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CASS: the grand finale

The Financial Conduct Authority's overhaul of its client asset regime, which has been coming into force in stages over the past year, culminates in a grand finale (for now) on 1 June 2015 when the last tranche of the new rules commences. **Richard Small** highlights these key changes to CASS and some issues that compliance officers looking to implement them should consider.

Split implementation

While this article does not consider the numerous changes to CASS that took effect from 1 June 2014 and 1 December 2014, as these have been adequately covered elsewhere, it is worth noting that some of the new CASS requirements have come into force at different times for different categories of client. These include:

- the new **delivery versus payment** rules which took effect in respect of existing clients on 1 December 2014, will apply for new clients from 1 June 2015; and
- the new rules in relation to the use of the **banking exemption**, requirements for written agreements in connection with **title transfer collateral** and **custody** arrangements and the new **acknowledgement of trust letters** which commenced with regard to new clients on 1 December 2014, will take effect in respect of existing clients from 1 June 2015, meaning that financial institutions should have their repapering exercises well underway by now with a view to completion by 1 June 2015.

New requirements from 1 June 2015

Firms should ensure that their systems and controls as well as internal policies and procedures have been updated and are fully operational by 1 June 2015, to allow them to be in compliance with the following changes to the CASS regime.

Title transfer collateral arrangements: firms will be required to allow clients to terminate the title transfer collateral arrangements under which money or assets are transferred to them and instead hold such money or assets under the applicable CASS rules.

Diversification of client money: firms will be obliged to assess periodically whether it is appropriate to diversify or further diversify the third parties with which they deposit some or all of the client money that they hold and wherever firms conclude that it is appropriate to do so they must make adjustments accordingly to the third parties they use and the amounts of client money deposited with them. Firms will further be required to record the grounds upon which they have satisfied themselves as to the appropriateness of their selection and the appointment of the third party to hold client money, with such records to be kept for five years.

Immediate segregation under the normal approach: under the normal approach, rather than receiving client money into a house account and then paying it promptly (no later than the next business day after receipt, into the client bank account), firms will now be required to ensure that all client money received is paid directly into the client account at the firm rather than being first received into the house account and then segregated. Firms may, when receiving client money in the form of cash, a cheque or other payable order, pay such monies no later than the business day after receipt into the client bank account. There are deviations from this rule where firms are using the alternative approach or where, for example, firms are subject to restrictions under the regulatory system or law.

Prudent segregation: where a firm determines that it would be prudent in order to prevent a shortfall in client money on the occurrence of a primary pooling event, to pay some of its own money into the client bank account, it must establish a written policy that is approved by the governing body of the firm detailing the specific anticipated risks in relation to which it would be prudent to make such payments into the client bank account, why the firm considers the use of such a payment a reasonable means of protecting client money against the risks set out in the policy, and the method that the firm has used to calculate the amount required to address each risk set out in the policy. This policy and documentation must be kept for a period of at least five years from the date that it ceases to retain such money in the client bank account.

Single customer view: firms will be required to maintain records to enable them to determine promptly the total amount of client money they should be holding for each of their clients. Firms must ensure that they can make this determination within two business days of having taken a decision to do so or at the request of the FCA.

Alternative approach to client money segregation: while the new rules in relation to the alternative approach came into force on 1 December 2014, firms that were operating the alternative approach on 30 November 2014 have until 1 June 2015 to comply. Broadly, firms that wish to adopt the alternative approach must document in writing their reasons for doing so. As part of this, a firm must note that adopting the normal approach would lead to greater operational risk to client money protection compared to the proposed alternative approach, that adopting the alternative approach would not result in undue operational risk to client money protection and that it has the necessary systems and controls in place to enable it to operate the alternative approach effectively and in compliance with the firm's obligations to protect client money. In addition, before adopting the alternative approach, a firm must send the FCA a report prepared by an independent auditor of the firm. The auditor's report must include an opinion from the auditor that the firm's systems and controls are suitably designed to enable it to fulfil its requirements under CASS including in relation to mandatory prudent segregation (as noted above).

Allocation of client money receipts: firms must allocate any client money that they receive to an individual client promptly and in any case no later than ten business days following receipt of such money. Pending the firm's allocation of a client money receipt to an individual account, it must record the client money received in its books and records as '*unallocated client money*'. Firms should therefore ensure that they have the correct systems and controls in place to be able to identify such client money and to ensure that pending identification or allocation such client money is paid into the client money account.

Client money arising from or in connection with safe custody assets: the FCA has made it clear that money arising from or in connection with the holding of a safe custody asset by a firm, which is due to clients, should (unless treated otherwise under the client money rules) be treated as client money by the firm. Similarly, where a firm has deposited safe custody assets with third parties and client money arises from or in connection with those safe custody assets then the firm is under an obligation to ensure that the third party either deposits the money in a client money bank account of the firm or in a client money transaction account for the benefit of the firm's clients as appropriate.

Registration of legal title: a firm will only be able to record legal title to their proprietary assets in the same name as assets held for their clients if doing so is incidental to the investment business that it carries on for the account of any client, or steps are taken by the firm to comply with an applicable custody rule. A firm may continue to record the legal title to its proprietary assets in the same name as that of its clients' assets where in accordance with the law or market practice of a jurisdiction outside of the UK.

Depositing assets with third parties: firms will be required to record the grounds on which they satisfy themselves as to the appropriateness of their selection and appointment of third party custodians. Firms should note the date that such record is created and keep it from that date until at least five years after they cease to use the third party custodian to hold assets belonging to their clients.

Concluding thoughts

Third-party compliance with CASS: one of the challenges facing firms seeking to implement the CASS regime is that some third-party providers such as central clearing counterparties, securities depositaries and overseas custodians may not yet have factored in the new CASS rules. As a result, in certain circumstances, it will be operationally impossible for firms to comply with the new requirements. Firms should therefore document their attempts to ensure that third-party providers alter their systems and controls to the extent necessary to allow firms to comply with the latest CASS obligations. This will enable firms to demonstrate to the FCA that they have made their best efforts to achieve compliance.

FCA thematic review: the regulator is likely to focus on a number of soft targets when it undertakes its long-promised CASS thematic review. We would expect acknowledgement of trust letters, single customer view (client money) and the client-specific safe custody asset record as well as immediate segregation under the normal approach, to be in particular focus. Firms should therefore be prepared to demonstrate that they are fully in compliance and, if not, that they are taking proactive steps to ensure that they are in compliance as quickly as possible.

Penalty calculations: compliance officers should bear in mind that the FCA is imposing ever stricter fines for breaches of CASS. On 15 April, the Bank of New York Mellon International and its London branch were penalised £126 million for CASS failures (see the News section of this volume). For more on the penalty calculations, please see 'Penalty calculations – a known unknown' by Tony Woodcock and Richard McGarry in *Compliance Monitor*'s November 2014 issue, which discusses the £37,745,000 Barclays Bank fine for CASS failings.

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