CLEVELAND & CO

External in-house counsel

CASS CUSTODY CHANGES – JUNE 2014

(FCA'S PS 14/09 REPORT)

Changes | 1 June 2015 Rule Implementation

1. GENERAL GUIDANCE ON THE APPLICATION OF THE CUSTODY RULES

Firms that are safekeeping physical share certificates fall within the scope of the 'safeguarding' part of the activity of safeguarding and administering investments under Article 40 of the Financial Markets Act 2000 (Regulated Activities) Order 2001	6.1.1R, 6.1.16FR, 6.1.16JR and 6.1.16KR

2. REGISTRATION OF FIRM ASSETS AND CUSTODY ASSETS UNDER THE SAME NAME

Registration of custody assets in the name of the firm would continue to be permitted only in specified circumstances where the asset is subject to local law or market practice outside of the UK — 6.2.3R to 6.2.6G

Examples of such situations:

- correcting, dealing or transaction errors that relate to client positions;
- processing or allocating assets for bulk deals;
- maintaining a small balance of the firm's own assets for purely operational and compliance purposes;
- allowing clients to trade in fractional units or shares; and
- making good a shortfall.

Note: It is common for sub-custodians to register a custodian's and an investor's assets in the same name.

3. DEPOSITING ASSETS WHEN USING THIRD PARTY CUSTODY SERVICES

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Not only must a firm keep records of the grounds upon which it satisfies itself of the appropriateness of its selection and appointment of a third party to hold custody assets, but the firm should also record each periodic review it makes of that selection. Firms must periodically review any third party custodian with whom they deposit assets. Types of checks outlined in the PS 14/09 report: ▪ Internal custody record checks; and ▪ Physical asset reconciliations.	6.3.1R to 6.3.4A-1R

4. WRITTEN AGREEMENT REQUIREMENTS

Firms will be required to have in place written agreements for when placing assets with third party custodians, or making such arrangements.	6.3.4AR to 6.3.4BG

5. CLIENTS' BEST INTEREST

Firms must consider their clients' best interest when agreeing to a right to use arrangements with a retail client.	6.4.1AG to 6.4.2G

6. RECORDKEEPING, RECORD CHECKS AND RECONCILIATIONS

• There will be a minimum frequency at which firms are required to undertake reconciliations or perform other checks; • There will be clarifications of the circumstances in which a firm is able to undertake a non-standard method of	6.5 will be replaced by 6.6, various provisions in 6.6 address this matter.

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internal client money reconciliation; and • There will be more detailed record keeping and notification requirements.	

7. TITLE TRANSFER COLLATERAL ARRANGEMENTS (“**TTCA**”) WRITTEN AGREEMENT REQUIREMENTS

Written agreements will need to be in place for all TTCA.	6.1.6BR to 6.1.6CG
The process firms must follow should a client request protections under CASS for assets and monies otherwise subject to TTCA will be stipulated. This process includes the firm ensuring both the client’s request and, based on feedback, the firm’s response are documented. On agreeing to a request for protection the firm will also be obliged to notify the client of its agreement and to state when the protection would come into effect.	7.11.1R to 7.11.8G

8. CLIENT PROTECTION REQUESTS

There will be a prescribed mechanism for firms to follow if a client requests protection under CASS for assets and money subject to Title Transfer Collateral Arrangements.	6.1.8AR to 6.1.8EG 7.11.9R to 7.11.13 G

9. DVP (“DELIVERY VERSUS PAYMENT”) EXCLUSION FOR COMMERCIAL SETTLEMENT SYSTEMS

Authorised fund managers will be able to cease treating money as client money for a one day window while carrying out a DvP transaction for the purpose of setting a transaction in relation to units in a regulated collected investment scheme.	6.1.12R to 6.1.12ER 7.11.14R to 7.11.20R

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These changes are aimed at improving clarity and certainty.	

10. UNCLAIMED CLIENT MONEY

Clarifications of the rules: — 7.11.48G to 7.11.58G

- Firms will be required to take into account the arrangements they have in place with their clients before paying away unclaimed client asset; and
- any payment away of unclaimed client assets must be permitted by law.

11. UNCLAIMED CUSTODY

There will be an optional mechanism in place for dealing with unclaimed custody assets (i.e. giving them to charity) if certain conditions are met. — 6.2.8G to 6.2.16G

12. DUE DILIGENCE

Due diligence standards will be enhanced. Firms will be required to periodically assess whether they are appropriately diversifying the third parties with which they place client money and following each assessment, make adjustments accordingly. — 7.13.8R to 7.13.12R and 7.13.20R to 7.13.25R

DISCLAIMER

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