7.15.29R(1) (Reconciliation discrepancies) after the primary pooling event into a client bank account that is included in that pool under paragraph (1), and
(b) the firm must not transfer any client money in a notional pool under sub-paragraphs (1)(a) or (b) to a client transaction account except where necessary to comply with sub-paragraph (2)(b);
(c) a notional pool under paragraph (1) shall cease to include client money from the point at which it is
(i) transferred by the firm under regulation 10H(4) of the IBSA Regulations from a client bank account that is included in that pool under paragraph (1); or
(ii) paid out after the primary pooling event from a client transaction account that is included in that pool under paragraph (1) where the payment is in relation to a margined transaction that the firm had entered into through the use of that client transaction account and which had not closed out before primary pooling event;
(2) the firm must, as soon as reasonably practicable:
(a) (subject to paragraph (4)) distribute client money comprising a notional pool in accordance with CASS 7.17.2R, so that each client who is a beneficiary of that pool receives a sum which is rateable to the client money entitlement calculated in accordance with CASS 7A.2.5R (Client money entitlements);
(b) (where applicable) transfer client money comprising a sub-pool to effect or facilitate porting of positions held for the clients who are beneficiaries of that sub-pool; and
(3) if, in connection with a regulated clearing arrangement, client money is remitted directly to the firm either from an authorised central counterparty or from a clearing member which is, in either case, held as part of a regulated clearing arrangement; and
(i) any such remittance in respect of a client transaction account that is an individual client account does not form a part of any notional pool under CASS 7A.2.4R(1) and must be distributed to the relevant client subject to CASS 7.17.2R (4); and
(ii) any such remittance in respect of a client transaction account that is an omnibus client account must form part of the notional pool under CASS 7A.2.4R(1)(b) and be subject to distribution in accordance with CASS 7A.2.4R(2)(a);
(c) any such remittance in respect of a client transaction account that is an omnibus client account must be distributed to the relevant clients for whom that omnibus client account is held if:
(i) no client money in excess of the amount recorded in that omnibus client account is held by the firm in margin in relation to the positions recorded in that omnibus client account; and
(ii) the amount of such remittance attributable to each client of the omnibus client account is recordable in the notional pool under CASS 7A.2.4R(1)(b) and be subject to distribution in accordance with CASS 7A.2.4R(2)(a); and
(d) any such remittance in respect of a client transaction account that is a net margined omnibus client account in respect of which the firm...
maintains a subpool must form part of such subpool under CASS 7A.2.4R(1)(a) to be distributed in accordance with CASS 7A.2.4R(2)(a); and
(b) as an alternative to distributing a client’s client money in a notional pool to the relevant client under CASS 7A.2.4R(2)(a) and in respect of client money that is not required to be transferred under CASS 7A.2.4R(2)(b), a firm (Firm A) may on its own initiative transfer some or all of that client’s client money in the relevant notional pool to any other person (Firm B) for safekeeping on behalf of the client provided that:
(i) as a consequence of any such transfer, Firm A does not distribute to any other client whose client money is in that notional pool, or transfer on behalf of any such other client to another person, an amount of money that would be less than that which such other client was entitled to have distributed or transferred under this rule;
(ii) unless Firm A is able to rely on regulation 10C(3)(b) of the IBSA Regulations for the transfer to Firm B to have effect without the consent of the client, either:
(A) Firm A has the specific consent of the client to the transfer to Firm B; or
(B) there is a written agreement between Firm A and the client which provides that Firm A may transfer the client’s client money in accordance with the client money rules; or
(c) Firm A has, in advance of the transfer under this rule, either:
(i) obtained a contractual undertaking from Firm B that the money transferred will be held by Firm B as client money in accordance with the client money rules; or
(ii) where the client money rules do not apply to Firm B, or where they do apply but Firm B is able to hold the money transferred other than as client money, satisfied itself, having exercised all due skill care and diligence in its assessment, that Firm B will apply adequate measures to protect the money transferred;
(d) where regulation 10C(3) of the IBSA Regulations does not apply, Firm A has, in advance of the transfer under this rule, obtained a contractual undertaking from Firm B that Firm B will return the money to the client at the client’s request; and
(e) Firm A has, in advance of the transfer under this rule, obtained a contractual undertaking from Firm B that Firm B will notify the client, within 14 days of the transfer of that client’s balance having commenced:
(i) of the applicable regulatory regime under which the money will be held by Firm B; and
(ii) of any relevant compensation scheme limits that may apply in respect of Firm B’s handling of the transferred money; or
(B) the fact that Firm B does not participate in a relevant compensation scheme, if that is the case; and
(c) where regulation 10C(3) of the IBSA Regulations does not apply, Firm A should, in advance of the transfer under CASS 7A.2.4R(4), 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 the money to the client, of the amount that was transferred to Firm B under this rule. Where regulation 10C(3) of the IBSA Regulations does apply, Firm A should, in advance of the transfer under CASS 7A.2.4R(4), obtain a contractual undertaking from Firm B that:
(1) Firm B will compensate the client for the difference between the amount transferred to Firm B and the amount that would have been transferred to the client under this rule; and
(2) Firm B will notify the client, within 14 days of the transfer of the money to the client, of the amount that was transferred to Firm B under this rule. Where regulation 10C(3) of the IBSA Regulations does apply, Firm A should, in advance of the transfer under CASS 7A.2.4R(4), obtain a contractual undertaking from Firm B that:
(1) Firm B will compensate the client for the difference between the amount transferred to Firm B and the amount that would have been transferred to the client under this rule; and
(2) Firm B will notify the client, within 14 days of the transfer of the money to the client, of the amount that was transferred to Firm B under this rule.
(i) return any balance due directly to those clients for whom the positions are held, if they are known to the authorised central counterparty; or
(ii) remit any balance to the firm for the account of its clients if the clients are not known to the authorised central counterparty.

(1A) Under the EMIR L2 Regulation or the MiFIR indirect clearing RTS, where a firm acting in connection with a regulated clearing arrangement for a client (who is also an indirect client) defaults, the clearing member with whom the firm has placed client money of the indirect client, may, in accordance with the EMIR indirect clearing default management obligations or MiFIR indirect clearing default management obligations:

(a) transfer the positions and assets either to another clearing member of the relevant authorised central counterparty or to another firm willing to act for the indirect client; or
(b) liquidate the assets and positions of the indirect client and remit all monies due to the indirect client.

(1B) For the avoidance of doubt, 'relevant clients' in the case of CASS 7A.2.4R (3)(a) and CASS 7A.2.4R (3)(c) includes a client who is also an indirect client.

(2) Where any balance remitted from an authorised central counterparty or, in the case of indirect clients, a clearing member, to a firm is client money, CASS 7A.2.4R (3) provides for the distribution of remittances from either an individual client account or an omnibus client account:

(1) Remittances received by the firm falling within CASS 7A.2.4R (3)(a) and CASS 7A.2.4R (3)(c) should be pooled with client money held in any client bank account operated by the firm at the time of the primary pooling event. Those remittances should be segregated and promptly distributed to each client on whose behalf the remittance was received.

(3) Remittances received by the firm falling within CASS 7A.2.4R (3)(a) and CASS 7A.2.4R (3)(c) should be treated as client money at the time of receipt and should be transferred to facilitate porting in accordance with CASS 7A.2.4R (8). Same comment as Row 721.

(4) The firm's obligation to its client in respect of client money held in a sub-pool is discharged to the extent that the firm transfers that client money to facilitate porting in accordance with CASS 7A.2.4R (8).

(5) The restrictions on transfers of client money at CASS 7A.2.4R (4) are each of the type referred to in regulation 10B(4) of the IBSA Regulations as “a restriction in client money rules”.

(6) Where Firm A has complied with the restrictions at CASS 7A.2.4R (4) for any transfers to Firm B, any money transferred to Firm B ceases to be client money held by Firm A (see CASS 7A.2.4R (2)(e) (Discharge of fiduciary duty)).

(7) But any money returned by Firm B to Firm A in the event of a 'reverse transfer' will be subject to the client money rules and client money distribution and transfer rules as applied to Firm A, and should be treated by Firm A in accordance with CASS 7A.2.7-AR (Client money received after the failure of the firm).

Same comment as Rev 721.

Client money entitlements

(2) Subject to paragraph (1)(b), each client’s entitlement to client money in a notional pool is calculated with reference to the client money requirement as shown by an internal client money reconciliation carried out in accordance with CASS 7.15.15R (Internal client money reconciliations) as at the primary pooling event.

(b) If, as at the primary pooling event, the firm had entered into one or more cleared margined transactions through the use of a client transaction account at a clearing house that had not closed out as at the primary pooling event, the client money requirement under (2)(a) must be calculated as follows:

(i) CASS 7.16.28R does not apply in respect of those cleared margined transactions; and
(ii) subject to CASS 7.16.30R, in respect of those cleared margined transactions a client’s equity balance is instead the amount which the firm is liable to pay to the client or the firm under the client money rules for margined transactions following the close-out of those margined transactions. This balance should include any cash margin the firm has received from the client in connection with those transactions.
Each client's client equity balance following any adjustments under paragraph (2) must be reduced by:

(a) any amount paid by:
   (i) an authorised central counterparty to a clearing member other than the firm in connection with a porting arrangement in accordance with CASS 7.11.34R (6) in respect of that client; and
   (ii) a clearing member to another clearing member or firm (other than the firm) in connection with a transfer in accordance with CASS 7.11.34R (8);
(b) any amount paid by:
   (i) an authorised central counterparty directly to that client, in accordance with CASS 7.11.34R (7); and
   (ii) a clearing member directly to an indirect client in accordance with CASS 7.11.34R (9); and
(c) any amount that must be distributed to that client in accordance with CASS 7A.2.4R (3)(a) or (c).

When, in respect of a client who is a beneficiary of a pool and following any adjustments under paragraph (2) and reductions under paragraph (1), there is a positive individual client balance and a negative client equity balance in relation to that pool, the credit for that pool must be offset against the debit for that pool reducing the individual client balance for that client.

When, in respect of a client who is a beneficiary of a pool and following any adjustments under paragraph (2) and reductions under paragraph (1), there is a negative individual client balance and a positive client equity balance in relation to that pool, the credit for that pool must be offset against the debit for that pool reducing the client equity balance for that client.

The effect of CASS 7A.2.5R(2)(b) is that the client equity balance for the relevant cleared margined transaction is with reference to the eventual close out or 'hindsight' value of the transaction, instead of being a notional balance as at the primary pooling event under CASS 7.16.28R.

In cases where CASS 7A.2.5R(2)(b) does not apply, the client equity balance for a margined transaction will be the notional balance as at the primary pooling event under CASS 7.16.28R.

Before a firm ceases to treat a balance of client money in a notional pool as client money by transferring it to itself under CASS 7.17.2R(5) it must:

(a) (subject to paragraph (2)) attempt to distribute the balance to the relevant client or transfer it to another person for safekeeping on behalf of the client in accordance with CASS 7A.2.4R (Pooling and distribution or transfer); and
(b) (subject to paragraph (3)) take reasonable steps to notify any client in respect of whom the firm has evidence that the money may belong, of the firm's proposed course of action;
(c) where the firm has failed, apply any of the following types of balances of client money in the notional pool towards any costs incurred in accordance with CASS 7.17.2R(4), including any costs incurred under paragraph (1)(d):
   (i) client money allocated to a client for which, following the steps taken by the firm to satisfy paragraph (1)(b), the client to whom the client money belongs has not provided the firm with instructions that would enable the firm to make a distribution or transfer under paragraph (1)(a); or
   (ii) client money belonging to a client who, in response to a notification made under paragraph (1)(b), has confirmed to the firm that disclaims the benefit of the statutory trust under CASS 7.17.2R in relation to the client money; or
   (iii) client money that, following the steps taken by the firm to satisfy paragraph (1)(b), is unallocated to any client in the firm's records and accounts; and
(d) immediately before transferring the balances of client money under paragraph (1)(c) to the firm itself, apply them towards making good any outstanding shortfall in the notional pool, and subsequently distribute or transfer them in accordance with CASS 7A.2.4R to or on behalf of clients for whom the firm is able to make such distributions or transfers.

A firm is not required to return or transfer the balance of client money under paragraph (1) where the client to whom the
balance belongs has confirmed to the firm that it disclaims the benefit of the statutory trust under CASS 7.17.2R in relation to the balance client money.

(3) A firm is not required to notify a client under paragraph (1)(b) where:
(a) the firm is able to distribute the client money to the relevant client or trustee or to another person on behalf of the client in accordance with CASS 7A.2.4R (Pooling and distribution or trustee);
(b) the client to whom the balance of client money belongs has confirmed to the firm that it disclaims the benefit of the statutory trust under CASS 7.17.2R in relation to the balance client money;
(c) in respect of a client for whom the firm has evidence that they were a retail client for the purposes of the client money rules at the time of the primary pooling event, the entitlement of that client is £25 or less when calculated under CASS 7A.2.9R (Client money entitlement); or
(d) in respect of a client for whom the firm has evidence that they were a professional client for the purposes of the client money rules at the time of the primary pooling event, the entitlement of that client is £100 or less when calculated under CASS 7A.2.9R (Client money entitlement).

739.

7A.2.6BG
(1) A firm may propose to cease to treat a balance of money as client money under CASS 7A.2.6AR(1) where the firm is using the procedure under regulation 12C of the IBsA Regulations to set a `hard bar date' by giving a `hard bar date notice', or another similar procedure in accordance with the legal procedure for the firm's failure.

(2) In any case, a firm should consider the whether its obligations under law (including trust law) or any agreement permit it to cease to treat a balance of money as client money in the way in which it proposes to do so.

(3) Balances of client money under CASS 7A.2.6AR(1)(c)(iii) include any remaining amount of those that the firm is holding to comply with:
(a) CASS 7.13.41R (Prudent segregation);
(b) CASS 7.13.65R(1) (The alternative approach to client money segregation); and
(c) CASS 7.13.73R(1) (Use of the normal approach in relation to certain regulated clearing arrangements).

740.

7A.2.6CE
(1) Reasonable steps in CASS 7A.2.6AR(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 client money rules at the time of the primary pooling event:
(i) writing to the client at the last known address either by post or by electronic mail:
(A) to inform it of the firm's intention to no longer treat the balance as client money;
(B) to inform it of the consequences of the firm's proposed course of action in relation to the client's ability to assert an ownership right to that money; and
(C) to invite the client to submit a claim for the money; and
(ii) where the client has not responded within 28 days of the communication under sub-paragraph (i), attempting to communicate the information in sub-paragraph (i) to the client on at least one further occasion by any means other than that used in (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 7A.2.6AR(1)(b).
(3) Contravention of paragraph (1) may be relied on as tending to establish contravention of CASS 7A.2.6AR(1)(b).

Same comment as Row 721.

Same comment as Row 721.
A.2.6DG For the purpose of CASS 7A.2.6CE(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.

A.2.6ER If the firm undertook a tracing exercise for the purposes of CASS 7.11.50R(3) (Allocated but unclaimed client money) before the primary pooling event but had not made the charity payment under that rule by the time of the primary pooling event then the findings of that exercise may be relied on for the purposes of CASS 7A.2.6CE(1)(a).

A.2.6FR (1) A firm must make a record of any balance under CASS 7A.2.6AR(1)(c)(i) or (ii) which is to be applied towards any costs or towards any shortfall in the relevant notional pool in accordance with CASS 7A.2.6AR(1)(c) or (d) respectively, immediately before taking such steps.

(2) The record under paragraph (1) must state:

(a) the amount of the balance of client money;
(b) the name and contact details of any client to whom that balance was allocated according to the firm’s records at the time of making the record under this rule; and
(c) either:

(i) the efforts applied by the firm to determine the client’s correct contact details under CASS 7A.2.6CE(1)(a); or
(ii) if being relied on under CASS 7A.2.6ER, the efforts applied by the firm to determine the client’s correct contact details for the purposes of CASS 7.11.50R(3) (Allocated but unclaimed client money).

(3) A firm must keep the record under (1) indefinitely.

A.2.7 AR

(1) This rule applies in respect of client money received by a firm after a primary pooling event that does not form part of a notional pool.

(2) Where the firm is using the normal approach under CASS 7.13.6R (The normal approach), client money to which this rule applies must be received into a client bank account that does not contain any client money forming part of a notional pool under CASS 7A.2.4R(1) (Pooling and distribution or transfer).

(3) (a) This paragraph applies in respect of client money that is received into an account other than a client bank account as required under CASS 7.13.62R (The alternative approach to client money segregation) or permitted under CASS 7.13.72R (Use of the normal approach in relation to certain regulated clearing arrangements).

(b) To the extent the firm makes any transfers from its own account to a client bank account under CASS 7.13.62R(3) (The alternative approach to client money segregation) or CASS 7.13.72R(2)(b) (Use of the normal approach in relation to certain regulated clearing arrangements), such transfers must be made into a client bank account that does not contain any client money forming part of a notional pool under CASS 7A.2.4R(1) (Pooling and distribution or transfer).

(4) Subject to paragraphs (5) and (6), a firm must promptly return to each relevant client all client money to which this rule applies.

(5) To the extent that client money relates to a transaction for a client that was concluded before the primary pooling event but had not yet settled at the time of the primary pooling event, the firm may use that client money to settle that transaction.

(6) (a) This paragraph applies where client money which is not received by the firm into a client transaction account relates to one or more cleared margined transactions entered into by the firm through the use of a client transaction account at a clearing house.

(b) Where such transactions have not settled as at the primary pooling event, then provided that the firm has not failed, it may transfer that client money to a client transaction account with the relevant clearing house in accordance with CASS 7A.2.4R(1) (Joint money held by a third party) for the purpose of collateralising those margined transactions.
A firm may open a client bank account after a primary pooling event for the purposes of complying with CASS 7A.2.7-AR(2) and CASS 7A.2.10AR(2). If it does so it must comply with CASS 7.18.15R regarding acknowledgement letters.

If a firm receives a mixed remittance after a primary pooling event other than where using the alternative approach under CASS 7.13.62R or under a regulated clearing arrangement to which CASS 7.13.72R applies, it must:
1) pay the full sum into a client bank account that meets the requirements of CASS 7A.2.7-AR(2); and
2) pay the money that is not client money out of that client bank account into a firm's own bank account within one business day of the day on which the firm would normally expect the remittance to be cleared.

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

A firm that is operating the normal approach to segregation under CASS 7.13 (Segregation of client money) which becomes liable to pay money to a client after a primary pooling event must promptly, and in any event no later than one business day after the money is due and payable, pay the money:
1) to, or to the order of, the client; or
2) into a client bank account that does not contain any client money forming part of a notional pool under CASS 7A.2-4R(1).

Where the firm has payment instructions from the client, the firm should pay the money to the order of the client, rather than into a client bank account.

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

A secondary pooling event occurs on the failure of a person to which client money held by the firm has been transferred under CASS 7.13.3R(1) to CASS 7.13.3R(3) (Depositing client money) or CASS 7.14.2R (Client money held by a third party).

CASS 7A.3-6 R to CASS 7A.3-12AR do not apply if, on the failure of the relevant person:
1) there is no secondary pooling shortfall; or
2) where there is a secondary pooling shortfall, the firm pays an amount equal to the amount of client money which would have been held in that person if a secondary pooling shortfall had not occurred either
(a) to its clients in the appropriate amounts such that they are compensated by the amount of the secondary pooling shortfall that they would otherwise be required to bear under this section; or
(b) into a client bank account at an unaffected bank with the effect that any shortfall that would otherwise arise for the purposes of CASS 7.15 (Records, accounts and reconciliations) is avoided.

When a person to which client money held by the firm has been transferred under CASS 7.13.3R(1) to CASS 7.13.3R(3) (Depositing...
client money or CASS 7.14R (Client money held by a third party) fails, and the firm decides not to make good any secondary pooling shortfall: the amount of client money held in that pool (see CASS 7A.3.2R), a secondary pooling event will occur. The firm should reflect the secondary pooling shortfall that arises in the general pool (where the firm maintains only a general pool) and, where relevant, in a particular sub-pool (where the firm maintains both a general pool and one or more sub-pools) in its records of the entitlement of clients and of money held with third parties under CASS 7.15 (Records, accounts and reconciliations).

555. CASS 7A.3.5G

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

556. Failure of a bank: pooling

CASS 7A.3.6R

If a secondary pooling event occurs as a result of the failure of a bank where one or more general client bank accounts are held, and/or where one or more designated client bank accounts or designated client fund accounts are held, for the general pool or a particular sub-pool, then:

1) in relation to every general client bank account of the firm maintained in respect of that pool, the provisions of CASS 7A.3.8 R, CASS 7A.3.13 R and CASS 7A.3.14 R will apply;
2) in relation to every designated client bank account held by the firm with the failed bank for the relevant pool, the provisions of CASS 7A.3.10 R, CASS 7A.3.13 R and CASS 7A.3.14 R will apply;
3) in relation to each designated client fund account held by the firm with the failed bank for the relevant pool, the provisions of CASS 7A.3.11 R, CASS 7A.3.13 R and CASS 7A.3.14 R will apply;
4) any money held at a bank, other than the bank that has failed, in designated client bank accounts for the relevant pool, is not pooled with any other client money held for that pool or any other pool; and
5) any money held in a designated client fund account in respect of that pool, as-part of which is held by the bank that has failed, is not pooled with any other client money held for that pool or any other pool.

557. CASS 7A.3.6AG

Depending on the person at which the secondary pooling event occurs, the types of client bank accounts and client transaction accounts that are affected by the secondary pooling shortfall, and the nature of a firm’s business with a particular client, it is possible that the client’s overall entitlement to client money held by the firm may be affected by a combination of CASS 7A.3.8R, CASS 7A.3.10R, CASS 7A.3.11R, CASS 7A.3.13R, and CASS 7A.3.14R.

558. Failure of an exchange, clearing house, intermediate broker, settlement agent or OTC counterparty: pooling

CASS 7A.3.7AR

If a secondary pooling event occurs as a result of the failure of a bank, intermediate broker, settlement agent, or OTC counterparty, then in relation to every general client bank account and client transaction account of the firm, CASS 7A.3.9R and CASS 7A.3.10R will apply, and CASS 7A.3.13R will additionally apply in the case of the failure of an authorised central counterparty.

559. Failure of a bank, intermediate broker, settlement agent, OTC counterparty, exchange or clearing house: treatment of general client bank accounts and client transaction accounts

CASS 7A.3.10R

Money Subject to CASS 7A.3.10R, if a secondary pooling event occurs as a result of the failure of a bank, intermediate broker, settlement agent, or OTC counterparty, exchange or clearing house, money held in each general client bank account and client transaction account of the firm for the general pool or a sub-pool must be treated as pooled and:

1) any secondary pooling shortfall in client money held, or which should have been held, in general client bank accounts and client transaction accounts for the relevant pool, that has arisen as a result of the failure of the bank, exchange, clearing house, intermediate broker, settlement agent or OTC counterparty, must be borne by all the clients who have funds in the pool or sub-pool in the general pool or in the sub-pool.
of that pool whose client money is held in each general client bank account or client transaction account of the firm, rateably in accordance with their entitlements;

(2) a new client money entitlement must be calculated for each client of the relevant pool by the firm, to reflect the requirements in paragraph (1), and the firm’s records must be amended to reflect the reduced client money entitlement;

(3) the firm must make and retain a record of each client’s share of the secondary pooling shortfall until the client is repaid; and

(4) the firm must use the new client money entitlements, calculated in accordance with paragraph (2), for the purposes of reconciliations pursuant to CASS 7.15.3 R (Records and accounts) for that pool.

760.

TA 3.9AR

If a secondary pooling event occurs as a result of the failure of an authorised central counterparty:

(1) any money held in a client transaction account that is an individual client account at the failed authorised central counterparty is not pooled by the firm with any of its other client money;

(2) any money held in a client transaction account that is an omnibus client account at the failed authorised central counterparty is not pooled by the firm with any of its other client money provided that:

(a) no client money in excess of the amount recorded in that omnibus client account is held by the firm as margin in relation to the positions recorded in that omnibus client account; and

(b) the client or clients of the firm to whom the amount recorded in that omnibus client account relates is or are readily apparent from information provided to the firm by the authorised central counterparty or, in the case of indirect clients, the clearing member;

(3) any money held in a client transaction account that is a net margined omnibus client account at the failed authorised central counterparty in respect of which the firm maintains a sub-pool is not pooled by the firm with any of its other client money;

(4) the proportion of any secondary pooling shortfall that arises as a result of client money held, or which should have been held, in an individual client account to which paragraph (1) applies must be borne by the client whose client money was held in that individual client account;

(5) the proportion of any secondary pooling shortfall that arises as a result of client money held, or which should have been held, in an omnibus client account to which paragraph (2) applies must either:

(a) be borne by all the clients whose client money is held in that account, rateably in accordance with their entitlements; or

(b) if the firm is required under applicable law to allocate the secondary pooling shortfall other than as under (a), be allocated as required by applicable law;

(6) the proportion of any secondary pooling shortfall that arises as a result of client money held, or which should have been held, in a net margined omnibus client account to which paragraph (3) applies must be borne by all the clients whose client money is held in the relevant sub-pool, rateably in accordance with their entitlements;

(7) a new client money entitlement must be calculated for each relevant client of the relevant pool, to reflect the requirements in paragraphs (1), (2) and (3), and the firm’s records must be amended to reflect the reduced client money entitlement;

(8) the firm must make and retain a record of each client’s share of the secondary pooling shortfall until the client is repaid; and

(9) the firm must use the new client money entitlements calculated under paragraph (7) for the purposes of reconciliations pursuant to CASS 7.15.3 R (Records and accounts) for the relevant pool.

761.

TA 3.9G

The term “which should have been held” is a reference to the relevant failed person’s failure to hold the client money at the time of its failure.

TA 3.9AG

(1) CASS 7A.3.8AR(5)(b) enables a firm to allocate the relevant part of a secondary pooling shortfall that arises in an omnibus client account under CASS 7A.3.5AR(2) other than on a “pro rata” basis, where this is required by applicable law.

(2) This would include, for example, where applicable law requires the firm to attribute a secondary pooling shortfall only to a particular client or clients.

Failure of a bank: treatment of designated client bank accounts and designated client fund accounts

TA 3.10R

Some comment as Rev 721.
For each client with a designated client bank account maintained by the firm for the general pool or a particular sub-pool and held at the failed bank:

1. any secondary pooling shortfall in client money held, or which should have been held, in designated client bank accounts that has arisen as a result of the failure, must be borne by all the clients of the relevant pool whose client money is held in a designated client bank account of the firm at the failed bank, severally in accordance with their client money entitlements;
2. a new client money entitlement must be calculated for each of the relevant clients of the relevant pool by the firm, and the firm's records must be amended to reflect the reduced client money entitlement;
3. the firm must make and retain a record of each client's share of the secondary pooling shortfall at the failed bank until the client is repaid;
4. the firm must use the new client money entitlements, calculated in accordance with paragraph (2), for the purposes of reconciliations pursuant to CASS 7.15.3 R (Records and accounts) in respect of the relevant pool.

764. 7A.3.11R Money held by the firm in each designated client fund account for the general pool or a particular sub-pool with the failed bank must be treated as pooled with any other designated client fund accounts for the general pool or a particular sub-pool as the case may be which contain part of the same designated fund and:

1. any secondary pooling shortfall in client money held, or which should have been held, in designated client fund accounts that has arisen as a result of the failure, must be borne by each of the clients of the relevant pool whose client money is held in that designated fund, severally in accordance with their entitlements;
2. a new client money entitlement must be calculated for each client of the relevant pool by the firm, in accordance with paragraph (1), and the firm's records must be amended to reflect the reduced client money entitlement;
3. the firm must make and retain a record of each client's share of the secondary pooling shortfall at the failed bank until the client is repaid;
4. the firm must use the new client money entitlements, calculated in accordance with paragraph (2), for the purposes of reconciliations pursuant to CASS 7.15.3 R (Records and accounts) for the relevant pool.

Same comment as Row 721.

765. 7A.3.12R A client whose money was held, or which should have been held, in a designated client bank account with a bank that has failed is not entitled to claim in respect of that money against any other client bank account or client transaction account of the firm.

Same comment as Row 721.

766. 7A.3.12AR A client whose money was held, or which should have been held, in a designated client fund account with a bank that has failed is not entitled to claim in respect of that money against any other client bank account of the firm that is not part of the same designated fund or against any client transaction account of the firm.

Same comment as Row 721.

767. Client money received after the secondary pooling event 7A.3.13R Client money received by the firm after the failure of a bank, exchange, clearing house, intermediate broker, settlement agent or OTC counterparty, that would otherwise have been paid into a client bank account or client transaction account at that bank, exchange, clearing house, intermediate broker, settlement agent or OTC counterparty, as the case may be, for either the general pool or a particular sub-pool:

1. must not be transferred to the failed person unless specifically instructed by the client in order to settle an obligation of that client to the failed person; and
2. must be, subject to paragraph (1), placed in a client bank account or client transaction account relating to the general pool or the particular sub-pool in the case of an event described in sub-paragraph (a) or (b) of paragraph 7A.3.13.2 R (Events requiring a mixed remittance).

Same comment as Row 721.

768. 7A.3.14R If a firm receives a mixed remittance after the secondary pooling event which consists of client monies that would have been paid into a
1. (1) pay the full sum into a client bank account other than one operated at the bank that has failed; and
(2) pay the money that is not client money out of that client bank account within one business day of the day on which the firm would normally expect the remittance to be cleared.

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

3. A firm must notify the FCA as soon as reasonably practical after it becomes aware of the failure of any bank, exchange, clearing house, intermediate broker, settlement agent, OTC counterparty or other entity with which it has placed, or whom it has allowed to hold, client money:
   (3) whether it intends to make good any secondary pooling shortfall that has arisen or may arise; and
   (4) the amount of that secondary pooling shortfall, or the expected amount if the actual amount is not known.

4. Article 24(4) MiFID II
   [Not replicated here for reasons of space as well as not being fully relevant for the purposes of the analysis in this row.]

5. Article 25(5) MiFID II
   The investment firm shall establish a record that includes the document or documents agreed between the investment firm and the client that set out the rights and obligations of the parties, and the other terms on which the investment firm will provide services to the client. The rights and duties of the parties to the contract may be incorporated by reference to other documents or legal texts.

6. Article 58 Commission Delegated Regulation
   The investment firm shall enter into a written basic agreement with the client, in paper or another durable medium, that sets out the main features of any services referred to in Section B(1) of Annex I to Directive 2014/65/EU to be provided, including where applicable the role of the firm with respect to corporate actions relating to client instruments and the terms on which securities financing transactions involving client securities will generate a return for the client.
Article 73 Commission Delegated Regulation

Records which set out the respective rights and obligations of the investment firm and the client under an agreement to provide services, or the terms on which the firm provides services to the client, shall be retained for at least the duration of the relationship with the client.

8.1.2AR

The mandate rules do not apply to a firm:

1) in relation to client money that the firm is holding in accordance with CASS 5 or CASS 7 (including client money that the firm has allowed another person to hold or control in accordance with CASS 7.4.2R) or CASS 11, or
2) in relation to custody assets that the firm is holding, or in respect of which the firm is carrying out safeguarding and administration of assets (without arranging), acting as trustee or depository of an AIF or acting as trustee or depository of a UCITS in accordance with CASS 6; or
2A) in relation to custody assets for which a small AIFM is:
(a) carrying on those excluded custody activities that would amount to safeguarding and administration of assets (without arranging) but for the exclusion in article 72AA of the RAO; and
(b) in doing so in accordance with CASS 6; or
3) in relation to a client's assets that the firm is holding or has received under an arrangement to which CASS 3 applies; or
4) when it acts as the operator of a regulated collective investment scheme in relation to property held for or within the scheme.

8.1.2BG

(1) CASS 8.1.2A R is not an absolute exemption, but it excludes the application of the mandate rules in relation to money or assets that a firm has received, is holding, or is responsible for (as appropriate and in the circumstances described in CASS 8.1.2A R).
(2) This means that, for example in respect of CASS 8.1.2A R (1), a firm holding client money in accordance with CASS 5 or CASS 7 does not also need to comply with the mandate rules in relation to the client money which it actually holds, but the mandate rules would apply if the firm has a mandate under which it can receive a client's money from another person in the course of, or in connection with, the activities set out in CASS 8.1.1 R (1) and CASS 8.1.1 R (2).
(3) Similarly, in respect of CASS 8.1.2A R (4), the mandate rules apply to a firm that is the operator of a regulated collective investment scheme if, for example, it has a mandate under which it can receive a client's money from another person for the purposes of investing it in the scheme.

8.1.3G

Firms are reminded that the mandate rules do not apply to an incoming EEA firm, other than an insurer, with respect to its passported activities. The application of the mandate rules is also dependent on the location from which the activity is undertaken (see CASS 1.3).

8.2 Definition of mandate

8.2.1R

A mandate is any means that give a firm the ability to control a client's assets or liabilities, which meet the conditions in (1) to (5):

(1) they are obtained by the firm from the client, and with the client's consent;

Broadly conceptually equivalent across all relevant rules save that UK rules are more prescriptive.
(2) Where those means are obtained in the course of, or in connection with, the firm's insurance distribution activity, they are in written form at the time they are obtained from the client;

(3) They are retained by the firm;

(4) They put the firm in a position where it is able to give any or all of the types of instructions described in (a) to (d):

(a) Instructions to another person in relation to the client's money that is credited to an account maintained by that other person for the client;

(b) Instructions to another person in relation to any money to which the client has an entitlement, where that other person is responsible to the client for that entitlement (including where that other person is holding client money for the client in accordance with CASS 5 or CASS 7);

(c) Instructions to another person in relation to an asset of the client, where that other person is responsible to the client for holding that asset (including where that other person is safeguarding and administering investments, acting as trustee or depositary of an AIF or acting as trustee or depositary of a UCITS);

(d) Instructions to another person such that the client incurs a debt or other liability to that other person (other than the firm); and

(5) Their circumstances are such that the client's further involvement would not be necessary for the firm's instructions described in (a) to (d) to be given effect.

The form of a mandate

8.2.2G

A mandate can take any form and need not state that it is a mandate. For example, it could take the form of:

(1) A standalone document containing certain information conferring authority to control a client's assets or liabilities on the firm;

(2) A specific provision within a document or agreement that also relates to other matters; or

(3) An authority provided by a client orally.

Retention by the firm

8.2.3G

(1) If a firm receives information that puts it in the position described in CASS 8.2.1 R (4) in order to effect transactions immediately on receiving that information, then such information could only amount to a mandate if the firm retained it (for example by not destroying the relevant document, electronic record or telephone recording):

(a) After it uses it to effect those immediate transactions; or

(b) Because those transactions are not, for whatever reason, effected immediately.

(2) If a firm receives information that puts it in the position described in CASS 8.2.1 R (4) and the firm retains that information (for example in accordance with its record-keeping procedures or in order to effect transactions in the future or over a period of time) then such information could amount to a mandate.

Ability to give instructions to another person

8.2.4G

The instructions referred to at CASS 8.2.1 R (4) are all instructions given by a firm to another person who also has a relationship with the firm's client. For example, the other person may be the client's bank, intermediary, custodian or credit card provider. This means, for example, that any means by which a firm can control a client's money or assets for which it is itself responsible to the client (rather than any other person) would not amount to a mandate. This includes where the firm is holding a client's money or assets other than in accordance with CASS 5, CASS 6 or CASS 7 (for example, because of an exemption in those rules).

8.2.5G

A mandate in relation to the type of instructions referred to in CASS 8.2.1 R (4) could include a direct debit instruction over a client's bank account in favour of the firm. The fact that the instruction was given by the client in the form of a paperless direct debit would not prevent it from being a mandate.

8.2.6G

A mandate in relation to the type of instructions referred to in CASS 8.2.1 R (4) could include the client's credit card details.

Conditions on use of mandate and client's further involvement

8.2.7G

Broadly conceptually equivalent across all relevant rules save that UK rules are more prescriptive.
1. If a firm obtains the means by which it can give the types of instructions referred to in CASS 8.2.1 R (4), but its use of those means is subject to any limits or conditions, then this does not necessarily prevent those means from being a mandate. For example, a client might require that a firm uses a mandate only in connection with transactions up to a certain value.

2. However, if a firm obtains the means by which it can give the types of instructions referred to in CASS 8.2.1 R (4), but the firm cannot, in practice, use those means without the client's further involvement, then the condition in CASS 8.2.1 R (5) would not be met. For example, a firm might have the means by which it can give instructions of the type referred to in CASS 8.2.1 R (4)(a) in relation to an account maintained by another person for a client, but that other person might require the client's signature or other authorisation before it gives effect to those instructions.

8.3.1R
A firm that has mandates must establish and maintain adequate records and internal controls in respect of its use of the mandates.

8.3.2R
The records and internal controls required by CASS 8.3.1 R must include:

1. an up-to-date list of each mandate that the firm has obtained, including a record of any conditions placed by the client or the firm's management on the use of the mandate and, where a mandate was received in non-written form in the course of, or in connection with, its designated investment business, the details required under CASS 8.3.2C R;
2. a record of each transaction entered into under such mandate that the firm has;
3. internal controls to ensure that each transaction entered into under each mandate that the firm has is carried out in accordance with any conditions placed by the client or the firm's management on the use of the mandate;
4. the details of the procedures and internal controls around the giving of instructions under the mandates that the firm has (such instructions being those referred to in CASS 8.2.1 R (4)); and
5. where the firm holds a passbook or similar documents belonging to the client, internal controls for the safeguarding (including against loss, unauthorised destruction, theft, fraud or misuse) of any passbook or similar document belonging to the client held by the firm.

8.3.2AR
(1) A firm's up-to-date list of mandates under CASS 8.3.2 R (1) must be maintained in a medium that allows the storage of information in a way accessible for future reference by the FCA or by an auditor preparing a report under SUP 3.10.4 R.

8.3.2BG
A firm may use version control to comply with CASS 8.3.2A R (2).

8.3.2CR
An entry in a firm's list of mandates under CASS 8.3.2 R (1) that relates to a mandate that was received in non-written form (eg in a telephone call) in the course of, or in connection with, its designated investment business must, as well as the information referred to at CASS 8.3.2 R (1), include the following details:

1. the nature of the mandate (eg debit card details);
2. the purpose of the mandate (eg collecting insurance premiums);
3. how the mandate was obtained (eg by telephone);
4. the name of the relevant client; and
5. the date on which the mandate was obtained.

8.3.2DG
If a firm receives information through a telephone call in the course of, or in connection with, its designated investment business that amounts to a mandate as a result of the firm retaining a recording of the call (see CASS 8.2.3 G), the requirements of CASS 8.3.2 R (1) apply, regardless of whether or not the firm intends to use the mandate in the future. The firm will meet the requirements of CASS Broadly conceptually equivalent across all relevant rules save that UK rules are more prescriptive.
When keeping a list of mandates under CASS 8.3.2 GR (1) up to date:

(1) if a firm should create a new entry in the list each time the firm obtains a new mandate;
(2) if, for an existing entry on its list, a firm obtains the same information as the conditions in CASS 8.2.1 R again (eg in a written confirmation following a paperless direct debit), the additional mandate is a new mandate and the firm should not create another entry on the list; but
(3) if the firm should, for every entry on its list, identify each of the locations in which it has retained the information that meets the conditions in CASS 8.2.1 R (eg a client's debit card details retained in a telephone recording and also the firm's written log of the call, or two separate documents containing the same information).

Records kept in accordance with this Regulation shall enter into a written basic agreement with the client, in paper or another durable medium, with the client setting out the essential rights and obligations of the firm and the client. Investment firms providing investment advice shall comply with this obligation only where a periodic assessment of the suitability of the financial instruments or services recommended is performed. The written agreement shall set out the essential rights and obligations of the parties, and shall include the following:
(a) a description of the services, and where relevant the nature and extent of the investment advice, to be provided;
(b) in case of portfolio management services, the types of financial instruments that may be purchased and sold and the types of transactions that may be undertaken on behalf of the client, as well as any instruments or transactions prohibited;
(c) a description of the main features of any services referred to in Section B(1) to Directive 2014/65/EU to be provided, including where applicable the role of the firm with respect to corporate actions relating to client instruments and the terms on which securities financing transactions involving client securities will generate a return for the client.

Retained records
6.3.2 GR
A firm must retain the records required under CASS 8.3.1 R in relation to a particular mandate for the following period after it ceases to have the mandate (eg because the firm has destroyed the relevant documents, electronic record or telephone recordings), as applicable:
(1) subject to (2), a minimum of one year;
(2) a minimum of five years, where the relevant mandate was held by the firm in the course of, or in connection with, its MiFID business.

Books, records, financial control and management information
9. (1) An investment business firm shall, at all times, have in place policies, resources and systems to identify, monitor, report on and manage risks to which it is or may be exposed in respect of their activities.

Record retention pursuant to MiFID Regulations are set out in:
• Article 16(6) MiFID II
• Article 23(1) MiFID Regulations

Broadly conceptually equivalent across all relevant rules save that UK rules are more prescriptive.
2. Investment firms shall keep at least the records identified in Annex I to this Regulation, depending upon the nature of their activities. The list of records identified in Annex I to this Regulation is without prejudice to any other record-keeping obligations arising from other legislation.

3. Investment firms shall also keep records of any policies and procedures they are required to maintain pursuant to Directives 2014/65/EU, Regulation (EU) No 600/2014, Directive 2014/71/EU and Regulation (EU) No 98/2014 and their respective implementing measures in the UK. Competent authorities may require investment firms to keep additional records to the list identified in Annex I to this Regulation.

5.2.2 R

Where a firm has an obligation under CASS 5.2.2 R to retain records after it ceases to have a particular mandate, it may keep the mandate on its list under CASS 5.2.2 R (1) for at least the relevant period, but the list should be updated to reflect the fact that it ceased to have the relevant mandate by the relevant date.

Regulation 23(5), (6) and (7) MiFID Regulations

(3) The records that must be kept include recordings of telephone conversations or electronic communications relating to at least—

(a) transactions concluded when dealing on own account,

(b) the provision of client order services that relate to the reception, transmission and execution of client orders, and

(c) telephone conversations and electronic communications that are intended to result in transactions concluded when dealing on own account or in the provision of client order services that relate to the reception, transmission and execution of client orders, even if such conversations or communications do not result in the conclusion of such transactions or in the provision of client order services.

(4) An investment firm shall take all reasonable steps to record relevant telephone conversations and electronic communications, made with, sent from or received by equipment provided by the investment firm to an employee or contractor or the use of which by an employee or contractor has been accepted or permitted by the investment firm. An investment firm shall notify new and existing clients that telephone communications or conversations between the investment firm and its clients that result or may result in transactions will be recorded. Such a notification may be made once, before the provision of investment services to new and existing clients. An investment firm shall not provide, by telephone, investment services and activities to clients who have not been notified in advance about the recording of their telephone communications or conversations, where such investment services and activities relate to the reception, transmission and execution of client orders. Orders may be placed by clients through other channels, however such communications must be made in a durable medium such as audio, video, email or documentation of client orders made at meetings. In particular, the content of relevant face-to-face conversations with a client may be recorded by using written minutes or notes. Such orders shall be considered equivalent to orders received by telephone. An investment firm shall take all reasonable steps to prevent an employee or contractor from making, sending or receiving relevant telephone conversations and electronic communications on privately owned equipment which the investment firm is unable to record or copy. The records kept in accordance with this paragraph shall be provided to the client on request and shall be kept for a period of five years and, where requested by the competent authority, for a period of up to seven years.

Broadly conceptually equivalent across all relevant rules save that UK and Irish rules are more prescriptive.

934. Article 16(7) MiFID II

Records shall include the recording of telephone conversations or electronic communications relating to—

1. transactions concluded when dealing on own account and the provision of client order services that relate to the reception, transmission and execution of client orders, or the use of equipment provided by the investment firm to an employee or contractor or the use of which by an employee or contractor has been accepted or permitted by the investment firm. An investment firm shall notify new and existing clients that telephone communications or conversations between the investment firm and its clients that result or may result in transactions will be recorded. Such a notification may be made once, before the provision of investment services to new and existing clients. An investment firm shall not provide, by telephone, investment services and activities to clients who have not been notified in advance about the recording of their telephone communications or conversations, where such investment services and activities relate to the reception, transmission and execution of client orders. Orders may be placed by clients through other channels, however such communications must be made in a durable medium such as audio, video, email or documentation of client orders made at meetings. In particular, the content of relevant face-to-face conversations with a client may be recorded by using written minutes or notes. Such orders shall be considered equivalent to orders received by telephone. An investment firm shall take all reasonable steps to prevent an employee or contractor from making, sending or receiving relevant telephone conversations and electronic communications on privately owned equipment which the investment firm is unable to record or copy. The records kept in accordance with this paragraph shall be provided to the client on request and shall be kept for a period of five years and, where requested by the competent authority, for a period of up to seven years.

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Article 76 (1) Commission Delegated Regulation

1. Investment firms shall establish, implement and maintain an effective recording of telephone conversations and electronic communications policy, set out in writing, and appropriate to the size and organisation of the firm, and the nature, scale and complexity of its business. The policy shall include the following content: (a) identification of the telephone conversations and electronic communications, including relevant internal telephone conversations and electronic communications, that are subject to the recording requirement in accordance with Article 167(7) of Directive 2014/65/EU, and 31.3.2017 EN Official Journal of the European Union L 378/3 (b) the objective of the procedures to be followed and measures to be adopted to ensure the firm’s compliance with the third and eighth subparagraph of Article 167(7) of Directive 2014/65/EU where exceptional circumstances arise and the firm is unable to record the communication or device issued, accepted or permitted by the firm. Evidence of such circumstances shall be retained and shall be accessible to competent authorities.

3.36. An investment firm that is also a takeover operator shall distinguish between conditions placed by a client on the firm’s use of a mandate, and criteria to which transactions effected by a firm with or for a client may be subject.

1. The requirements in CASS 6.2 R (1) and CASS 6.2 R (3) apply only in respect of conditions placed around the firm’s use of a mandate itself or around the instructions described in CASS 6.2 R (1). Examples of these include conditions under which a mandate may only be used by the firm in connection with transactions up to a certain value, or under which instructions under a mandate may only be given by certain personnel within the firm.

2. The requirements in CASS 6.2 R (2) and CASS 6.2 R (3) are relevant only in respect of criteria which relates to the nature and circumstances of transactions effected by a firm with or for a client. Examples of these criteria include investment restrictions or exposure limits for a managed portfolio, and required or preferred execution prices or execution venues.

Annex I — The terms of business of a firm

Chapter 9

Information to clients

9.1. Application

This chapter applies as follows:

(a) CASS 9.2 and CASS 9.3 apply in the same way to a prime brokerage firm to which CASS 9.2 R (1) and CASS 9.2 R (3) do not apply in respect of criteria which relate to the nature and circumstances of transactions effected by the firm with or for a client.

(b) CASS 9.2 and CASS 9.3 do not apply to a firm which only applies CASS 9.2 to a firm to which either or both CASS 6 (Custody rules) and CASS 7 (Client money rules) applies to a firm which only applies CASS 7 (Client money rules) applies to a firm to which CASS 9.2 and CASS 9.3 do not apply.

(c) CASS 9.2 and CASS 9.3 do not apply to a firm which only applies CASS 9.2 R (1) and CASS 9.2 R (3) do not apply in respect of criteria which relates to the nature and circumstances of transactions effected by a firm with or for a client.

(d) CASS 9.2 and CASS 9.3 do not apply to a firm which only applies CASS 6 (Custody rules) and CASS 7 (Client money rules) applies to a firm to which CASS 9.2 and CASS 9.3 do not apply.

9.1 Application

Information to be provided to clients in the terms of business

Regulation 59 IMR 2017

Information to be provided to clients in the terms of business

9.1. Prior to first receiving client assets an investment firm shall disclose to clients or potential clients in the terms of business—

(a) arrangements relating to the receipt of client assets;

(b) if applicable, a statement detailing its exchange rate policy (in the case of CASS 8.3.2 R (1));

(c) whether interest is payable in respect of client funds and the terms on which such interest is payable (in the case of CASS 8.3.2 R (3));

(d) where applicable, arrangements relating to—

(i) the registration of client financial instruments and collateral, if these are not to be registered in the client’s name,

(ii) claiming and receiving dividends, interest payments and other rights accruing to the client;

(iii) the exercise of conversion, subscription and redemption rights,

(iv) dealing with take-overs and capital re-organisations.

9.2. Client Assets Key Information Document

What information should an investment firm provide to clients regarding arrangements for holding client assets prior to first receiving client assets?

671 (3) The Central Bank expects the information in respect of Regulations 7(2) to 7(6) will be disclosed in an investment firm’s terms of business or investment agreement. An investment firm should ensure that the information is clearly documented.

Note, “prior to first receiving client assets” refers to the initial receiving of client assets from the client and not to each time an investment firm receives client assets from the same client. Additional disclosures may be required if there is a change in a service offered to the client or type of asset received, e.g., securities financing.

What information should an investment firm provide to clients regarding arrangements for holding client assets?

671 (4) The Central Bank expects that, in the ordinary course of business, an investment firm will provide this information in its terms of business or investment agreement.

How should the Client Assets Key Information Document be presented to retail clients?

671 (9) An investment firm should document in its CASSP public client version of its Client Assets Key Information Document (‘CAKID’) to in

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(b) CASS 9.2 and CASS 9.3 do not apply to a firm which only applies CASS 7 (Client money rules) applies to a firm to which either or both CASS 6 (Custody rules) and CASS 7 (Client money rules) applies to a firm to which CASS 9.2 and CASS 9.3 do not apply.

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(d) CASS 9.2 and CASS 9.3 do not apply to a firm which only applies CASS 6 (Custody rules) and CASS 7 (Client money rules) applies to a firm to which CASS 9.2 and CASS 9.3 do not apply.
potential client may, if permitted by national law, be held in an nominee account by a third party, the investment firm shall inform the client or potential client where it is not possible under national law for client financial instruments held with a third party to be separately identifiable from the proprietary financial instruments of the third party or of the investment firm and shall provide a prominent warning of the resulting risks. The investment firm shall inform the client or potential client where accounts that contain financial instruments or funds belonging to the client or potential client are or will be subject to the law of a jurisdiction other than that of a Member State and shall indicate that the rights of the client or potential client relating to these financial instruments or funds may differ accordingly.

6. An investment firm shall inform the client about the existence and the terms and any security interest or lien which the firm has or may have over the client’s financial instruments or funds, or any right of set-off in relation to those financial instruments or funds. Where applicable, it shall also inform the client of the fact that a depositary may have a security interest or lien over, or right of set-off in relation to those financial instruments or funds. An investment firm, before entering into securities finance transactions in relation to financial instruments held by it on behalf of a client, or before otherwise using such financial instruments for its own account or the account of another client shall in good time before the use of those financial instruments provide the client, in a durable medium, with clear, full and accurate information on the obligations and responsibilities of the investment firm in respect of those financial instruments, including the terms for their insolvency, and on the risks involved.

Pay attention to Article 49 MiFID II Regulation Article 49

Information concerning safeguarding of client financial instruments or client funds (Article 24(4) of Directive 2014/65/EU)

1. Investment firms holding financial instruments or funds belonging to clients shall provide those clients or potential clients with the information specified in paragraphs 2 to 7 where relevant.

2. The investment firm shall inform the client or potential client where the financial instruments of another client or of a third party on behalf of the investment firm and of the responsibility of the investment firm under the applicable national law for any acts or omissions of the third party and the consequences for the client of the insolvency of the third party.

3. Where financial instruments of the client or potential client are not held by the investment firm in the client’s own name and do not apply

4. The investment firm shall inform the client or potential client where it is not possible under national law for client financial instruments held with a third party to be separately identifiable.

(c) the existence of voting rights,
(d) where client assets are to be held in a pooled account, the nature of a pooled account and the risks of client assets being held in a pooled account,
(e) the trading name, registered address and website address (if any) of third party with whom the client assets are to be deposited,
(f) if client assets are to be deposited with a third party outside of the State—
(i) that in the event of a default of a third party outside of the State, those client assets may be treated differently from the position which would apply if the client assets were deposited with a third party in the State; and
(ii) any additional risks that may arise where client assets are deposited with a third party outside of the State,
(g) in the case of collateral margined transactions, where an investment firm is to deposit collateral with, pledge, charge or grant a security arrangement over the collateral to a relevant party or pledge, securitisation—
(i) that the collateral will not be registered in the client’s name if this is the case,
(ii) of the procedure which will apply in the event of the client’s default, where the proceeds of sale of the collateral exceed the amount owed by the client to the investment firm,
(h) of the circumstances in which the investment firm shall use a client’s financial instruments in this manner.

Regulation 69 FISR 2017

Client assets key information document

69.1 Prior to a retail client entering an investment agreement to open an account with an investment firm, an investment firm shall provide the total client with a Client Assets Key Information Document, which shall be—
(a) written in a language and a style that is clear, succinct and comprehensible,
(b) a separate and standalone document to any other document,
(c) accurate and relevant, and
(d) provided in a durable medium.

2. The Client Assets Key Information Document shall provide—
(a) an explanation of the key features of the regulatory regime that applies to the safeguarding of client assets,
(b) an explanation of what constitutes client assets under that regime,
(c) the circumstances in which that regime applies and does not apply,
(d) the arrangements applying to the holding of client assets and the relevant risks associated with these arrangements.

3. An investment firm shall—
(a) treat the regulation applied to client assets as having the objective of safeguarding the handling of client assets, it can never fully demonstrate all risks relating to client assets, e.g., fraud, negligence.
(b) An explanation of what constitutes client assets under the Regulations.
(c) An investment firm should explain that, under the client asset regime, client assets must be held in accordance with the requirements of the client asset regime and which are not holding it in safe custody arrangements.
(d) An explanation of the circumstances in which the Regulations apply and do not apply.
(e) An investment firm should state the circumstances where the client asset regime applies and explains any limitations (e.g. the client asset regime will not apply in respect of funds received for an activity that is not a regulated financial service).
(f) An investment firm should explain when assets are to be held by the investment firm and of the responsibility of the investment firm under the applicable national law for any acts or omissions of the third party and the consequences for the client of the insolvency of the third party.
(g) An investment firm should be able to demonstrate, when requested to do so, evidence that it provided the CAKID to its retail clients. An investment firm should be able to demonstrate, when requested to do so, evidence that it provided the CAKID to its retail clients.

What information is an investment firm required to include in the Client Assets Key Information Document?

69 (18) For the avoidance of doubt, Regulation 7(19) applies to all retail clients, for existing retail clients (a retail client of the investment firm at the date of commencement of the Regulations), Regulation 7(20) applies. For the purpose of Regulation 7(19) an investment firm may provide this document on its website. An investment firm should also retain a copy of this document for each retail client, a notice that the CAKID is on its website.

69 (11) The CAKID should at least contain the following where applicable:
(a) An explanation of the Regulations. An investment firm should refer to the Regulations outlining what the Regulations mean. The investment firm should also refer to the retail client to the Guidance explaining the purpose of each Guidance. A link to the Regulations and Guidance on the Central Bank’s website should also be provided.
(b) An explanation of what constitutes client assets under the Regulations.
(c) An investment firm should explain that, under the client asset regime, client assets must be held and safeguarded in accordance with the client asset regime.
(d) An investment firm should explain that the client asset regime does not relate to the value of a client investment.
(e) The circumstances in which the Regulations apply and do not apply.
(f) An investment firm should state the circumstances where the client asset regime applies and explains any limitations (e.g., the client asset regime will not apply in respect of funds received for an activity that is not a regulated financial service).
(g) An investment firm should explain when assets are to be held by the investment firm and of the responsibility of the investment firm under the applicable national law for any acts or omissions of the third party and the consequences for the client of the insolvency of the third party.
(h) An investment firm should explain any unique circumstances where the client asset regime may/may not apply. For example, the investment firm should state that the client asset regime will not apply to the Retail Client’s own name, and the investment firm is not holding it in safe custody arrangements.
(i) An investment firm should explain what information is required to be provided in a durable medium.
(j) An investment firm should provide the total client with a Client Assets Key Information Document, which shall be—
(a) written in a language and a style that is clear, succinct and comprehensible,
(b) a separate and standalone document to any other document,
(c) accurate and relevant, and
(d) provided in a durable medium.

2. The Client Assets Key Information Document shall provide—
(a) an explanation of the key features of the regulatory regime that applies to the safeguarding of client assets,
(b) an explanation of what constitutes client assets under that regime,
(c) the circumstances in which that regime applies and does not apply,
(d) the arrangements applying to the holding of client assets and the relevant risks associated with these arrangements.

3. An investment firm shall—
(a) treat the regulation applied to client assets as having the objective of safeguarding the handling of client assets, it can never fully demonstrate all risks relating to client assets, e.g., fraud, negligence.
(b) An explanation of what constitutes client assets under the Regulations.
(c) An investment firm should explain that, under the client asset regime, client assets must be held in accordance with the requirements of the client asset regime and which are not holding it in safe custody arrangements.
(d) An explanation of the circumstances in which the Regulations apply and do not apply.
(e) An investment firm should state the circumstances where the client asset regime applies and explains any limitations (e.g. the client asset regime will not apply in respect of funds received for an activity that is not a regulated financial service).
(f) An investment firm should explain when assets are to be held by the investment firm and of the responsibility of the investment firm under the applicable national law for any acts or omissions of the third party and the consequences for the client of the insolvency of the third party.
(g) An investment firm should explain any unique circumstances where the client asset regime may/may not apply. For example, the investment firm should state that the client asset regime will not apply to the Retail Client’s own name, and the investment firm is not holding it in safe custody arrangements.
(h) An investment firm should explain what information is required to be provided in a durable medium.

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The investment firm shall inform the client or potential client relating to those financial instruments or funds of any material change to the Client Assets Key Information Document in a durable medium, and in any event within one month of such changes having been issued.

Regulation 61 DISR 2017
Statement of client financial instruments or client funds
61. (1) The statement of client financial instruments or client funds referred to in Article 63 of the 25 April 2017 Commission Delegated Regulation shall, in addition to the information to be provided under Article 63(2) of that Regulation, include the following information:
(a) the amounts of cash balances (which may be shown on a separate statement held by the investment firm as of the statement date);
(b) information to be provided under Article 63 of that Regulation, including the following:
(i) identification of those client financial instruments registered in the client’s name which are held in custody by, or on behalf of, the investment firm separately from those registered in any other name; and
(ii) the market values of any collateral held as at the date of the statement.

An investment firm should inform its retail clients of any material change to the Client Assets Key Information Document.

67 (12) An investment firm should inform its retail clients of any material change to the Client Assets Key Information Document. To this end it will notify the retail clients of any material change to the CAKID. For clarity, the CAKID may be provided for existing retail clients on an investment firm’s website. However, for any subsequent changes to the CAKID the investment firm has to provide such notification in a durable medium. A website is not a durable medium for this purpose. Note, it is only the subsequent changes that are required to be provided and not the complete CAKID document.

Broadly conceptually equivalent across all relevant rules save that UK rules are more prescriptive in detail and that UK specific rules apply as to concept at “grain broker” as a type of supervised role for the purposes of CASS.

9.2 Prime broker’s daily report to clients
9.2.1B (1) A firm must make available to each of its clients to whom it provides prime brokerage services a statement in a durable medium:
(a) relating the value at the close of each business day of the firm’s client assets and the total amount of client money held by that prime brokerage firm for a client;
(b) detailing any other matters which that firm considers are necessary to ensure that a client has up-to-date and accurate information about the amount of client money and the value of safe custody assets held by that firm for it;
(c) the arrangements applying to the holding of client assets and the relevant risks associated with these arrangements.

An investment firm should document in its arrangements in regard to the holding of client assets:
• the possible risks involved;
• the controls in place to mitigate these possible risks.

An investment firm should draft their own responses under the headings in (a) to (c) above tailored to suit their particular business. It is essential that the investment firm drafts this document in a comprehensive manner, in order to ensure that retail clients can fully understand how their assets will be held and can consequently make informed decisions. As each document will be tailored to suit the particular business of the investment firm, the Central Bank does not intend to provide a CAKID template.
(b) The cash value of each of the following:

(i) Cash loans made to that client and accrued interest;
(ii) Securities to be redeployed by that client under open short positions entered into on behalf of that client;
(iii) Short sale cash proceeds held by the firm in respect of short positions entered into on behalf of that client;
(iv) Cash margin held by the firm in respect of open futures contracts entered into on behalf of that client;
(v) Mark-to-market close-out exposure of any OTC transaction entered into on behalf of that client secured by safe custody assets or client money;
(vi) Total secured obligations of that client against the prime brokerage firm; and
(vii) All other safe custody assets held for that client.

(c) Total collateral held by the firm in respect of secured transactions entered into under a prime brokerage agreement, including where the firm has exercised a right of use in respect of that client's safe custody assets;

d) The location of all of a client's safe custody assets, including assets held with a sub-custodian;

(e) A list of all the institutions at which the firm holds or may hold client money, including money held in client bank accounts and client transaction accounts.

Statement of client financial instruments or client funds

See row 795 for text.

9.2.2G Where a firm has entered into an agreement with a client under article 91 (Reporting obligations for prime brokers) of the AIFMD level 2 regulation, and to the extent that the firm makes available to the client the same statements as specified by that article that it is required to provide to the relevant depositary, the FCA will treat the obligations under CASS 9.2.1 R as satisfied by the firm.

Broadly conceptually equivalent across all relevant rules save that UK rules are more prescriptive in detail and that UK specific rules apply as to concept of “prime broker” as a type of supervised role for the purposes of CASS.

9.3 Prime brokerage agreement disclosure annex

9.3.1R (1) A firm must ensure that every prime brokerage agreement that includes its right to use safe custody assets for its own account includes a disclosure annex.

(2) A firm must ensure that the disclosure annex sets out a summary of the key provisions within the prime brokerage agreement permitting the use of safe custody assets, including:

(a) The contractual limit, if any, on the safe custody assets which a prime brokerage firm is permitted to use;
(b) All related contractual definitions upon which the limit is based;
(c) A list of numbered references to the provisions within that prime brokerage agreement which permit the firm to use the safe custody assets; and
(d) A statement of the key risks to that client's safe custody assets if they are used by the firm, including but not limited to the risk to the safe custody assets on the failure of the firm.

(3) A firm must ensure that it sends to the client in question an updated disclosure annex if the terms of the prime brokerage agreement are amended after completion of that agreement such that the original disclosure annex no longer accurately records the key provisions of the amended agreement.

Broadly conceptually equivalent across all relevant rules save that UK rules are more prescriptive in detail and that UK specific rules apply as to concept of “prime broker” as a type of supervised role for the purposes of CASS.

9.3.2G (1) Principle 10 (Clients' assets) requires a firm to arrange adequate protection for client's 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.

(2) Subject to paragraph (3), a prime brokerage firm should not enter into right-to-use arrangements for a client's safe custody assets unless:

(a) in the case of a CASS small firm or a firm to which CASS 1A.3.1C R applies, the person in that firm to whom the responsibilities set out in CASS 1A.3.1 R or in CASS 1A.3.1C R (2) respectively have been allocated; or
(b) in the case of any other firm, the person who carries out the CASS operational oversight function; and
(c) Those of that firm's managers who are responsible for those safe custody assets are each satisfied that the firm has adequate systems and controls to discharge its obligations under Principle 10 which include (where applicable):

(i) The daily reporting obligations in CASS 9.2.1 R, and
(ii) The record-keeping obligations in CASS 9.3A R.

Broadly conceptually equivalent across all relevant rules save that UK rules are more prescriptive in detail and that UK specific rules apply as to concept of “prime broker” as a type of supervised role for the purposes of CASS.
Paragraph (2) does not apply where the prime brokerage firm is also acting as trustee or depositary of an AIF which is an unauthorised AIF and exercises a right of reuse for a safe custody asset of that unauthorised AIF under FUND 3.11.24 R (Reuse of assets).

9.4 Information to clients concerning custody assets and client money

9.4.1

(1) Firms to which COBS 6.1 applies are reminded that, under COBS 6.1.7 R, a firm that holds client designated investments or client money must provide its clients with specific information about how the firm holds those client designated investments and client money and how certain arrangements might give rise to specific consequences or risks for those client designated investments and client money.

(2) COBS 6.1 (Information about the firm and compensation information (non-MiFID and non-insurance distribution provisions)) applies to a firm in relation to its designated investment business, other than MiFID, equivalent third country or optional exemption business or insurance distribution activities, for a retail client.

9.4.2

A firm to which COBS 6.1 applies that holds custody assets or client money must, in relation to its business for which COBS 6.1 applies:

(1) provide the information in COBS 6.1.7 R for any custody assets the firm may hold for a client, including any custody assets which are not designated investments; and

(2) provide the information in COBS 6.1.7 R and in (1) to each of its clients.

Broadly conceptually equivalent across all relevant rules save that UK rules are more prescriptive in detail and that UK specific rules apply as to concept of “prime broker” as a type of supervised role for the purposes of CASS.
any right of set-off it holds in relation to those instruments or funds. Where applicable, it shall also inform the client of the fact that a depository may have a security interest or lien over, or right of set-off in relation to those instruments or funds.

7. An investment firm, before entering into securities financing transactions in relation to financial instruments held by it on behalf of a client, or before otherwise using such financial instruments for its own account or the account of another client shall in good time before the use of those instruments provide the client, in a durable medium, with clear, full and accurate information on the obligations and responsibilities of the investment firm with respect to the use of those financial instruments, including the terms for their restoration, and on the risks involved.

8. An investment firm, before entering into securities financing transactions in relation to financial instruments held by it on behalf of a client, or before otherwise using such financial instruments for its own account or the account of another client shall in good time before the use of those instruments provide the client, in a durable medium, with clear, full and accurate information on the obligations and responsibilities of the investment firm with respect to the use of those financial instruments, including the terms for their restoration, and on the risks involved.

9.4.2BR A firm to which COBS 6.1ZA applies that holds custody assets or client money must, in relation to its business for which COBS 6.1ZA applies:

(1) provide the information referred to in paragraphs 2 to 7 of article 49 of the MiFID Org Regulation for any custody asset that the firm may hold for a client, including:
   (a) any custody asset which is a designated investment but not a financial instrument; and
   (b) any custody asset which is neither a designated investment nor a financial instrument; and

(2) provide the information in (1) to each of its clients.

BROADLY CONCEPTUALLY EQUIVALENT ACROSS ALL RELEVANT RULES SAVE THAT UK RULES ARE MORE PRESCRIPTIVE IN DETAIL AND THAT UK SPECIFIC RULES APPLY AS TO CONCEPT OF “PRIME BROKER” AS A TYPE OF SUPERVISED ROLE FOR THE PURPOSES OF CASS.

9.4.3G A firm should provide the information required in CASS 9.4.2 R or CASS 9.4.2BR (as applicable) to any client for whom it holds custody assets or client money, including a retail client, a professional client and an eligible counterparty.

BROADLY CONCEPTUALLY EQUIVALENT ACROSS ALL RELEVANT RULES SAVE THAT UK RULES ARE MORE PRESCRIPTIVE IN DETAIL AND THAT UK SPECIFIC RULES APPLY AS TO CONCEPT OF “PRIME BROKER” AS A TYPE OF SUPERVISED ROLE FOR THE PURPOSES OF CASS.

9.4.4G (1) Firms are reminded of their obligation, under COBS 4.2.1 R, to be fair, clear and not misleading in their communications with clients.

(2) Firms are also reminded of the requirements in respect of communications made to retail clients under COBS 4.5 and clients under article 44 of the MiFID Org Regulation and COBS 4.5A (as applicable).

BROADLY CONCEPTUALLY EQUIVALENT ACROSS ALL RELEVANT RULES.

Article 44 Commission Delegated Regulation

Fair, clear and not misleading information requirements (Article 24(3) of Directive 2014/65/EU)

1. Investment firms shall ensure that all information they address to, or disseminate in such a way that it is likely to be received by, retail or professional clients or potential retail or professional clients, including marketing communications, satisfies the conditions laid down in paragraphs 2 to 8.

2. Investment firm shall ensure that the information referred to in paragraph 1 complies with the following conditions:

(a) the information includes the name of the investment firm,

(b) the information is accurate and always gives a fair and prominent indication of any relevant risk, when referencing any potential benefits of an investment service or financial instrument,

(c) the information uses a font size in the indication of relevant risks that is at least equal to the predominant font size used throughout the information provided, as well as a layout ensuring such indication is prominent,

(d) the information is sufficient for, and presented in a way that is likely to be understood by, the average member of the group to whom it is directed, or by whom it is likely to be received.

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(e) the information does not disguise, diminish or obscure important items, statements or warnings,
(f) the information is consistently presented in the same language throughout all forms of information and marketing materials that are provided to each client, unless the client has accepted to receive information in more than one language,
(g) the information is up-to-date and relevant to the means of communication used.

3. Where the information compares investment or ancillary services, financial instruments, or persons providing investment or ancillary services, investment firms shall ensure that the following conditions are satisfied:

(a) the comparison is meaningful and presented in a fair and balanced way;
(b) the sources of the information used for the comparisons are specified;
(c) the key facts and assumptions used to make the comparisons are included.

4. Where the information contains an indication of past performance of a financial instrument, a financial index or an investment service, investment firms shall ensure that the following conditions are satisfied:

(a) the indication is not the most prominent feature of the communication;
(b) the information must include appropriate performance information which covers the preceding 5 years, or the whole period for which the financial instrument has been offered, the financial index has been established, or the investment service has been provided where less than five years, or each longer period the firm may decide, and in every case that performance information is based on complete 12-month periods;
(c) the reference period and the source of information is clearly stated;
(d) the information contains a prominent warning that the figures refer to the past and that past performance is not a reliable indicator of future results;
(e) where the indication relies on figures denominated in a currency other than that of the Member State in which the retail client or potential retail client is resident, the currency is clearly stated, together with a warning that the return may increase or decrease as a result of currency fluctuations;
(f) where the indication is based on gross performance, the effect of commissions, fees or other charges are disclosed.

5. Where the information includes or refers to simulated past performance, investment firms shall ensure that the information relates to a financial instrument or a financial index, and the following conditions are satisfied:

(a) the simulated past performance is based on the actual past performance of one or more financial instruments or financial indices which are the same as, or substantially the same as, or underlie the financial instrument concerned.
(b) in respect of the actual past performance referred to in point (a), the conditions set out in points (a) to (1), (c) and (f) of paragraph 4 are satisfied;

(c) the information contains a prominent warning that the figures refer to simulated past performance and that past performance is not a reliable indicator of future performance.

6. Where the information contains information on future performance, investment firms shall ensure that the following conditions are satisfied:

(a) the information is not based on or refer to simulated past performance;

(b) the information is based on reasonable assumptions supported by objective data;

(c) where the information is based on gross performance, the effect of commissions, fees or other charges is disclosed;

(d) the information is based on performance scenarios in different market conditions (both negative and positive scenarios), and reflects the nature and risks of the specific types of instruments included in the analysis;

(e) the information contains a prominent warning that such forecasts are not a reliable indicator of future performance.

7. Where the information refers to a particular tax treatment, it shall prominently state that the tax treatment depends on the individual circumstances of each client and may be subject to change in the future.

8. The information shall not use the name of any competent authority in such a way that would imply or suggest endorsement or approval by that authority of the products or services of the investment firm.

8.5. Article 25(6) MiFID II

The investment firm shall provide the client with adequate reports on the service provided in a durable medium. Those reports shall include periodic communications to clients, taking into account the type and the complexity of financial instruments involved and the nature of the service provided to the client and shall include, where applicable, the costs associated with the transactions and services undertaken on behalf of the client. When providing investment advice, the investment firm shall, before the transaction is made, provide the client with a statement on suitability in a durable medium specifying the advice given and how that advice meets the preferences, objectives and other characteristics of the retail client. Where an agreement to buy or sell a financial instrument is concluded using a means of distance communication which prevents the prior delivery of the suitability statement, the investment firm may provide the written statement on suitability in a durable medium immediately after the contract is concluded by any agreement, provided both the following conditions are met: (a) the client has consented to receiving the suitability statement without undue delay after the conclusion of the transaction, and (b) the investment firm has given the client the option of delaying the transaction in order to receive the written suitability statement in advance. Where an investment firm provides portfolio

8.5.1. Reporting to clients on request

(1) Firms to which COBS 16.4 applies are reminded that, under COBS 16.4, they are required to send to each of their clients at least once a year a statement in a durable medium of those designated investments and/or client money they hold for that client. A firm which manages investments may provide this statement in its periodic statement, as required under COBS 16.5.

(2) COBS 16.6 (Statements of client designated investments or client money) applies, in accordance with COBS 16.1.2R, to a firm carrying on designated investment business other than MiFID, equivalent third country or optional exemption business.
management or has informed the client that it will carry out a periodic assessment of suitability, the periodic report shall contain an updated statement of how the investment meets the client’s preferences, objectives and other characteristics of the retail client.

Article 63 Commission Delegated Regulation Statements of client financial instruments or client funds

(Article 25(6) of Directive 2014/65/EU)

1. Investment firms that hold client financial instruments or client funds shall send at least on a quarterly basis, to each client for whom they hold financial instruments or funds, a statement in a durable medium of those financial instruments or funds unless such a statement has been provided in any other periodic statement. Upon client request, firms shall provide such statement more frequently at a commercial cost.

The first subparagraph shall not apply to a credit institution authorised under Directive 2000/12/EC of the European Parliament and of the Council (26) in respect of deposits within the meaning of that Directive held by that institution.

2. The statement of client assets referred to in paragraph 1 shall include the following information:

(a) details of all the financial instruments or funds held by the investment firm for the client at the end of the period covered by the statement;

(b) the extent to which any client financial instruments or client funds have been the subject of securities financing transactions;

(c) the extent to which any benefit that has accrued to the client by virtue of participation in any securities financing transactions, and the basis on which that benefit has accrued;

(d) a clear indication of the assets or funds which are subject to the rules of Directive 2014/65/EU and its implementing measures and those that are not, such as those that are subject to Title Transfer Collateral Agreement;

(e) a clear indication of which assets are affected by some peculiarities in their ownership status, for instance due to a security interest;

(f) the market or estimated value, when the market value is not available, of the financial instruments included in the statement with a clear indication of the fact that the absence of a market price is likely to be indicative of a lack of liquidity. The evaluation of the estimated value shall be performed by the firm on a best effort basis.

In cases where the portfolio of a client includes the proceeds of one or more unsettled transactions, the information referred to in point (a) shall be based either on the trade date or the settlement date, provided that the same basis is applied consistently to all such information in the statement.

The periodic statement of client assets referred to in paragraph 1 shall not be provided where the investment firm provides its clients with access to an online system, which qualifies as a durable medium, where up-to-date statements of client's
financial instruments or funds can be easily accessed by the client and the firm has evidence that the client has accessed this statement at least once during the relevant quarter.

3. Investment firms which hold financial instruments or funds and which carry out the service of portfolio management for a client may include the statement of client assets referred to in paragraph 1 in the periodic statement it provides to that client pursuant to Article 60(1).

806. Firms are reminded that the requirements in COBS 16.4, article 63 of the MiFID Org Regulation and COBS 16A.4 only set out the minimum frequency at which firms must report to their clients on their holdings of designated investments and/or client money. Firms may choose to report to their clients more frequently.

807. Subject to CASS 9.5.5AR and CASS 9.5.4R, CASS 9.5.4RR and CASS 9.5.5R require firms to comply with a client's request for information on the custody assets and/or client money the firm holds for a client under CASS 6 and/or CASS 7, and such request may be made by a client at any time.

808. When a firm to which COBS 16A applies receives a request, made by a client, or on a client's behalf, for a statement of the custody assets and/or client money that the firm holds for that client, the firm must provide the client with the statement requested in a durable medium.

809. Firms to which COBS 16A applies are reminded of the requirements under article 63 of the MiFID Org Regulation (which are directly applicable to some firms and which are also applied to firms in other circumstances under COBS 16A.2BR) in relation to quarterly statements when the firm is holding a client's financial instruments or funds (see COBS 16A.4.1EU and COBS 16A.5.1EU).

810. When a firm receives a request, made by a client, or on a client's behalf, for a copy of any statement of custody assets and/or client money previously provided to that client, the firm must provide the client with the copy of the statement requested in a durable medium and within five business days following the receipt of the request.

811. A firm to which COBS 16A applies may combine the statement required under CASS 9.5.4RR with a statement issued in response to a request made under the last sub-paragraph of article 63(1) of the MiFID Org Regulation.

812. When a firm receives a request, made by a client, or on a client's behalf, for a copy of any statement of custody assets and/or client money previously provided to that client, the firm must provide the client with the copy of the statement requested in a durable medium and within five business days following the receipt of the request.

813. A firm is not required to provide a client with a statement under CASS 9.5.4R or CASS 9.5.4RR, or a copy of a statement under CASS 9.5.5R (as applicable) where the following conditions are met:

1. The firm provides the client with access to an online system, which qualifies as a durable medium;
2. a running status statement of the client’s custody assets and/or client money can be easily accessed by the client via the system under (1), and
3. the firm has evidence that the client has accessed this statement at least once during the relevant quarter.

814. Broadly conceptually equivalent across all relevant rules.
Any charge agreed between the firm and the client for providing the statements in CASS 9.5.4R, CASS 9.5.4RB or CASS 9.5.5R (as applicable) must be at a commercial cost.

9.5.6G

Consistent with the fair, clear and not misleading rule, a firm should ensure that, in any statements of custody assets and/or client money it provides to its clients, it is clear from the statement which assets and/or monies the firm holds as being for the client’s account, or are not protected under CASS 6 and/or CASS 7 (e.g. if the statement also indicates the assets and/or monies which are not held by the firm for that client which are not subject to the custody rules and/or client money rules).

9.5.9G

Firms are reminded that under CASS 3.2.4G firms that enter into arrangements with retail clients covered by CASS 3 (Collateral) should, when appropriate, identify in any statement of custody assets sent to the client under COBS 16.4 (Statements of client designated investments or client money), article 63 of the MiFID II Regulation or COBS 16A.4 (as applicable) or this section the details of the assets which form the basis of that collateral arrangement.

Chapter 10

CASS resolution pack

10.1 Application, purpose and general provisions

Application

10.1.1R

(1) Subject to (2) this chapter applies to a firm when it:

(a) holds financial instruments, is safeguarding and administering investments, is acting as trustee or depositary of an AIF or is acting as trustee or depositary of a UCITS, in accordance with CASS 6;

(aa) is acting as a small AIFM and carries on excluded custody activities in accordance with CASS 6; and/or

(b) holds client money in accordance with CASS 7.

(2) This chapter does not apply to a firm to which CASS 6 applies merely because it is:

(a) a firm which arranges safeguarding and administration of assets; or

(b) a small AIFM carrying on those excluded custody activities that would amount to arranging safeguarding and administration of assets but for the exclusion in article 72AA of the RAO.

Purpose

10.1.4G

A firm is required to maintain a CASS resolution pack at all times when CASS 10.1.1R applies to it.

General provisions

10.1.5G

(1) The rules in this chapter specify the types of documents and records that must be maintained in a firm’s CASS resolution pack and the retention period for the pack. The firm should maintain the component documents of the CASS resolution pack in order for there

Broadly conceptually equivalent across all relevant rules.
to be retrieved in accordance with CASS 10.1.7 R, and shall not use the retrieval period to start producing these documents.

2. The contents of the documents that constitute the CASS resolution pack will change from time to time (for example, because daily reconciliations must be included in the pack).

3. A firm is only required to retrieve the CASS resolution pack in the circumstances as prescribed in CASS 10.1.7 R.

203.

10.1 R

For the purpose of this chapter, a firm will be treated as satisfying a rule in this chapter requiring it to include a document in its CASS resolution pack if a person of that firm's group includes that document in its own CASS resolution pack, provided that:

1) that group member is subject to the same rule; and
2) the firm is still able to comply with CASS 10.1.7 R.

204.

Article 2(5) of the MiFID Delegated Directive

Member States shall require that investment firms make information pertaining to clients' financial instruments and funds readily available to the following entities: competent authorities, appointed insolvency practitioners and those responsible for the resolution of failed institutions. The information to be made available shall include the following:

(a) related internal accounts and records that readily identify the balances of funds and financial instruments held for each client;

(b) details of where financial instruments are held by the firm's group in accordance with Article 4, details on the accounts in which client funds are held and on the relevant agreements with those firms;

(c) details of third-party custody arrangements in place with third parties and those relevant agreements with those third parties, as well as details on the relevant agreements with those investment firms;

(d) details of third-party custody arrangements where the outsourced party is part of the same group.

(e) key individuals of the firm involved in related processes, including those responsible for the oversight of the firm's requirements in relation to the safeguarding of client assets; and

(f) agreements relevant to establish client ownership over assets.

10.1 R

In relation to each document in a firm's CASS resolution pack, a firm must:

1) put in place adequate arrangements to ensure that an administrator, receiver, trustee, liquidator or analogous officer appointed in respect of it or any material part of its property is able to retrieve each document as soon as practicable and in any event within 48 hours of that officer's appointment; and
2) ensure that it is able to retrieve each document as soon as practicable, and in any event within 48 hours, where it has taken a decision to do so or as a result of an FCA or Bank of England request.

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

Regulation 64 RRR 2017

Outsourcing requirements

64. (1) If an investment firm outsources another party, the performance of the reconciliation referred to in Regulation 57 or the daily calculation referred to in Regulation 58, the investment firm shall take reasonable steps to ensure that the other party has appropriate processes, systems and controls in place to ensure continuity in the effective performance of the outsourced activity.

(2) The manner in which the investment firm exercises oversight should be documented in the investment firm's CAMP. The investment firm should maintain a record to evidence the oversight of the process.

(3) A firm is only required to retrieve the CASS resolution pack if a member of that firm's group includes that document in its own CASS resolution pack, provided that:

1) that group member is subject to the same rule; and
2) the firm is still able to comply with CASS 10.1.7 R.

64 (h)

When an investment firm exercises the performance of reconciliations, it should have adequate oversight of the process to ensure that the third party has appropriate processes, systems and controls for the performance of this activity. This would also apply where the outsourced provider is part of the same group. The manner in which the investment firm exercises oversight should be documented in the investment firm's CAMP. The investment firm should maintain a record to evidence the oversight of the process.

64 (h)

When an investment firm exercises the performance of the daily calculation, it should have adequate oversight of the process to ensure that the third party has appropriate processes, systems and controls for the performance of this activity. This would also apply where the outsourced provider is part of the same group. The manner in which the investment firm exercises oversight should be documented in the investment firm's CAMP. The investment firm should maintain a record to evidence the oversight of the process.

64 (b)

An investment firm should, exercise the performance of reconciliation to another party, the performance of the reconciliation referred to in Regulation 57 or the daily calculation referred to in Regulation 58, the investment firm shall take reasonable steps to ensure that the other party has appropriate processes, systems and controls in place to ensure continuity in the effective performance of the outsourced activity.

64 (b)

Where an investment firm exercises the performance of reconciliations, it should have adequate oversight of the process to ensure that the third party has appropriate processes, systems and controls for the performance of this activity. This would also apply where the outsourced provider is part of the same group. The manner in which the investment firm exercises oversight should be documented in the investment firm's CAMP. The investment firm should maintain a record to evidence the oversight of the process.

64 (b)

Where an investment firm exercises the performance of the daily calculation, it should have adequate oversight of the process to ensure that the third party has appropriate processes, systems and controls for the performance of this activity. This would also apply where the outsourced provider is part of the same group. The manner in which the investment firm exercises oversight should be documented in the investment firm's CAMP. The investment firm should maintain a record to evidence the oversight of the process.

64 (b)

An investment firm should, exercise the performance of reconciliation to another party, the performance of the reconciliation referred to in Regulation 57 or the daily calculation referred to in Regulation 58, the investment firm shall take reasonable steps to ensure that the other party has appropriate processes, systems and controls in place to ensure continuity in the effective performance of the outsourced activity.

64 (b)

Where an investment firm exercises the performance of reconciliations, it should have adequate oversight of the process to ensure that the third party has appropriate processes, systems and controls for the performance of this activity. This would also apply where the outsourced provider is part of the same group. The manner in which the investment firm exercises oversight should be documented in the investment firm's CAMP. The investment firm should maintain a record to evidence the oversight of the process.
(g) the most recent external client money reconciliations referred to in CASS 10.3.1R(7A).
(2) Where a firm is reliant on the continued operation of certain systems for the provision of component documents in its CASS resolution pack, it should have arrangements in place to ensure that these systems will remain operational and accessible to it after its insolvency.
(3) Contravention of (1) or (2) may be relied upon as tending to establish contravention of CASS 10.1.7 R.

827. 10.1.1G
Where a firm anticipates that it might be the subject of an insolvency order, it is likely to have sought advice from an external adviser. The firm should make the CASS resolution pack available promptly, on request, to such an adviser.

Same comment as Row 818.

828. 10.1.10G
Where a firm anticipates that it might be the subject of an insolvency order, it is likely to have sought advice from an external adviser. The firm should make the CASS resolution pack available promptly, on request, to such an adviser.

Same comment as Row 818.

829. 10.1.12G
For the purpose of CASS 10.1.11R (2), an example of a change that would render a document inaccurate in a material respect is a change of institution identified pursuant to CASS 10.2.1R (2).

Same comment as Row 818.

830. 10.1.13G
A firm may hold in electronic form any document in its CASS resolution pack provided that it continues to be able to comply with CASS 10.1.7 R and CASS 10.1.11 R in respect of that document.

Same comment as Row 818.

831. 10.1.14R
The individual to whom responsibility for CASS operational oversight has been allocated under CASS 1A.3.1 R, CASS 1A.3.1A R or, as the case may be, CASS 1A.3.1CR (2), must report at least annually to the firm's governing body in respect of compliance with the rules in this chapter.

Same comment as Row 818.

832. 10.1.15G
Individuals allocated functions relating to CASS operational oversight pursuant to CASS 1A.3.1 R, CASS 1A.3.1A R or, as the case may be, CASS 1A.3.1CR (2), are reminded that their responsibilities include compliance with the provisions in this chapter.

Same comment as Row 818.

833. 10.1.16R
A firm must notify the FCA in writing immediately if it has not complied with, or is unable to comply with, CASS 10.1.3 R.

Same comment as Row 818.

834. 10.2 Core content requirements
10.2.1R
A firm must include within its CASS resolution pack:
(1) a master document containing information sufficient to retrieve each document in the firm's CASS resolution pack;
(2) a document which identifies the institutions the firm has appointed (including through an appointed representative, tied agent, field representative or other agent):
(a) in the case of client money, for the placement of money in accordance with CASS 7.13.3 R or to hold client money in accordance with CASS 7.14.2 R; and
(b) in the case of safe custody assets, for the deposit of those assets in accordance with CASS 6.3.1 R;
(3) a document which identifies each appointed representative, tied agent, field representative or other agent of the firm which receives client money or safe custody assets in its capacity as the firm’s agent;
(4) a document which identifies:
(a) each senior manager and director and any other individual and the nature of their responsibility within the firm who is critical or important to the performance of operational functions related to any of the obligations imposed on the firm by CASS 6 or CASS 7; and
(b) the individual to whom responsibility for CASS operational oversight has been allocated under CASS 1A.3.1 R or, as the case
may be, to whom the CASS operational oversight function has been allocated under CASS 1A.3.1A R;
(5) for each institution identified in CASS 10.2.1R (2), a copy of each executed agreement, including any side letters or other agreements used to clarify or modify the terms of the executed agreement, between that institution and the firm that relates to the holding of client money or safe custody assets including any written notification or acknowledgement letter sent or received pursuant to CASS 7.18;
(a) a document which
(1) identifies each member of the firm’s group involved in operational functions related to any obligations imposed on the firm under CASS 6 or CASS 7, including the case of a member that is a nominee company, identification in such a case, and
(2) identifies each third party which the firm uses for the performance of operational functions related to any of the obligations imposed on the firm by CASS 6 or CASS 7; and
(c) for each group member identified in (a), the type of entity (such as branch, subsidiary and or nominee company) the group member is, its jurisdiction of incorporation if applicable, and a description of its related operational functions;
(7) a copy of each executed agreement, including any side letters or other agreements used to clarify or modify the terms of the executed agreement, between the firm and each third party identified in (6)(b);
(8) where the firm relies on a third party identified in (6)(b), a document which describes how to:
(9) a copy of the firm’s manual in which are recorded its procedures for the management, recording and transfer of the client money and safe custody assets that it holds.
838. **COBS 8.1.4 R or COBS 8A.1.9R (retail and professional client agreements).**

839. **CASS 10.3.1 R** does not change the record keeping requirements of the rules referred to therein.

840. **CHAPTER 11**

Debt management client money chapter

841. **11.1 Application**

This chapter (the debt management client money chapter) applies to a CASS debt management firm that receives or holds client money as set out in this chapter.

842. **11.1.2G**

The requirements imposed on a CASS debt management firm that holds client money vary depending on whether a firm is classified as a CASS small debt management firm or a CASS large debt management firm in CASS 11.2.3 R (CASS debt management firm types). CASS 11.1.4 R to CASS 11.1.6 R indicate which rules in the debt management client money chapter apply to which category of firm.

843. **11.1.3G**

The debt management client money chapter applies (to the extent indicated by CASS 11.1.4 R to CASS 11.1.6 R) to a CASS debt management firm, even if at the date of the determination or, as the case may be, the notification, referred to in CASS 11.2.4 R, the CASS debt management firm is not holding client money, provided that:

1. it held client money in the previous calendar year; or
2. it projects to hold client money in the current calendar year.

844. **11.1.4R**

Subject to CASS 11.1.6 R, only the rules and guidance in the debt management client money chapter listed in the table below apply to CASS small debt management firms.

<table>
<thead>
<tr>
<th>Reference</th>
<th>Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td>CASS 11.1.1 R to CASS 11.1.4 R and CASS 11.1.6 R</td>
<td>Application</td>
</tr>
<tr>
<td>CASS 11.2.1 R to CASS 11.2.9 G</td>
<td>Firm classification</td>
</tr>
<tr>
<td>CASS 11.3.1 R to CASS 11.3.2 R and CASS 11.3.6 R</td>
<td>Responsibility for CASS operational oversight</td>
</tr>
<tr>
<td>CASS 11.4.1 G to CASS 11.4.4 G</td>
<td>Selection of client money and discharge of fiduciary duty</td>
</tr>
<tr>
<td>CASS 11.5.1 R and CASS 11.5.2 R</td>
<td>Organisational requirements</td>
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<tr>
<td>CASS 11.6.1 R and CASS 11.6.2 G</td>
<td>Statutory trust</td>
</tr>
<tr>
<td>CASS 11.7.1 G and CASS 11.7.5 G</td>
<td>Selecting an approved bank at which to hold client money</td>
</tr>
<tr>
<td>CASS 11.8.1 G to CASS 11.8.13 R</td>
<td>Client bank account acknowledgment letters</td>
</tr>
<tr>
<td>CASS 11.9.1 R to CASS 11.9.15 G</td>
<td>Segregation and the operation of client money accounts</td>
</tr>
<tr>
<td>CASS 11.10.1 R to CASS 11.10.7 G</td>
<td>Payments to creditors</td>
</tr>
</tbody>
</table>
843. Application to CASS large debt management firms
11.1.5R
Subject to CASS 11.1.6 R, the rules and guidance in the debt management client money chapter apply to CASS large debt management firms, except where indicated otherwise in the relevant rule.

844. Solicitors
11.1.6R
(1) An authorised professional firm regulated by the Law Society of England and Wales, the Law Society of Scotland or the Law Society of Northern Ireland that, with respect to its regulated activities, is subject to the following rules of its designated professional body, must comply with those rules and, if it does so, it will be deemed to comply with the debt management client money chapter:
(a) if the firm is regulated by the Law Society of England and Wales, the SRA Accounts Rules 2011;
(b) if the firm is regulated by the Law Society of Scotland, the Law Society of Scotland Practice Rules 2011; and
(c) if the firm is regulated by the Law Society of Northern Ireland, the Solicitors’ Accounts Regulations 1999.

845. Firm classification
11.2.1R
(1) A CASS debt management firm must, once every year and by the time it is required to make a notification in accordance with CASS 11.2.4 R, determine whether it is a CASS large debt management firm or a CASS small debt management firm according to the amount of client money which it held during the previous year or, if it did not hold client money during the previous year, according to the amount of client money it projects to hold in the following year, in each case using the limits set out in the table in CASS 11.2.3 R.

<table>
<thead>
<tr>
<th>CASS debt management firm type</th>
<th>Highest total amount of client money held during the previous calendar year ending on 31 December</th>
</tr>
</thead>
<tbody>
<tr>
<td>CASS large debt management firm</td>
<td>[Limit]</td>
</tr>
<tr>
<td>CASS small debt management firm</td>
<td>[Limit]</td>
</tr>
</tbody>
</table>

11.2.2R
For the purpose of calculating the value of the total amounts of client money that it holds on any given day during a calendar year (in complying with CASS 11.2.1 R) a CASS debt management firm must base its calculation on accurate internal records of client money holdings. A CASS large debt management firm must do this using the internal reconciliations performed during the previous year that are prescribed in CASS 11.11.13 R. A CASS small debt management firm must use the records used in carrying out checks required of it under CASS 11.11.8 R.
11.2.4R

Once every calendar year, a CASS debt management firm must notify the FCA, in writing, of the information in (1), (2) or (3), as applicable, and the information in (4), in each case no later than the day specified in (1) to (4):

1. if it held client money in the previous calendar year, the highest total amount of client money held during the previous calendar year, notification of which must be made no later than the fifteenth business day of January; or
2. if it did not hold client money in the previous calendar year but at any point up to the fifteenth business day of January the firm projects that it will do so in the current calendar year, the highest total amount of client money that the firm projects that it will hold during the current calendar year, notification of which must be made no later than the fifteenth business day of January; or
3. in any other case, the highest total amount of client money that the firm projects that it will hold during the remainder of the current calendar year, notification of which must be made no later than the business day before the firm begins to hold client money; and
4. in every case, of its ‘CASS debt management firm type’ classification, notification of which must be made at the same time the firm makes the notification under (1), (2) or (3).

11.2.5R

For the purpose of the annual notification in CASS 11.2.4 R, a CASS debt management firm must apply the calculation rule in CASS 11.2.2 R.

11.2.6G

CASS 11.2.7 R provides a CASS debt management firm with the ability to opt in to a higher category of ‘CASS debt management firm type’. This may be useful for a CASS debt management firm whose holding of client money is near the upper categorisation limit for a CASS small debt management firm.

11.2.7R

1. Provided that the conditions in (2) are satisfied, a CASS debt management firm that would otherwise be classified as a CASS small debt management firm under the limits provided for in CASS 11.2.3 R may elect to be treated as a CASS large debt management firm.
2. The conditions to which (1) refers are that in either case:
   a. the election is notified to the FCA in writing;
   b. the notification in accordance with (a) is made at least one week before the election is intended to take effect; and
   c. the FCA has not objected.

11.2.8R

A firm’s ‘CASS debt management firm type’ and any change to it takes effect:

1. if the firm notifies the FCA in accordance with CASS 11.2.4 R (1) or CASS 11.2.4 R (2), on 1 February following the notification; or
2. if the firm notifies the FCA in accordance with CASS 11.2.4 R (3), on the day it begins to hold client money; or
3. if the firm makes an election under CASS 11.2.7 R and provided the conditions in CASS 11.2.7 R (2) are satisfied, on the day the notification made under CASS 11.2.7 R (2)(c) states that the election is intended to take effect.
11.2.9G
Any written notification made to the FCA under this chapter should be marked for the attention of: “Debt Management Client Assets Firm Classification.”

11.3.1R
(1) A CASS small debt management firm, other than a not-for-profit debt advice body, must allocate to a director or senior manager responsibility for:
(a) oversight of the firm’s operational compliance with CASS 11;
(b) reporting to the firm’s governing body in respect of that oversight; and
(c) completing and submitting a CCR005 return in accordance with SUP 16.12.29CR.

11.3.1AG
CASS 11.3.3G(5) to (11) apply to a CASS small debt management firm that is an SMCR firm and the function in CASS 11.3.1R. However:
(1) the function in CASS 11.3.1R is not a separate FCA certification function; and
(2) the person performing that function will not necessarily be subject to the employee certification regime described in SYSC 27 (Senior managers and certification regime: Certification regime).

11.3.2R
(1) A CASS small debt management firm that is a not-for-profit debt advice body must allocate to a director or senior manager:
(a) oversight of the firm’s operational compliance with CASS 11;
(b) reporting to the firm’s governing body in respect of that oversight; and
(c) completing and submitting a CCR005 return in accordance with SUP 16.12.29CR.

11.3.3G
(1) CASS 11.3.4R describes the FCA controlled function known as the CASS operational oversight function (CF10a) in relation to CASS large debt management firms, including not-for-profit debt advice bodies.
(2) As a consequence of CASS 11.3.4R (in conjunction with SUP 10A.4.1R and SUP 10A.7.10R), in a CASS large debt management firm (including a not-for-profit debt advice body fitting into that category) the function described in CASS 11.3.4R is required to be discharged by a director or senior manager.
(3) In the case of a firm that is not an SMCR firm, the director or senior manager in (2) should be an approved person under the approved persons regime provided for in SUP 10A (FCA Approved Persons).
(4) However, the CASS operational oversight function does not apply to an SMCR firm.
(4A) For an SMCR firm, the function in CASS 11.3.4R is not a separate controlled function and performing that function does not require approval as an approved person. Paragraphs (5) to (11) describe how CASS 11.3.4R applies to such firms.
(4B) There are three elements of the regime for SMCR firms that are particularly relevant to CASS 11, although they do not all apply to all SMCR firms:
(a) a firm’s obligation to allocate certain responsibilities to its SMF managers (see SYSC 26 (Senior managers and certification regime: Allocation of prescribed responsibilities));
(b) a firm’s obligation to ensure that one or more of its SMF managers have overall responsibility for each of its activities, business areas and management functions (see SYSC 26 (Senior managers and certification regime: Overall and local responsibility)); and
(c) the certification regime (see SYSC 27 (Senior managers and certification regime: Certification regime)).
Paragraphs (6) to (9) explain how CASS 11.3.4R applies to an SMCR firm to which SYSC 24 and SYSC 26 apply.

(6) The SMCR firm must allocate responsibility for the firm’s compliance with CASS to one of its SMF managers (see SYSC 24.2.1R). That responsibility is an “FCA-prescribed senior management responsibility”. The full list of FCA-prescribed senior management responsibilities is in the table in SYSC 24.2.4R.

(7) Although the CASS function in SYSC 24.2.1R is different from the function in CASS 11.3.4R, the SMCR firm may allocate the function in CASS 11.3.4R to the SMF manager in (6).

(8) The SMCR firm may allocate the CASS FCA-prescribed senior management responsibility described in (6) to an SMF manager who does not perform any other function coming within the FCA regime for SMF managers in SMCR firms. See SUP 10C.7 (Other overall responsibility functions (SMF18)) and SUP 10C.8 (Other local responsibility function (SMF22)) for details.

(9) The SMCR firm may choose to allocate the function in CASS 11.3.4R to someone who is not an approved person and SMF manager. If so:

(a) that person will be subject to the employee certification regime described in SYSC 27 (Senior managers and certification regime: Certification regime);
(b) that person will be subject to supervision by the SMF manager in (6); and
(c) the function in CASS 11.3.4R will be the CASS oversight FCA certification function in SYSC 27.8.1R.

(10) In relation to an SMCR firm to which neither SYSC 24 nor SYSC 26 apply is slightly different. The firm may choose to allocate the function in CASS 11.3.4R to an SMF manager.

(11) The firm may instead choose to allocate the CASS function to someone who is not an SMF manager.

(a) Where (c) applies, the person performing the function in CASS 11.3.4R will fall into the certification regime. The function in CASS 11.3.4AR will be the CASS oversight FCA certification function in SYSC 27.8.1R.

11.3.4R

A CASS large debt management firm must allocate to a director or senior manager the function of:

(1) oversight of the operational effectiveness of that CASS debt management firm’s systems and controls that are designed to achieve compliance with CASS 11;
(2) reporting to the CASS debt management firm’s governing body in respect of that oversight; and
(3) completing and submitting a CCR005 return to the FCA in accordance with SUP 16.12.29C R.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

11.3.5R

If, at the time a CASS debt management firm that is not an SMCR firm becomes a CASS large debt management firm in accordance with CASS 11.2.8 R, the firm is not able to comply with CASS 11.3.4R because it has no director or senior manager who is an approved person in respect of the CASS operational oversight function, the firm must:

(1) take the necessary steps to ensure that it complies with CASS 11.3.4 AR as soon as practicable, which must at least include submitting an application for a candidate in respect of the CASS operational oversight function within 30 business days of the firm becoming a CASS large debt management firm;
(2) until such time as it is able to comply with CASS 11.3.4R, allocate to a director or senior manager performing a significant-influence function responsibility for:

(a) oversight of the firm’s operational compliance with CASS 11;
(b) reporting to the firm’s governing body in respect of that oversight;

and
(3) completing and submitting a CCR005 return to the FCA in accordance with SUP 16.12.29C R.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

11.3.5AG

(1) CASS 11.3.5R provides a grace period for a firm that is not an SMCR firm to apply for someone to be approved to perform the CASS operational oversight function.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.
12. There is no equivalent to CASS 11.3.5R for an SMCR firm, because a person does not need specific FCA approval before carrying out the function. This is explained in (11) to (15), below.

13. As explained in CASS 11.3.9R, the function in CASS 11.3.9R is not by itself a controlled function.

14. Therefore, an approved person is to perform the function for an SMCR firm, it can be allocated to any director or senior manager who is already an approved person who is suitable to carry it out. However, if the firm wishes to allocate the function to someone as described in CASS 11.3.9G(1), it will need to get FCA approval before the firm appoints the person.

15. If the function is to be carried out by a certification employee:
   (a) FCA approval is not needed because performance of a role that falls into the certification regime does not require FCA approval;
   (b) the firm should:
      (i) either issue them with a certificate under SYSC 27 (Senior managers and certification regime: Certification regime) before the firm becomes a CASS large debt management firm; or
      (ii) give the function to a suitable approved person pending issue of the certificate.

861. Record of responsibility for CASS operational oversight

11.3.6R

(1) Subject to (2), a CASS debt management firm must make and retain an appropriate record of the person to whom responsibility is allocated in accordance with, as applicable, CASS 11.3.1 R, CASS 11.3.2 R, and CASS 11.3.4 R.

(2) A CASS small debt management firm must make and retain such a record only where it allocates responsibility to a person other than the person in that firm who performs the compliance oversight function.

(3) A CASS debt management firm must ensure that a record made under this rule is retained for a period of five years after it is made.

862. 11.4 Definition of client money and discharge of fiduciary duty

11.4.1G

CASS 11 provides important safeguards for the protection of client money held by CASS debt management firms that sit alongside the fiduciary duty owed by firms in relation to client money: CASS 11.4.2 R to CASS 11.4.4 G provide guidance and rules for when money ceases to be client money for the purposes of both those rules and of the fiduciary duty which CASS debt management firms owe to clients in relation to client money.

11.4.2R

Money ceases to be client money if:

1. It is paid to the client, or a duly authorised representative of the client;
2. It is paid to a third party on the instruction of the client, or with the specific consent of the client;
3. It is paid into an account of the client (not being an account which is also in the name of the firm) on the instruction, or with the specific consent, of the client;
4. It is due and payable to the firm for its own account;
5. It is paid to the firm as an excess in the client bank account (see CASS 11.11.12 R (2) and CASS 11.11.23 R (3)).

11.4.3R

When a CASS debt management firm draws a cheque or other payable order to discharge its fiduciary duty to the client, it must continue to treat the sum concerned as client money until the cheque or order is presented and paid.

11.4.4G

Money is not client money when it is properly due and payable to the firm for its own account. The circumstances in which money may become due and payable to the firm could include what flows have become due and payable from the client to the firm under the agreement between the client and the firm.

863. 11.5 Organisational requirements

11.5.1R

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.
A CASS debt management firm must, when holding client money, make adequate arrangements to safeguard the client’s rights and prevent the use of client money for its own account.

11.5.1R A CASS debt management firm must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client money, or of rights in connection with client money, as a result of misuse of client money, fraud, poor administration, inadequate record keeping or negligence.

UK jurisdiction-specific rules that extend EU and UK-specific principles to these type of firms.

11.5.2R A CASS debt management firm must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client money, or of rights in connection with client money, as a result of misuse of client money, fraud, poor administration, inadequate record keeping or negligence.

UK jurisdiction-specific rules.

11.6 Statutory trust

11.6.1R A CASS debt management firm receives and holds client money as trustee on the following terms:

(1) for the purposes and in the terms of the debt management client money rules and the debt management client money distribution rules;
(2) subject to (3), for the clients for whom that money is held, according to their respective interests in it;
(3) on failure of the CASS debt management firm, for the payment of the costs properly attributable to the distribution of the client money in accordance with (2), and
(4) after all valid claims and costs under (2) and (3) have been met, for the CASS debt management firm itself.

UK jurisdiction-specific rules.

11.7 Selecting an approved bank at which to hold client money

11.7.1G A CASS debt management firm owes a duty of care as a trustee to its clients in relation to client money and has to exercise that duty of care in deciding where to hold client money.

UK jurisdiction-specific rules.

11.7.2R Before a CASS large debt management firm opens a client bank account and as often as is appropriate on a continuing basis (such frequency being no less than once in each financial year) it must take reasonable steps to establish that it is appropriate for the firm to hold client money at the approved bank concerned.

UK jurisdiction-specific rules.

11.7.3R A CASS large debt management firm must consider the risks associated with holding all client money with one approved bank and should consider whether it would be appropriate to hold client money in client bank accounts at a number of different approved banks.

UK jurisdiction-specific rules.

11.7.4G In complying with CASS 11.7.3 R a CASS large debt management firm should consider as appropriate, together with any other relevant matters:

(1) the amount of client money held by the firm;
(2) the amount of client money the firm anticipates holding at the approved bank; and
(3) the creditworthiness of the approved bank.

UK jurisdiction-specific rules.

11.7.5G A CASS small debt management firm can demonstrate compliance with CASS 11.7.3 G by checking that the person it proposes to hold client money with is an approved bank and that nothing has come to
the firm’s attention to cause it to believe that such person is not an appropriate place at which to hold client money.

11.7.6R
A CASS large debt management firm must make a record of the grounds upon which it satisfies itself as to the appropriateness of its selection of an approved bank. The firm must make the record on the date it makes the selection and must keep it from the date of such selection until five years after the firm ceases to use the approved bank to hold client money.

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11.8 Client bank account acknowledgement letters

11.8.1G
The main purposes of a client bank account acknowledgement letter are:

(1) to put the approved bank on notice of a firm’s clients’ interests in client money that has been deposited with such person;

(2) to ensure that the client bank account has been opened in accordance with CASS 11.9.3 R, and is distinguished from any account containing money that belongs to the firm; and

(3) to ensure that the approved bank understands and agrees that it will not have any recourse or right against money standing to the credit of the client bank account, in respect of any liability of the firm to such person (or parent connected to such person).

11.8.2R
(1) For each client bank account, a CASS debt management firm must, in accordance with CASS 11.8.4 R, complete and sign a client bank account acknowledgement letter clearly identifying the client bank account, and send it to the approved bank with whom the client bank account is, or will be, opened, requesting the bank to acknowledge and agree to the terms of the letter by countersigning it and returning it to the firm.

(2) Subject to CASS 11.8.6 R, a CASS debt management firm must not hold or receive any client money in or into a client bank account unless it has received a duly countersigned client bank account acknowledgement letter from the approved bank that has not been inappropriately redrafted and clearly identifies the client bank account.

11.8.3R
In drafting client bank account acknowledgement letters under CASS 11.8.2 R a CASS debt management firm is required to use the relevant template in CASS 11 Annex 1 R.

11.8.4R
When completing a client bank account acknowledgement letter under CASS 11.8.2 R (1), a CASS debt management firm:

(1) must not amend any of the acknowledgement letter fixed text;

(2) subject to (3), must ensure the acknowledgement letter variable text is removed, included or amended as appropriate; and

(3) must not amend any of the acknowledgement letter variable text in a way that would alter or otherwise change the meaning of the acknowledgement letter fixed text.

11.8.5G
CASS 11 Annex 2 contains guidance on using the template client bank account acknowledgement letters, including on when and how firms should amend the acknowledgement letter variable text that is in square brackets.

11.8.6R
(1) If, on countersigning and returning the client bank account acknowledgement letter to a firm, the relevant approved bank has also:

(a) made amendments to any of the acknowledgement letter fixed text; or

(b) made amendments to any of the acknowledgement letter variable text in a way that would alter or otherwise change the meaning of the acknowledgement letter fixed text;

the client bank account acknowledgement letter will have been inappropriately redrafted for the purposes of CASS 11.8.2 R (2).

(2) Amendments made to the acknowledgement letter variable text, in the client bank account acknowledgement letter returned to a firm by the relevant approved bank, will not have the result that the letter has
been inappropriately redrafted if those amendments do not affect the meaning of the acknowledgement letter fixed text, have been specifically agreed with the firm and do not cause the client bank account acknowledgement letter to be inaccurate.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

A CASS debt management firm must use reasonable endeavours to ensure that any individual that has countersigned a client bank account acknowledgement letter that has been returned to the firm was authorised to countersign the letter on behalf of the relevant approved bank.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

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<th>Text</th>
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<tr>
<td><strong>492.</strong> 11.9.4R</td>
<td>Cheques received by a CASS debt management firm, made out to the firm, representing client money or a mixed remittance must be treated as client money from receipt by the firm.</td>
</tr>
<tr>
<td><strong>493.</strong> 11.9.5R</td>
<td>Where a CASS debt management firm receives client money in the form of cash, a cheque or other payable order, it must: 1) pay the money into a client bank account in accordance with CASS 11.9.1 R promptly and no later than on the business day after it receives the money. 2) if the firm holds the money overnight, hold it in a secure location in line with Principle 10; and 3) record the receipt of the money in the firm's books and records under the applicable requirements of CASS 11.11 (Records, accounts and reconciliations).</td>
</tr>
<tr>
<td><strong>494.</strong> 11.9.6R</td>
<td>Mixed remittance If a CASS debt management firm receives a mixed remittance it must: 1) pay the full sum into a client bank account promptly and in accordance with CASS 11.9.1 R to CASS 11.9.5 R; and 2) no later than one business day after the payment of the mixed remittance into the client bank account has cleared, pay the money that is not client money out of the client bank account.</td>
</tr>
<tr>
<td><strong>495.</strong> 11.9.7R</td>
<td>Allocation of client money receipts If a CASS debt management firm receives any client money it receives to an individual client promptly and, in any case, no later than five business days following the receipt. 2) Pending a CASS debt management firm's allocation of a client money receipt to an individual client under 1), it must record the received client money in its books and records as &quot;unallocated client money&quot;.</td>
</tr>
<tr>
<td><strong>496.</strong> 11.9.8R</td>
<td>If a CASS debt management firm receives money (either in a client bank account or an account of its own) which it is unable immediately to identify as client money or its own money, it must: 1) take all necessary steps to identify the money as either client money or its own money. 2) it considers it reasonably prudent to do so, given the risk that client money may not be adequately protected if it is not treated as such, treat the entire balance of money as client money and record the money in its books and records as &quot;unidentified client money&quot; while it performs the necessary steps under 1).</td>
</tr>
<tr>
<td><strong>497.</strong> 11.9.9G</td>
<td>If a CASS debt management firm is unable to identify money that it has received as either client money or its own money under CASS 11.9.8 R, it should consider whether it would be appropriate to return the money to the person who sent it (or, if that is not possible, to the source from where it was received, for example, the bank). A firm should have regard to its fiduciary duties when considering such matters.</td>
</tr>
<tr>
<td><strong>498.</strong> 11.9.10R</td>
<td>Money received by appointed representatives, tied agents, field representatives and other agents If a CASS debt management firm is unable to identify money that it has received as either client money or its own money under CASS 11.9.8 R, it should consider whether it would be appropriate to return the money to the person who sent it (or, if that is not possible, to the source from where it was received, for example, the bank). A firm should have regard to its fiduciary duties when considering such matters.</td>
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<td>899.</td>
<td><strong>Interest</strong>&lt;br&gt;11.9.1R&lt;br&gt;A CASS debt management firm must pay a client any interest earned on client money held for that client.</td>
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<tr>
<td>900.</td>
<td><strong>Returning money to clients</strong>&lt;br&gt;11.9.2R&lt;br&gt;A CASS debt management firm must, on receipt of a written request to withdraw client money from a debt management plan, promptly return to the client any client money held by it for the client.</td>
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<tr>
<td>901.</td>
<td><strong>11.9.1G</strong>&lt;br&gt;The FCA would expect compliance with the requirements in CASS 11.9.12 R to ensure client money promptly is returned to a client within five business days of the date on which a client's withdrawal from a debt management plan takes effect.</td>
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<tr>
<td>902.</td>
<td><strong>11.10 Payments to creditors</strong>&lt;br&gt;11.10.1R&lt;br&gt;Where a CASS debt management firm receives client money from a client to enrol in a debt management plan or for the purpose of distribution to the client's creditors, the firm must pay that money to creditors as soon as reasonably practicable, save in the circumstances referred to in CASS 11.10.3 R.</td>
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<td>903.</td>
<td><strong>11.10.3R</strong>&lt;br&gt;In the FCA's view, the payment to creditors under CASS 11.10.1 R should normally be within five business days of the receipt of cleared funds.</td>
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<td>904.</td>
<td><strong>11.10.4R</strong>&lt;br&gt;The circumstances referred to in CASS 11.10.1 R are: (1) the contract between the client and the CASS debt management firm expressly provides that client money might be held for more than five business days without being distributed to creditors; (2) the existence of such a term expressly providing that client money might be held for more than five business days without being distributed to creditors has been separately brought to the attention of the client prior to his entering into the contract; and (3) the CASS debt management firm has explained to the client the risks and implications, if any, of payment to creditors being delayed prior to the entry into the contract.</td>
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<td>905.</td>
<td><strong>11.10.4R</strong>&lt;br&gt;On each occasion that a CASS debt management firm receives client money from a client in relation to a debt management plan, or for the purpose of distribution to the client's creditors, and it is proposed not to make a client's payment to creditors within five business days of receipt of the client money in the circumstances described in CASS 11.10.3 R (1), the firm must: (1) inform the client of the delay and the reason for the delay; (2) inform the client's creditors of the fact that it has received client money from the client for the purpose of distribution to his creditors; and (3) perform daily reconciliations of the money held for the client concerned in accordance with the provisions of CASS 11.11.</td>
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<tr>
<td>906.</td>
<td><strong>11.10.4R</strong>&lt;br&gt;On each occasion a CASS debt management firm receives client money from a client in relation to a debt management plan, or for the purpose of distribution to the client's creditors, and it is unable for any reason other than in the circumstances described in CASS 11.10.3 R (1) to make a payment to the client's creditors within five business days of receipt, it must: (1) inform the client of the delay and the reason for the delay; 5. Holding and Depositing Investor Money (1) As part of the assessment provided for in Regulation 72(5), the Central Bank expects a fund service provider to take into account how investor rights would be affected in the event of the insolvency of the fund service provider, or the third party, or both. (2) The Central Bank expects a fund service provider to clearly document in its investor money management plan the procedures it would follow to carry out the review required by Regulations 72(6) and 72(7).</td>
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11.11 Records, accounts and reconciliations

Records and accounts

A CASS debt management firm must keep such records and accounts as are necessary to enable it, at any time and without delay, to distinguish client money held for one client from client money held for any other client, and from its own money.

In accordance with CASS 11.11.1 R, a CASS debt management firm must maintain internal records and accounts of the client money it holds (for example, a cash book). These internal records are separate from any external records that have been obtained from approved banks with whom it has deposited client money (for example, bank statements).

A CASS debt management firm must maintain up-to-date records that detail all payments to, from, or made on behalf of, clients and creditors and oral contact with clients and their creditors.

Policies and procedures

CASS debt management 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.

Checks and reconciliations of internal records

So that a CASS debt management firm may check that it has sufficient money segregated in its client bank accounts to meet its obligations to clients for whom it is undertaking debt management activity, it is required periodically to carry out reconciliations of its internal records and accounts to check that the total amount of client money that it should have segregated in client bank accounts is equal to the total amount of client money it actually has segregated in client bank accounts. CASS 11.11.4 R to CASS 11.11.23 R provide rules that the different types of CASS debt management firms are obliged to follow to meet this obligation.

Checks of internal records: CASS small debt management firm

S-1 Holding and Depositing Investor Money

(1) As part of the assessment provided for in Regulation 72(6), the Central Bank expects a fund service provider to consider how investor rights would be affected in the event of the insolvency of the fund service provider, or the third party, or both.

(2) The Central Bank expects a fund service provider to clearly document in its investor money management plan the procedures it would follow to carry out the review required by Regulations 72(6) and 72(7).

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

11.11.1 R

Subject to (2), where a CASS debt management firm receives client money from a client in relation to a debt management plan or for the purpose of distribution to the client’s creditors, and it fails to pay that money to creditors as soon as reasonably practicable following its receipt (see CASS 11.10.1 R and CASS 11.10.2 R), it must put the client into the financial position he would have been in had the delay not occurred.

(2) Paragraph (1) does not apply in the circumstances described in CASS 11.10.1 R or where the delay is due to circumstances beyond the firm’s control.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

11.11.2 G

During a client into the position he would have been in had the delay not occurred under CASS 11.10.1 R, it should include paying to the client a sum equivalent to the amount of any additional interest which would not have accrued but for the delay and any default charges that have been applied to the account as a result of the delay.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

11.11.3 R

In accordance with CASS 11.11.1 R, a CASS debt management firm must maintain internal records and accounts of the client money it holds (for example, a cash book). These internal records are separate from any external records that have been obtained from approved banks with whom it has deposited client money (for example, bank statements).

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

11.11.4 R

A CASS debt management firm must maintain up-to-date records that detail all payments to, from, or made on behalf of, clients and creditors and oral contact with clients and their creditors.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

11.11.5 R

A CASS debt management firm must maintain its records and accounts of the client money it holds (for example, bank statements). These internal records are separate from any external records that have been obtained from approved banks with whom it has deposited client money (for example, bank statements).

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

11.11.6 G

As required by Regulation 72(6), the Central Bank expects a fund service provider to consider how investor rights would be affected in the event of the insolvency of the fund service provider, or the third party, or both.

(2) The Central Bank expects a fund service provider to clearly document in its investor money management plan the procedures it would follow to carry out the review required by Regulations 72(6) and 72(7).

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

11.11.7 G

Checks of internal records: CASS small debt management firm

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.
For a CASS small debt management firm to demonstrate it has maintained its records and accounts in a way envisaged by CASS 11.11.3 R, it should carry out checks of its internal records and accounts that are reasonable and proportionate to its business. CASS 11.11.8 R provides a rule that a CASS small debt management firm is obliged to follow to meet this obligation.

11.11.8 R
A CASS small debt management firm must undertake periodic checks of its internal records and accounts that are reasonable and proportionate to its business. CASS 11.11.8 R provides a rule that a CASS small debt management firm is obliged to follow to meet this obligation.

11.11.9 R
In carrying out the checks required by CASS 11.11.8 R a CASS small debt management firm must use the values contained in its internal records and ledgers (for example, its cash book or other internal accounting records), rather than the values contained in the records it has obtained from approved banks with whom it has deposited client money (for example, bank statements).

11.11.10 G
The checks that a CASS small debt management firm is required to undertake under CASS 11.11.8 R include checking that its internal records and accounts accurately record the balances of client money held in respect of individual clients, and that the aggregate of these individual client money balances are equal to the total client money segregated in its client bank accounts. In undertaking the comparison between the internal records of balances of client money and the client money segregated in client bank accounts, a firm should use the previous day's closing client money balances and should compare those with other records relating to the same day. In determining an appropriate frequency for its record checks, a firm should consider the volume and frequency of transactions in its client bank accounts.

11.11.11 G
In seeking to comply with its obligation to carry out checks on its internal records and accounts, a CASS small debt management firm may choose to follow the steps specifically required of CASS large debt management firms in undertaking a CASS large debt management firm internal client money reconciliation and CASS large debt management firm external client money reconciliation. A CASS small debt management firm which follows that procedure is likely to be regarded by the FCA as having fulfilled its obligation under CASS 11.11.8 R.

11.11.12 R
Where the check of its internal records and accounts that a CASS small debt management firm is required to undertake under CASS 11.11.8 R reveals a difference between the amount of money it holds in its client bank accounts and the amount of client money that should be held and segregated under CASS 11.9, a CASS small debt management firm must:

1. ensure that any shortfall in the amount held in its client bank accounts as compared to the amount that should be held is made up by a prompt payment into the firm’s client bank accounts;
2. ensure that any excess in the amount held in its client bank accounts as compared to the amount that should be held is promptly withdrawn from its client bank accounts; and
3. ensure that any correction of a shortfall or excess of the kind referred to in (1) and (2) is carried out, at the latest, before the end of the business day following the day on which the difference was discovered.

11.11.13 R
A CASS large debt management firm must, as regularly as is necessary, but no less often than every five business days, carry out a CASS large debt management firm internal client money reconciliation.

11.11.14 R
A CASS large debt management firm internal client money reconciliation requires a CASS large debt management firm to check whether its client money resource, as determined by CASS 11.11.16 R, on the previous business day, was at least equal to the client money...
requirement, as determined by CASS 11.11.17 R as at the close of business on that day.

UK jurisdiction—specific rules that extends EU and UK-specific principles to these type of firms.

11.11.18G

The client money requirement calculated in accordance with CASS 11.11.17 R should represent the total amount of client money a CASS debt management firm is required to have segregated in client bank accounts under the debt management client money chapter.

UK jurisdiction—specific rules that extends EU and UK-specific principles to these type of firms.

11.11.20G

The following guidance applies where a CASS debt management firm receives client money in the form of cash, a cheque or other payable order:

UK jurisdiction—specific rules that extends EU and UK-specific principles to these type of firms.

11.11.21R

The individual client balance for each client must be calculated as follows:

UK jurisdiction—specific rules that extends EU and UK-specific principles to these type of firms.
the amount paid by the client to the CASS debt management firm; plus 
the amount of any interest, and any other sums, due to the client; less: 
the aggregate of the amount of money: 
paid back to that client; and 
due and payable by the client to the CASS debt management firm; and 
paid out to a third party for, or on behalf of, that client.

Where the individual client balance calculated in respect of an 
individual client under CASS 11.11.21 R is a negative figure (because 
the amounts paid by or due to a client under CASS 11.11.21 R (1) and 
CASS 11.11.21 R (2) are less than the amounts paid out or due and 
payable by that client under CASS 11.11.21 R (3)), that individual 
client balance should be treated as zero for the purposes of the 
calculations of the firm’s client money requirement in CASS 11.11.17 
R.

Large debt management firms: reconciliation differences and 
discrepancies

A CASS large debt management firm should perform a CASS large 
debt management firm external client money reconciliation: 
(1) as regularly as is necessary; and 
(2) no less frequently than the CASS large debt management firm 
internal client money reconciliations; and 
(3) as soon as reasonably practicable after the date to which the 
reconciliation relates; to ensure the accuracy of its internal 
accounts and records against those of approved banks with whom client money is held.

The FCA expects a CASS large debt management firm which carries 
out transactions for its clients on a daily basis to carry out a CASS 
large debt management firm external client money reconciliation on a 
daily basis.

When any discrepancy is revealed by a CASS large debt management 
firm external client money reconciliation, a CASS large debt 
management firm must identify the reason for the discrepancy and 
correct it as soon as possible, unless the discrepancy arises solely as a 
result of timing differences between the accounting systems of the 
party providing the statement or confirmation and that of the firm.
While a CASS large debt management firm is unable to resolve a discrepancy arising from the CASS large debt management firm external client money reconciliation, and one record or a set of records examined by the firm during the reconciliation process indicates that there is a need to keep greater amount of client money than is in fact the case, the firm must assume, until the matter is finally resolved, that the record or set of records is accurate and pay its own money into a relevant account.

Notification requirements

A CASS debt management firm must inform the FCA in writing without delay if:

1. its internal records and accounts of client money are materially out of date or materially inaccurate so that the firm is no longer able to comply with the requirements in CASS 11.11.1 R to CASS 11.11.4 R; or
2. becomes aware that, at any time in the preceding 12 months, the amount of client money segregated in its client bank accounts materially differed from the total aggregate amount of client money the firm was required to segregate in client bank accounts in accordance with the segregation requirements in CASS 11.9.

A CASS large debt management firm must inform the FCA in writing without delay if:

1. after having carried out a CASS large debt management firm internal client money reconciliation in accordance with CASS 11.11.13 R it will be unable to, or materially fails to, pay any shortfall into (or withdraw any excess from) a client bank account so that the firm is unable to comply with CASS 11.11.25 R; or
2. after having carried out a CASS large debt management firm external client money reconciliation in accordance with CASS 11.11.25 R it will be unable to, or materially fails to, identify and correct any discrepancies in accordance with CASS 11.11.28 R; or
3. it will be unable to or materially fails to conduct a CASS large debt management firm internal client money reconciliation in compliance with CASS 11.11.13 R; or
4. it will be unable to or materially fails to conduct a CASS large debt management firm external client money reconciliation in compliance with CASS 11.11.25 R.

CASS debt management firms are also reminded of their obligation to notify the appropriate regulator of a significant breach of a rule under SUP 15.3.11 R.

The purpose of the CASS 11 resolution pack is to ensure that a firm maintains and is able to retrieve information that would, in the event of its insolvency, assist an insolvency practitioner in dealing with client money in a timely manner.

A CASS debt management firm which holds client money must maintain at all times and be able to retrieve, in the manner described in this section, a CASS 11 resolution pack.

A CASS debt management firm must include within its CASS 11 resolution pack all those documents referred to in CASS 11.12.3 R.

The documents in CASS 11.12.5 R that a CASS debt management firm must include within its CASS 11 resolution pack are:

1. a master document containing information sufficient to retrieve each document in the firm’s CASS 11 resolution pack;
2. a document which identifies all the approved banks with whom client money may be deposited;
3. a document which identifies all the approved banks with whom client money may be deposited;
(3) a document which identifies each appointed representative, field representative or other agent of the firm which may receive client money in its capacity as the firm's agent;
(4) a document which identifies each senior manager and director and any other individual and the nature of their responsibility within the firm who is critical or important to the performance of operational functions related to any of the obligations imposed on the firm under the debt management client money rules;
(5) for all approved banks identified in (2) the written client bank account acknowledgement letters sent and received in accordance with CASS 11.8.2 R; and
(6) records relating to the internal and external client money checks it is required to carry out under CASS 11.11.

945. In relation to each document in a CASS debt management firm's CASS 11 resolution pack a firm must:

(1) put in place adequate arrangements to ensure that an administrator, receiver, trustee, liquidator or analogous officer appointed in respect of it or any material part of its property is able to retrieve each document as soon as practicable and, in any event, within 48 hours of that officer's appointment; and
(2) ensure that it is able to retrieve each document as soon as practicable and, in any event, within 48 hours where it has taken a decision to do so or as a result of an FCA request.

946. A CASS debt management firm must ensure that it reviews the content of its CASS 11 resolution pack on an ongoing basis to ensure that it remains accurate.

947. A CASS debt management firm must notify the FCA in writing immediately if it has not complied with, or is unable to comply with, CASS 11.12.2 R and CASS 11.12.6 R.

948. This section (the debt management client money distribution rules) applies to a CASS debt management firm that holds client money which is subject to the debt management client money rules when a primary pooling event or a secondary pooling event occurs.

Purpose

The debt management client money distribution rules seek, in the event of the failure of a CASS debt management firm or of an approved bank at which the CASS debt management firm holds client money, to protect client money and to facilitate the timely payment of sums to creditors or the timely return of client money to clients.

Failure of a CASS debt management firm: primary pooling event

A primary pooling event occurs:

(1) on the failure of a CASS debt management firm;
(2) on the vesting of assets in a trustee in accordance with an 'assets requirement' imposed under section 55P(1)(b) or (c) (as the case may be) of the Act where such a requirement is imposed in respect of all client money held by the firm.

Pooling and distribution after a primary pooling event

If a primary pooling event occurs, then:

(1) all client money held in the CASS debt management firm's client bank accounts; and
(2) received by the CASS debt management firm on behalf of a client but not yet paid into the firm's client bank accounts, is treated as pooled together to form a notional pool,
12) a CASS debt management firm must calculate the amount it should be holding on behalf of each individual client as at the time of the primary pooling event using the method of calculating individual client balance provided for by CASS 11.11.21 R.

13) a CASS debt management firm must decide whether it is in the best interests of its clients to transfer all its debt management activity to another CASS debt management firm.

952. Distribution of client money not transferred to another firm

CASS 11.13.7R

When a primary pooling event occurs and the client money is not transferred to another firm in accordance with CASS 11.13.4 R, a CASS debt management firm must distribute client money comprising the notional pool so that each client receives a sum that is rateable to their entitlement to the notional pool calculated in CASS 11.13.4 R (2).

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

953. Transfer of client money to another firm

CASS 11.13.6G

If the event of a primary pooling event occurring the debt management activity business undertaken by a CASS debt management firm ("the transferor") is to be transferred to another CASS debt management firm ("the transferee"), then the transferor may also move the client money associated with that business to the transferee.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

954. The remaining client money may be transferred under CASS 11.13.6 G only if it will be held by the transferee in accordance with the debt management client money chapter, including the statutory trust in CASS 11.6.1 R.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

955. If there is a shortfall in the client money transferred under CASS 11.13.6 G then the client money must be allocated to each of the clients for whom the client money was held so that each client is allocated a sum which is rateable to that client’s client money entitlement in accordance with CASS 11.13.4 R (2). This calculation may be done by either transferor or transferee in accordance with the terms of any transfer.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

956. The transferee must, within seven days after the transfer of client money under CASS 11.13.6 G notify clients that:

1) their money has been transferred to the transferee; and

2) they have the option of having client money returned to them or to their order by the transferee, otherwise the transferee will hold the client money for the clients and conduct debt management activities for those clients.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

957. Failure of an approved bank; secondary pooling event

CASS 11.13.10R

A secondary pooling event occurs on the failure of an approved bank at which a CASS debt management firm holds client money in a client bank account.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

958. Money held in each client bank account of the firm must be treated as pooled and:

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

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.
12. a new client money entitlement must be calculated for each client by the firm, to reflect the requirements in (1); and the firm’s records must be amended to reflect the reduced client money entitlement. The term 'which should have been held' is a reference to the failed approved bank's failure to hold the client money at the time of the pooling event.

11.5.1.3R

Any interest earned on client money following a primary or secondary pooling event will be due to clients in accordance with CASS 11.9.11R (Interest).

11.13.14R

Under condition 2(g) of the Part 30 exemption order, a firm with exemptive relief represents to the CFTC that it consents to refuse to allow any US customer the option of not having its money treated as client money if it is held or received in respect of transactions on non-US exchanges, unless that US customer is an "eligible contract participant" as defined in section 1a(18) of the Commodity Exchange Act, 7 U.S.C. 12.2.1G

The FCA understands that in complying with condition 2(g) of the Part 30 exemption order, a firm is representing that it will not:

1. Refuse to use the opt-out arrangements in CASS 7.10.9G to CASS 7.10.13G; or
2. Conduct business to which the client money rules do not apply because of the exemption for CRD credit institutions and approved banks in CASS 7.10.16R to CASS 7.10.24R; or
3. Enter into any TTCA under CASS 7.11.

12.2.2G

The PCA understands that in complying with condition 2(g) of the Part 30 exemption order, a firm is representing that it will not:

1. Make use of the opt-out arrangements in CASS 7.10.9G to CASS 7.10.13G; or
2. Conduct business to which the client money rules do not apply because of the exemptions for CRD credit institutions and approved banks in CASS 7.10.16R to CASS 7.10.24R; or
3. Enter into any TTCA under CASS 7.11; in relation to business conducted pursuant to the Part 30 exemption order.

12.2.3G

For firms with exemptive relief under the Part 30 exemption order, the CFTC has issued certain no-action letters which, on the PCA’s understanding, would allow such firms to use an LME bond arrangement as an alternative to complying with condition 2(g) of the Part 30 exemption order. Under an LME bond arrangement, a firm...
may arrange for a binding letter of credit to be issued to cover the
'secured amount' (as defined by section 30.7 of the General
Regulations under the US Commodity Exchange Act). The letter of
credit must be drawn up in a pre-specified format and may be issued
for either:
(1) an omnibus account in favour of a specified trustee; or
(2) a specified client who is the named beneficiary.

UK jurisdiction-specific rules that extends EU and UK-specific principles to
these type of firms.

A firm must not reduce the amount of, or cancel a letter of credit
issued under, an LME bond arrangement where this will cause the
firm to be in breach of the conditions of the Part 30 exemption order.

UK jurisdiction-specific rules that extends EU and UK-specific principles to
these type of firms.

A firm must notify the FCA immediately if it arranges the issue of a
letter of credit for a specified client who is the named beneficiary
under an LME bond arrangement.

UK jurisdiction-specific rules that extends EU and UK-specific principles to
these type of firms.

A firm's use of an LME bond arrangement does not remove the need
for the firm to act in accordance with the client money rules.

UK jurisdiction-specific rules that extends EU and UK-specific principles to
these type of firms.

12.2.4R
A firm must notify the FCA immediately if it arranges the issue of a
letter of credit for a specified client who is the named beneficiary
under an LME bond arrangement.

UK jurisdiction-specific rules that extends EU and UK-specific principles to
these type of firms.

A firm must make and retain an appropriate record of the person
to whom responsibility is allocated in accordance with CASS 13.2.3R.

But a firm must make and retain such a record only where:
(a) there is a person
in that firm who performs the compliance
oversight function; and
(b) it allocates responsibility in accordance with CASS 13.2.3R to a
person other than the person in that firm who performs the
compliance oversight function.

UK jurisdiction-specific rules that extends EU and UK-specific principles to
these type of firms.

A firm must allocate to a director or senior manager responsibility for:
(1) oversight of the firm's operational compliance with CASS 13;
(2) reporting to the firm's governing body in respect of that oversight;
and
(3) completing and submitting the client money parts of a CMC001
return in accordance with SUP 16.25.3R to SUP 16.25.8R.

UK jurisdiction-specific rules that extends EU and UK-specific principles to
these type of firms.

A firm must make and retain such a record only where:
(a) there is a person
in that firm who performs the compliance
oversight function; and
(b) it allocates responsibility in accordance with CASS 13.2.3R to a
person other than the person in that firm who performs the
compliance oversight function.

UK jurisdiction-specific rules that extends EU and UK-specific principles to
these type of firms.

A firm must adhere to the following requirements:
(1) they must introduce adequate organisational
arrangements to minimise the risk of the loss or
diminution of client assets, or of rights in
connection with those assets, as a result of misuse
of the assets, fraud, poor administration, inadequate record
keeping or negligence.

UK jurisdiction-specific rules that extends EU and UK-specific principles to
these type of firms.

A firm must allocate to a director or senior manager responsibility for:
(1) oversight of the firm's operational compliance with CASS 13;
(2) reporting to the firm's governing body in respect of that oversight;
and
(3) completing and submitting the client money parts of a CMC001
return in accordance with SUP 16.25.3R to SUP 16.25.8R.

UK jurisdiction-specific rules that extends EU and UK-specific principles to
these type of firms.

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these type of firms.

UK jurisdiction-specific rules that extends EU and UK-specific principles to
these type of firms.
A firm receives and holds client money as trustee on the following terms:

1. for the purposes and on the terms of the claims management client money rules and the claims management client money distribution rules;
2. subject to (3), for the customers for whom that money is held, according to their respective interests in it;
3. on failure of the firm, for the payment of the costs properly attributable to the distribution of the client money in accordance with (2) and (4) after all valid claims and costs under (2) and (3) have been met, for the firm itself.

13.4 Selecting an approved bank at which to hold client money

13.4.1G A firm owes a duty of care as a trustee to its clients in relation to client money and has to exercise that duty of care in deciding where to hold client money.

13.4.2R Before a firm opens a client bank account and as often as is appropriate on a continuing basis (such frequency being no less than once in each financial year) it must take reasonable steps to establish that it is appropriate for the firm to hold client money at the approved bank concerned.

13.4.3R A firm must consider the risks associated with holding all client money with one approved bank and should consider whether it would be appropriate to hold client money in client bank accounts at a number of different approved banks.

13.4.4G In complying with CASS 13.4.3R, a firm should consider as appropriate, together with any other relevant matters:

1. the amount of client money held by the firm;
2. the amount of client money the firm anticipates holding at the approved bank; and
3. the creditworthiness of the approved bank.

13.4.5G A firm can demonstrate compliance with CASS 13.4.2R by checking that the person it proposes to hold client money with is an approved bank and that nothing has come to the firm’s attention to cause it to believe that such person is not an appropriate place at which to hold client money.

13.5 Client bank account acknowledgement letters

13.5.1G The main purposes of a client bank account acknowledgement letter are:

1. to put the approved bank on notice of a firm’s clients’ interests in client money that has been deposited with such person;
2. to ensure that the client bank account has been opened in accordance with CASS 13.6.3R, and is distinguished from any account containing money that belongs to the firm; and
3. to ensure that the approved bank understands and agrees that it will not have any recourse or right against money standing to the credit of the client bank account, in respect of any liability of the firm to such person (or person connected to such person).

13.5.2R (1) For each client bank account, a firm must, in accordance with CASS 13.5.4R, complete and sign a client bank account acknowledgement letter clearly identifying the client bank account, and send it to the approved bank with whom the client bank account is, or will be, opened, requesting the bank to acknowledge and agree to the terms of the letter by countersigning it and returning it to the firm.

13.5.3R (2) Subject to CASS 13.5.6R, a firm must not hold or receive any client money in or into a client bank account unless it has received a duly countersigned client bank account acknowledgement letter from the bank.

UK jurisdiction-specific rules that extend EU and UK specific principles to these type of firms.
the approved bank. The letter must not have been inappropriately redrafted and should clearly identify the client bank account.

13.5.3R

In drafting client bank account acknowledgement letters under CASS 13.5.2R a firm is required to use the relevant template in CASS 13 Annex 1R.

13.5.4R

When completing a client bank account acknowledgement letter under CASS 13.5.2R (1) a firm:
(1) must not amend any of the acknowledgement letter fixed text;
(2) subject to (3), must ensure the acknowledgement letter variable text is removed, included or amended as appropriate; and
(3) must not amend any of the acknowledgement letter variable text in a way that would alter or otherwise change the meaning of the acknowledgement letter fixed text.

13.5.5R

CASS 13 Annex 2G contains guidance on using the template client bank account acknowledgement letters, including on when and how firms should amend the acknowledgement letter variable text that is in square brackets.

13.5.6R

(1) If, on countersigning and returning the client bank account acknowledgement letter to a firm, the relevant approved bank has also:
(a) made amendments to any of the acknowledgement letter fixed text; or
(b) made amendments to any of the acknowledgement letter variable text in a way that would alter or otherwise change the meaning of the acknowledgement letter fixed text;
the client bank account acknowledgement letter will have been inappropriately redrafted for the purposes of CASS 13.5.2R(2).

(2) Amendments made to the acknowledgement letter variable text, in the client bank account acknowledgement letter returned to a firm by the relevant approved bank, will not have the result that the letter has been inappropriately redrafted if those amendments:
(a) do not affect the meaning of the acknowledgement letter fixed text;
(b) have been specifically agreed with the firm; and
(c) do not cause the client bank account acknowledgement letter to be inaccurate.

13.5.7R

A firm must use reasonable endeavours to ensure that any individual that has countersigned a client bank account acknowledgement letter that has been returned to the firm was authorised to countersign the letter on behalf of the relevant approved bank.

13.5.8R

A firm must retain each countersigned client bank account acknowledgement letter it receives from the date of receipt until the expiry of a period of five years starting on the date on which the last client bank account to which the acknowledgement letter relates is closed.

13.5.9R

A firm must also retain any other documentation or evidence it believes is necessary to demonstrate that it has complied with each of the applicable requirements in this section (such as any evidence it has obtained to ensure that the individual that has countersigned a client bank account acknowledgement letter that has been returned to the firm was authorised to countersign the letter on behalf of the relevant approved bank).

13.5.10R

A firm must, periodically (at least annually, and whenever it becomes aware that something referred to in a client bank account acknowledgement letter has changed) review each of its countersigned client bank account acknowledgement letters to ensure that they remain accurate.
### 13.5.1R
Whenever a firm finds a countersigned client bank account acknowledgement letter to contain an inaccuracy, the firm must promptly draw up a new replacement client bank account acknowledgement letter under CASS 13.5.2R and ensure that the new client bank account acknowledgement letter is duly countersigned and returned by the relevant approved bank.

### 13.5.12G
Under CASS 13.5.10R, a firm should obtain a replacement client bank account acknowledgement letter whenever:
1. there has been a change in any of the parties’ names or addresses or a change in any of the details of the relevant account(s) as set out in the letter; or
2. it becomes aware of an error or misspelling in the letter.

### 13.5.13R
If a firm’s client bank account is transferred to another approved bank, the firm must promptly draw up a new client bank account acknowledgement letter under CASS 13.5.2R and ensure that the new client bank account acknowledgement letter is duly countersigned and returned by the relevant approved bank within 20 business days of the firm sending it to that person.

### 13.6 Segregation and the operation of client money accounts

#### Requirement to segregate
13.6.1R A firm must take all reasonable steps to ensure that all client money it receives is paid directly into a client bank account at an approved bank, rather than being first received into the firm’s own account and then segregated.

#### 13.6.2G
A firm should arrange for clients and third parties to make transfers and payments of any money which will be client money directly into the firm’s client bank accounts.

#### 13.6.3R
A firm must ensure that client money is held in a client bank account at one or more approved banks.

#### 13.6.4R
Cheques received by a firm, made out to the firm, representing client money or a mixed remittance must be treated as client money from receipt by the firm.

#### 13.6.5R
Where a firm receives client money in the form of cash, a cheque or other payable order, it must:
1. pay the money into a client bank account in accordance with CASS 13.6.1R promptly and no later than the business day after the day on which it receives the money;
2. if the firm holds the money overnight, hold it in a secure location in line with Principle 10; and
3. record the receipt of the money in the firm’s books and records under the applicable requirements of CASS 13.10 (Records, accounts and reconciliations).

#### 13.6.6R
If a firm receives money (either in a client bank account or an account of its own) which it is unable immediately to identify as client money or its own money, it must:
1. take all necessary steps to identify the money as either client money or its own money; and
2. if it considers it reasonably prudent to do so, given the risk that client money may not be adequately protected if it is not treated as such, treat the entire balance of money as client money and record the money in its books and records as “unidentified client money” while it performs the necessary steps under (1).

#### 13.6.7G
If a firm is unable to identify money that it has received as either client money or its own money under CASS 13.6.6R(1), it should consider whether it would be appropriate to return the money to...
person who sent it, or, if that is not possible, to the source from where it was received, for example, the bank. A firm should have regard to its fiduciary duties when considering such matters.

1001

13.6.8R A firm must ensure that client money received by its agents is: 
(1) received directly into a client bank account of the firm; or 
(2) if it is received in the form of a cheque or other payable order: 
(a) paid into a client bank account of the firm promptly and, in any event, no later than the next business day after receipt; or 
(b) forwarded to the firm promptly and, in any event, so that it is received by the firm no later than the close of the third business day following the receipt of the money from the customer; or 
(3) if it is received in the form of cash, paid into a client bank account of the firm promptly and, in any event, no later than the next business day after receipt.

1004

Mixed remittance 13.6.9R If a firm receives a mixed remittance it must: 
(1) pay the full sum into a client bank account promptly and in accordance with CASS 13.6.1R to 13.6.5R; and 
(2) no later than one business day after the payment of the mixed remittance into the client bank account has cleared, pay the money that is not client money out of the client bank account.

1005

Interest 13.6.10R A firm must pay a client any interest earned on client money held for that client.

1006

13.7 Money due and payable to the firm 13.7.1R Money is not client money when it is or becomes properly due and payable to the firm for its own account.

1007

13.7.2G (1) The circumstances in which money may be or become due and payable to the firm for its own account could include: 
(a) when fees and/or third party disbursements have become due and payable to the firm for its own account under the agreement between the customer and the firm; and 
(b) when money recovered for a customer or a sum in respect of damages, compensation or settlement of a claim is paid into a client bank account and the firm has agreed with the client that a proportion of the sum is to be paid to the firm for fees or in respect of liabilities the firm has incurred on behalf of the customer. 
(2) The circumstances in which money is due and payable will depend on the contractual arrangement between the firm and the client.

1008

13.7.3G Firms are reminded that when entering into or varying contractual arrangements with customers regarding circumstances in which money becomes properly due and payable to the firm for its own account, firms should comply with any relevant obligations to customers including the client’s best interests rule and requirements under the Unfair Terms Regulations and the Consumer Rights Act 2015.

1009

13.8 Money due to a client or third party 13.8.1R Client money in respect of money recovered for a customer or money in respect of damages, compensation or settlement of a claim received into a client bank account must be paid to the customer, or a duly authorised representative of the customer, as soon as reasonably practicable after receipt and, in any event, a firm must take steps within two business days of receipt to make such a payment.

1010

13.8.2R Money received from a customer in respect of third party disbursements which is due and payable to the third party in accordance with the terms of the contractual arrangements between the customer and the third party shall be paid to the third party promptly so that it is received by the third party no later than the close of the second business day following the receipt of the money from the customer.
the parties should be paid to the third party as soon as reasonably practicable after receipt.

13.9 Discharge of fiduciary duty

13.9.1 CASS 13 provides important safeguards for the protection of client money held by firms that sit alongside the fiduciary duty owed by firms in relation to client money. CASS 13.9.2R to 13.9.3R provide for when money ceases to be client money for the purposes of CASS 13 and the fiduciary duty which firms owe to clients in relation to client money.

13.9.2R Money ceases to be client money if:

1. it is paid to the customer, or a duly authorised representative of the customer, or
2. it is:
   (a) paid to a third party on the instruction of the customer, or with the specific consent of the customer; or
   (b) paid to a third party further to an obligation on the firm under any applicable law; or
3. it is paid into an account of the customer (not being an account which is also in the name of the firm) on the instruction, or with the specific consent, of the customer; or
4. it is due and payable to the firm for its own account (see CASS 13.7.1R to 13.7.2G); or
5. it is paid to the firm as an excess in the client bank account (see CASS 13.10.15R(3)).

13.9.3R When a firm draws a cheque or other payable order to discharge its fiduciary duty to the client, it must continue to treat the sum concerned as client money until the cheque or order is presented and paid.

13.10 Records, accounts and reconciliations

13.10.1R A firm must keep such records and accounts as are necessary to enable it, at any time and without delay, to distinguish client money held for one customer from client money held for any other customer, and from its own money.

13.10.2G In accordance with CASS 13.10.1R, a firm must maintain internal records and accounts of the client money it holds (for example, a cash book and client ledger accounts). These internal records are separate to any external records it has obtained from approved banks with whom it has deposited client money (for example, bank statements).

13.10.3R A firm must maintain its records and accounts in a way that ensures their accuracy and, in particular, their correspondence to the client money held for individual customers.

13.10.4R A firm must maintain up-to-date records that detail all payments received for, or on behalf of, customers and all payments to, from, or made on behalf of, customers.

13.10.5R An internal client money reconciliation requires a firm to check whether its client money resource, as determined by CASS 13.10.8R, on the previous business day, was at least equal to the client money.
requirement, as determined by CASS 13.10.9R, as at the close of business on that day.

13.10.7R
In carrying out an internal client money reconciliation, a firm must use the values contained in its internal records and ledgers (for example, its cash book or other internal accounting records), rather than the values contained in the records it has obtained from approved banks with whom it has deposited client money (for example, bank statements).

13.10.8R
The client money resource for client money held in accordance with CASS 13.10.6R is the aggregate of the balances on the firm’s client bank accounts, as at the close of business on the previous business day.

UK jurisdiction - specific rules that extends EU and UK-specific principles to these type of firms.

13.10.9R
(1) The client money requirement is the sum of:
(a) the aggregate of all individual customer balances calculated in accordance with CASS 13.10.13R and CASS 13.10.14R;
(b) the amount of any unallocated client money under CASS 13.10.1R(3); and
(c) any other amounts of client money included in the calculation under (2).
(2) For the purposes of (1)(d), the firm must consider whether there are amounts of client money, other than those in (1)(a) to (c), to which the requirement to segregate applies and that it is appropriate to include in the calculation of its client money requirement and, if so, adjust the calculation accordingly.

UK jurisdiction - specific rules that extends EU and UK-specific principles to these type of firms.

13.10.10G
The client money requirement calculated in accordance with CASS 13.10.9R should represent the total amount of client money a firm is required to have segregated in client bank accounts under CASS 13.

UK jurisdiction - specific rules that extends EU and UK-specific principles to these type of firms.

13.10.11G
Firms are reminded that, under CASS 13.9.3R, if a firm has drawn any cheques, or other payable orders, to discharge its fiduciary duty to its clients (for example, to return client money to the client), the sum concerned must be included in the firm’s calculation of its client money requirement until the cheque or order is presented and paid.

UK jurisdiction - specific rules that extends EU and UK-specific principles to these type of firms.

13.10.12G
(1) The following guidance applies where a firm receives client money in the form of cash, a cheque or other payable order.
(2) In carrying out the calculation of the client money requirement, a firm may initially include the amount of client money received as cash, cheques or payment orders that has not yet been deposited in a client bank account in line with CASS 13.6.5R. If it does so, the firm should ensure, before finalising the calculation, that it deducts these amounts to avoid them giving rise to a difference between the firm’s client money requirement and client money resource.
(3) In carrying out the calculation of the client money requirement, a firm may alternatively exclude the amount of client money received as cash, cheques or payment orders that has not yet been deposited in a client bank account in line with CASS 13.6.5R. If it does so, the firm is reminded that it must separately record the receipt of the money in the firm’s books and records under CASS 13.6.3R(2).
(4) 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 into a client bank account promptly and no later than on the business day after it receives the money (see CASS 13.6.6R).

UK jurisdiction - specific rules that extends EU and UK-specific principles to these type of firms.

13.10.13R
The individual customer balance for each client must be calculated as follows:
(a) the amount received for or on behalf of the customer by the firm; plus
(b) the amount of any interest, and any other sums, due from the firm to the customer; less
(c) the aggregate of the amount of money
(a) paid to that customer by the firm; and
(b) due and payable by the customer to the firm; and

UK jurisdiction - specific rules that extends EU and UK-specific principles to these type of firms.
13.10.14R
Where the individual customer balance calculated in respect of an individual client under CASS 13.10.13R is a negative figure (because the amounts received for or on behalf of, or due, to a client under CASS 13.10.13R(1) and CASS 13.10.13R(2) are less than the amounts paid by, or due and payable by, that client under CASS 13.10.13R(3)), that individual customer balance should be treated as zero for the purposes of the calculation of the firm’s client money requirement in CASS 13.10.9R.

13.10.15R
When an internal client money reconciliation reveals a difference between the client money resource and its client money requirement a firm must:
1. identify the reason for the difference;
2. ensure that any shortfall in the amount of the client money resource as compared to the amount of the client money requirement is made up by a payment into the firm’s client bank accounts by the end of the business day following the day on which the difference was discovered; and
3. ensure that any excess in the amount of the client money resource as compared to the amount of the client money requirement is withdrawn from the firm’s client bank accounts by the end of the business day following the day on which the difference was discovered.

13.10.16R
The purpose of the reconciliation process required by CASS 13.10.17R is to ensure the accuracy of a firm’s internal accounts and records against those of any third parties by whom client money is held.

13.10.17R
A firm must perform an external client money reconciliation:
1. each business day; and
2. as soon as reasonably practicable after the relevant internal client money reconciliation, to ensure the accuracy of a firm’s internal accounts and records by comparing its internal accounts records against those of approved banks with whom client money is deposited.

13.10.18R
When any discrepancy is revealed by an external client money reconciliation, a firm must identify the reason for the discrepancy and correct it as soon as possible, unless the discrepancy arises solely as a result of timing differences between the accounting systems of the party providing the statement or confirmation and that of the firm.

13.10.19R
While a firm is unable to resolve a discrepancy arising from an external client money reconciliation, and one record or a set of records examined by the firm during the reconciliation process indicates that there is a need to hold greater amount of client money than is in fact the case, the firm must assume, until the matter is finally resolved, that the record or set of records is accurate and pay its own money into a relevant client bank account.

13.10.20R
A firm must inform the FCA in writing without delay if:
1. its internal records and accounts of client money are materially out of date or materially inaccurate so that the firm is no longer able to comply with the requirements in CASS 15.10.1R to CASS 15.10.4R, or
1033. 13.11 Client money distribution in the event of a failure of a firm or approved bank
Application 13.11.1R
This section (the claims management client money distribution rules) applies to a firm that holds client money which is subject to the claims management client money rules when a primary pooling event or a secondary pooling event occurs.

1034. Purpose
13.11.2G
The claims management client money distribution rules seek, in the event of the failure of a firm or of an approved bank at which the firm holds client money, to protect client money and to facilitate the timely return of client money to clients.

1035. Failure of the authorized firm: primary pooling event
13.11.3R
A primary pooling event occurs:
(1) on the failure of the firm;
(2) on the vesting of assets in a trustee in accordance with an ‘assets requirement’ imposed under section 55P(1)(b) or (c) (as the case may be) of the Act; or
(3) on the coming into force of a requirement or requirements which, either separately or in combination:
(a) is or are for all client money held by the firm; and
(b) require the firm to take steps to cease holding all client money.

1036. Pooling and distribution after a primary pooling event
13.11.4R
If a primary pooling event occurs, then:
(1) all client money:
(a) held in the firm’s client bank accounts; and
(b) any client money identifiable in any other account held by the firm
into which client money has been received;
are treated as pooled together to form a notional pool; and
(2) a firm must calculate the amount it should be holding on behalf of each individual customer as at the time of the primary pooling event using the method of calculating individual customer balance provided for by CASS 13.10.13R.

1037. Distribution if client money not transferred to another firm
13.11.5R
If the transferor decides to move the client money pool to the transferee, the transferor must immediately on making the decision, and before the move takes place, notify the FCA in writing of:

1038. Transfer of client money to another firm
13.11.6R
If, in the event of a primary pooling event occurring, the regulated claims management activity business undertaken by a firm (“the transferor”) is to be transferred to another firm (“the transferee”), then the transferee may move the client money pool to the transferee.
1040.13.11.8R

The client money pool may be transferred under CASS 13.11.6R only if it will be held by the transferee in accordance with CASS 13, including the statutory trust in CASS 13.3.1R.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

1041.13.11.9R

If there is a shortfall in the client money transferred under CASS 13.11.6R then the client money must be allocated to each of the customers for whom the client money was held so that each client is allocated a sum which is rateable to that customer’s client money entitlement in accordance with CASS 13.11.4R(2). This calculation may be done by either transferor or transferee in accordance with the terms of any transfer.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

1042.13.11.10R

The transferee must, within seven days after the transfer of client money under CASS 13.11.6R notify customers that:

1) their money has been transferred to the transferee; and
2) they have the option of having client money returned to them or to their order by the transferee, otherwise the transferee will hold the client money for the customers and conduct regulated claims management activities for those customers.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

1043.13.11.11R

A secondary pooling event occurs on the failure of an approved bank at which a firm holds client money in a client bank account.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

1044.13.11.12R

(1) Subject to (2), if a secondary pooling event occurs as a result of the failure of an approved bank where one or more client bank accounts are held then in relation to every client bank account of the firm, the provisions of CASS 13.11.13R(1), CASS 13.11.13R(2) and CASS 13.11.13R(3) will apply.

(2) CASS 13.11.13R does not apply if, on the failure of the approved bank, the firm pays to its clients, or pays into a client bank account at an unaffected approved bank, an amount equal to the amount of client money that would have been held if a shortfall had not occurred as a result of the failure.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

1045.13.11.13R

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

1) any shortfall in client money held, or which should have been held, in client bank accounts, that has arisen as a result of the failure of the approved bank, must be borne by all customers whose client money is held in a client bank account of the firm, unalterably in accordance with their entitlements to the pool;
2) a new client money entitlement must be calculated for each customer by the firm, to reflect the requirements in (1), and the firm’s records must be amended to reflect the reduced client money entitlement;
3) the firm must make and retain a record of each client’s share of the client money shortfall in the failed approved bank until the client is repaid; and
4) the firm must use the new client entitlements, calculated in accordance with (2), when performing the client money calculation in CASS 13.10.9R.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

1046.13.11.14R

The term “which should have been held” is a reference to the failed approved bank’s failure to hold the client money at the time of the pooling event.

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.

1047.13.11.15R

Any interest earned on client money following a primary or secondary pooling event will be due to clients in accordance with CASS 13.6.10R (Interest).

UK jurisdiction-specific rules that extends EU and UK-specific principles to these type of firms.
| 1048 | Applicable across all EU legislative instruments but not relevant for the purposes of this analysis | Transitional provisions and schedules | UK jurisdiction-specific rules that extends EU and UK specific principles to these type of firms |
Endnotes to Annexes 1 and 2

15 While cash does include reference to any currency it does not include, due to the drafting pre-dating the existence and strong growth in interest and volumes of transactions related to virtual currencies. Part of whether the EU-FCD ought to be extended to include virtual currencies is rooted in the question as to whether it is "money" inasmuch as whether crypto- or digital- assets more widely are "financial instruments".
16 In the EU’s opinion (more correctly that of the ICF) in relation to whether virtual currency is money and in the UK and Irish commentary in relation to whether instruments of money, or with "money-like" attributes are money means looking at its functions. Halsbury (5th Ed. Volume 49 para. 1276) considers money to have the primary function: ""...to serve as a medium of exchange, and as such it is accepted without question in final discharge of debts or payment for goods or services. Money also serves - "as a common standard of value by reference to which comparative values of different commodities are ascertained, as a unit of account to which debts and liabilities are expressed, and as a store of value or purchasing power."

Moreover, money also operates on the essential premise that it operates as a currency or unit of account that is generally accepted, including by a central bank or monetary authority, in a relevant jurisdiction.

17 While the EU rules apply to Gibraltar, Gibraltar is a British Overseas Territory with a separate legislature as well as the Gibraltar Financial Services Commission exercising competent jurisdiction in respect of the EU Rules as applied within the territory of Gibraltar and relevant firms. Matters of Gibraltar law and regulatory practice of the GFSIC are beyond the scope of this paper.

- Available here as viewed on 1 September 2019: https://www.handbook.fca.org.uk/handbook/CASS.pdf
- Available here as viewed on 1 September 2019: https://www.centralbank.ie/docs/default-source/investment-industry-market-sectors/funds-service-providers/regulatory-requirements/guidance/investor-require.jpg?sfvrsn=2
- Available here as viewed on 1 September 2019: https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/client-assets/guidance-on-client-asset-regulations-for-investment-
- Available here as viewed on 1 September 2019: http://www.irishstatutebook.ie/eli/2017/60/made/en/print