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CASS Rules Update – FCA Policy Statement 14/9

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Agenda

Introduction

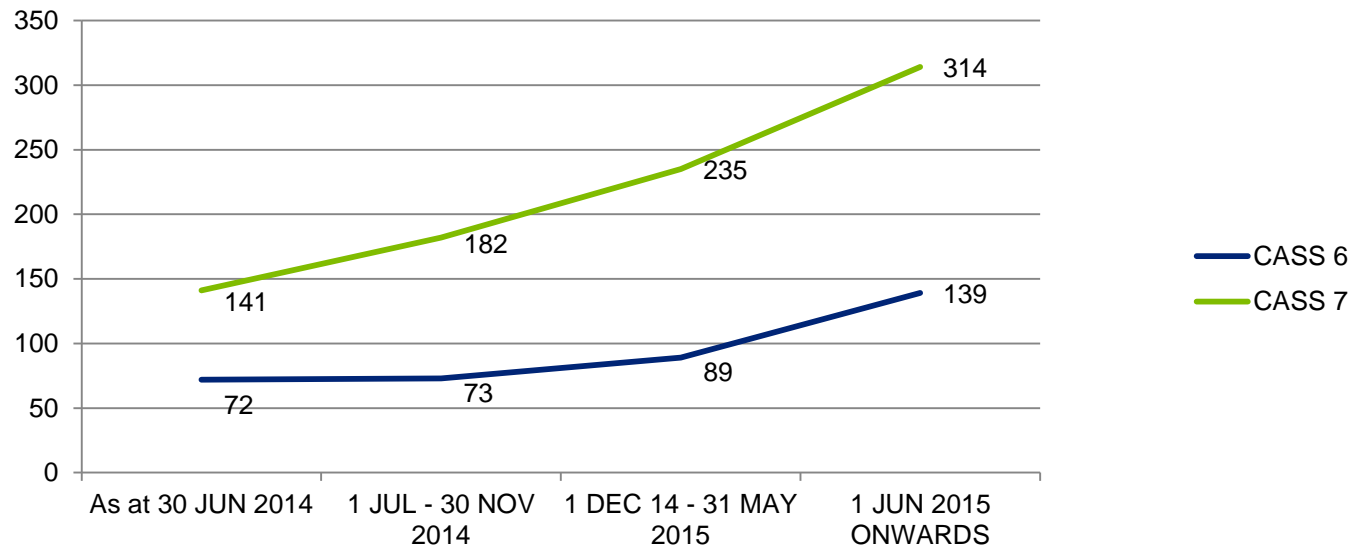
FCA Policy Statement 14/9 – Impact of 1 June 2015 changes

Quarterly Consultation CP 15/8 – CASS DvP CIS

Outlook of CASS Risks for 2015

Background and context

- CASS rules changes following Financial Conduct Authority ('FCA') Policy Statement ('PS') 14/9 come into force in three phases: 1 July 2014, 1 December 2014 and 1 June 2015
- This session to cover CASS rules coming into force 1 June 2015
- FCA continued focus on CASS – e.g. recent fine: £38 million (Sept 2014), and six Section 166 commissioned on CASS during 2014
- Significant increase in the number of CASS rules and guidance:



FCA Policy Statement 14/9 – Impact of 1 June 2015 changes

Rules came into force 1 Dec 2014

1. CASS 6 Custody and CASS 7 Client Money – DvP for commercial settlement systems

- Requirement for firms to obtain client's written agreement to the use of the DvP exemption
- Requirement for the DvP transaction to be through a commercial settlement system (e.g. CREST) and for the firm to be a direct member / participant or sponsored member of the relevant commercial settlement system
- Must be in relation to a DvP transaction only (i.e. cannot apply for Free of Payment transactions)
- If any of the above requirements are not met – cannot use the DvP exemption

Key challenges and considerations

- Identification of markets where the firm is not a direct member / participant or sponsored member of the relevant commercial settlement system – and its impact on operating model for markets that cannot use the DvP exemption
- Assessment of what is deemed to be a commercial settlement system

CASS 6.1.12 R to 6.1.12E R and CASS 7.2.8A G to 7.2.8AE R

Rules coming into force 1 June 2015

2. CASS 6 Custody – Registration of firm assets in same names as custody assets

- Amendment to the current rules to restrict firms from registering own assets in the name of the client or any nominee in whose name a custody asset is also registered, unless:
 - doing so arises incidentally to the investment business that the firm carries on for the account of a client or to other steps taken by the firm to comply with custody rules. E.g. handling dealing errors, allocating bulk deals etc. which are set out as guidance in the CASS rules
 - it arises as a result of the law or market practice of an overseas jurisdiction

Key challenges and considerations

- Re-registration of firm assets where they are registered in the same nominee company – may not always be feasible for certain markets / jurisdictions.

CASS 6.2.3R to 6.2.6G

Rules coming into force 1 June 2015

3. CASS 6 Custody – Depositing custody assets with third parties

- Changes to the rules to provide clarification and guidance on factors a firm should consider before choosing third party custody services

Key challenges and considerations

- Minimal impact as these are clarification of existing rules

CASS 6.3.1R to 6.3.4A-1R

Rules coming into force 1 June 2015

4. CASS 6 Custody – Custody recordkeeping, record checks and reconciliations

- Internal custody record checks:
 - Internal custody reconciliation method (not for all firms – must have separate records)
 - Internal system evaluation method (default if firm does not have separate records)
- Obligation to fund shortfalls in custody assets where the firm is responsible
- Requirement to maintain internal procedures and policies for custody reconciliations

Key challenges and considerations

- Implementation of new controls, systems and ledgering process to perform internal custody record checks
- Timeliness of identifying and funding a shortfall identified from the reconciliation
- Adequate detail documented in policies and internal procedures for custody reconciliations

CASS 6.6

Rules coming into force 1 June 2015

5. CASS 6 Custody and CASS 7 Client Money – TTCA Procedure for switching

- Newly prescribed mechanism that a firm should follow if a client requests a change in level of protection for money/assets subject to TTCA
- Dependency on the firm being able to provide a reliable estimate of when the protection will come into effect
- Both client's request and firm response should be documented and a record should be kept for 5 years, whether the firm agrees or disagrees with the TTCA switch
- For a switch from TTCA into client money protection, the firm must treat money as client money from the start of the next business day following the date of termination set out in the firm's notification

Key challenges and considerations

- Potential re-papering to include clauses relating to termination of TTCA.
- Process to deal with TTCA switching and to make and retain appropriate records.

CASS 6.1.8AR to 6.1.8EG and 7.11.9R to 7.11.13G

Rules coming into force 1 June 2015

6. CASS 7 Client Money – DvP for Collective Investment Schemes

- New DvP window of 1 business day (previously 4 business days per COLL)
- Obligation to obtain clients' written agreement to prior to the use of the DvP exemption
- Must be in relation to units in a regulated collective investment scheme

Key challenges and considerations

- Potential intra-day liquidity funding issue due to cleared funds requirement
- Trading on cleared funds, e.g. direct debit, cheques
- Payments to / receipts from the trustee / depositories

CASS 7.11.21 R to 7.11.24 R

Rules coming into force 1 June 2015

7. CASS 7 Client Money – Client bank accounts – due diligence and diversification

- Clarification that due diligence of third party banks should focus on the specific legal entity, and not the group as a whole
- Enhancement requiring firms to specifically assess whether client money is appropriately diversified across third parties
- Introduction of an explicit requirement for firms to make and keep record of each periodic review of a bank and diversification assessment - minimum of five years after it has ceased to use the bank

Key challenges and considerations

- Ability to evidence firm's considerations and conclusions of third party banks at the point of appointment, its periodic review, and diversification assessment
- Frequency that the firm assess whether client money is appropriately diversified across third parties and the factors considered

CASS 7.13.8 R to 7.13.12 R and 7.13.20 R to 7.13.25 R

Rules coming into force 1 June 2015

8. CASS 7 Client Money – Immediate segregation

- Clarification that firms operating the normal approach are required to receive client money directly into a client bank account, unless specifically allowed in the rules, e.g. money due to a client from a firm; or exempted, e.g. the use of DvP exemption
- 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 client bank accounts

Key challenges and considerations

- Improved controls and processes to ensure third parties and clients make payments of client money directly into the firm's client bank account
- Every instance of client money received incorrectly into the firm's own account will be a breach of the rules, even in circumstances where it may be the client's fault for making a payment into the incorrect bank account

CASS 7.13.6 R to 7.13.7 G

Rules coming into force 1 June 2015

9. CASS 7 Client Money – Physical receipts

- Clarification that when a firm operating the normal approach physically receives client money in the form of cash, cheque or other payable order, it must record the receipt of money in the firm's books and records
- The physical receipt must be paid into a client bank account promptly, and no later than one business day after it receives the money
- Enhanced rules to clarify the treatment of future dated cheques

Key challenges and considerations

- Monitoring of physical receipts and timely payment into the client bank account

CASS 7.13.32 R to 7.13.33 R

Rules coming into force 1 June 2015

10. CASS 7 Client Money – Cleared funds

- Reiterating the principle that one client's money should not be used to fund another client's investment business
- Firm must allow for sufficient time for payments of client money to the firm to become available for use, 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
- Firms may use their own money to fund clients' trades by making use of the prudent segregation rules to mitigate the risk of using one client's money for another client's trades

Key challenges and considerations

- Identification of payment cycle for all types of client money receipts / payments, e.g. different settlement cycle, T+2 vs. T+3
- Design and implement appropriate organisational arrangements to minimise the risk of contravening CASS 7.12.3 G

CASS 7.12.3 G

Rules coming into force 1 June 2015

11. CASS 7 Client Money – Money due to client from firm

- Current guidance is made into a rule for firms operating the normal approach to pay money due to a client within one business day, either directly to the client, or into a client bank account

Key challenges and considerations

- Minimal impact as these are clarification of existing rules

CASS 7.13.39 R to 7.13.40 G

Rules coming into force 1 June 2015

12. CASS 7 Client Money – Prudent segregation

- New rules impose additional procedures and record keeping requirements for firms operating a prudent segregation
- Rules require amounts that are prudently segregated to be linked to specific types of risks rather than risk generally, e.g. risk relating to the use of payment service providers where monies are not immediately paid into a client bank account

Key challenges and considerations

- Identification of specific risks which may result in a client money shortfall
- Design of an appropriate prudent segregation calculation methodology to address each of the risks identified
- Detailed documentation requirement – need for a written policy addressing the specific points required by the rules and also a prudent segregation record

7.13.41 R to 7.13.53 R

Rules coming into force 1 June 2015

13. CASS 7 Client Money – Client money relating to custody assets held at a custodian

- New rules to clarify that money derived from custody assets held with third parties must be recognised as client money – and must be held in a client bank account in the name of the firm
- Alternatively firms may hold client money relating to custody assets in a client transaction account where these monies should then be transferred to a client bank account, i.e. a firm should not hold excess client money in its client transaction accounts

Key challenges and considerations

- Firms should already be treating monies arising from safe custody assets as client money
- Previous guidance (CASS 7.4.27 G) which allowed firms to pay entitlements received outside the UK into a client bank account within 5 business days will no longer be in place from 1 June 2015 onwards
- Contractual settlement vs. cash settlement basis

CASS 7.14.5 G to 7.14.9 G

Rules coming into force 1 June 2015

14. CASS 7 Client Money – Client money record keeping and reconciliations

- Revised rules stipulate firms are required to carry out internal client money reconciliations each business day and external client money reconciliations at least on a monthly basis
- Clear requirements in CASS 7.16 as to the steps a firm is expected to follow when undertaking a standard method of the internal client money reconciliation – e.g. must use values contained in its internal records and ledgers to carry out internal client money reconciliation, not values obtained directly from an external / third party's records
- Restrictions on the use of the net negative add-back method

Key challenges and considerations

- Need to address poor record-keeping practices, e.g. manual journals not updated on a timely basis, and improve operational processes to ensure book keeping systems are kept up-to-date on a timely basis
- Adequate detail documented in policies and internal procedures for client money reconciliations

CASS 7.15 and 7.16

Other CASS rule changes

CASS 8 – Non-written mandates

a

CASS 9 – Reporting to clients on client assets and information to clients on safeguarding client assets

b

CASS 10 – CASS Resolution Pack

c

CASS 7A – Client money distribution rules

d

SUP 16 – Client Money and Assets Return ('CMAR')

e

Quarterly Consultation CP 15/8 – CASS DvP CIS

Quarterly Consultation CP15/8

Clarification on application of DvP Exemption for CIS

- In relation to the DvP exemption for CIS as proposed in PS14/9 – clarification by the FCA that AFMs will not be in breach of the client money rules when transferring client money (except cheques) from a client bank account into a corporate account before the money is transferred to a third party.
- E.g. AFMs are required to segregate client money under the client money rules because they hold it for longer than one day when using the new DvP exemption. They are then allowed to transfer that client money into the corporate account when transferring to a third party, provided this is done only for the purposes of making an immediate payment from that account.

CASS 7.15 and 7.16

Outlook of CASS Risks for 2015

FCA Client Assets Thematic Reviews

- FCA carried out 26 full scope CASS reviews last year, four emergency visits and nine visits with specific focus on CASS 6 and CASS 7.
- FCA also carried out 36 CASS 10 Resolution Pack thematic visits – findings:
 - Information documented in CASS RP is inconsistent with information reported in CMAR
 - CASS RP not fit for purpose or documentation not updated, e.g. broken links
 - Annual attestation by the CF10a to board not carried out

FCA Client Assets Thematic Reviews (continued)

Other findings relating to CASS 6 / 7:

- Incomplete capture of areas giving rise to client money / custody assets

- Confusion over legal entities – postings to wrong legal entities or sharing of books and records between legal entities

- Inappropriate dealing of shortfalls identified from external custody reconciliation

- Agreements missing with sub-custodians

- Unclear over roles and responsibilities of third party and ultimate responsibility for CASS compliance is with the firm

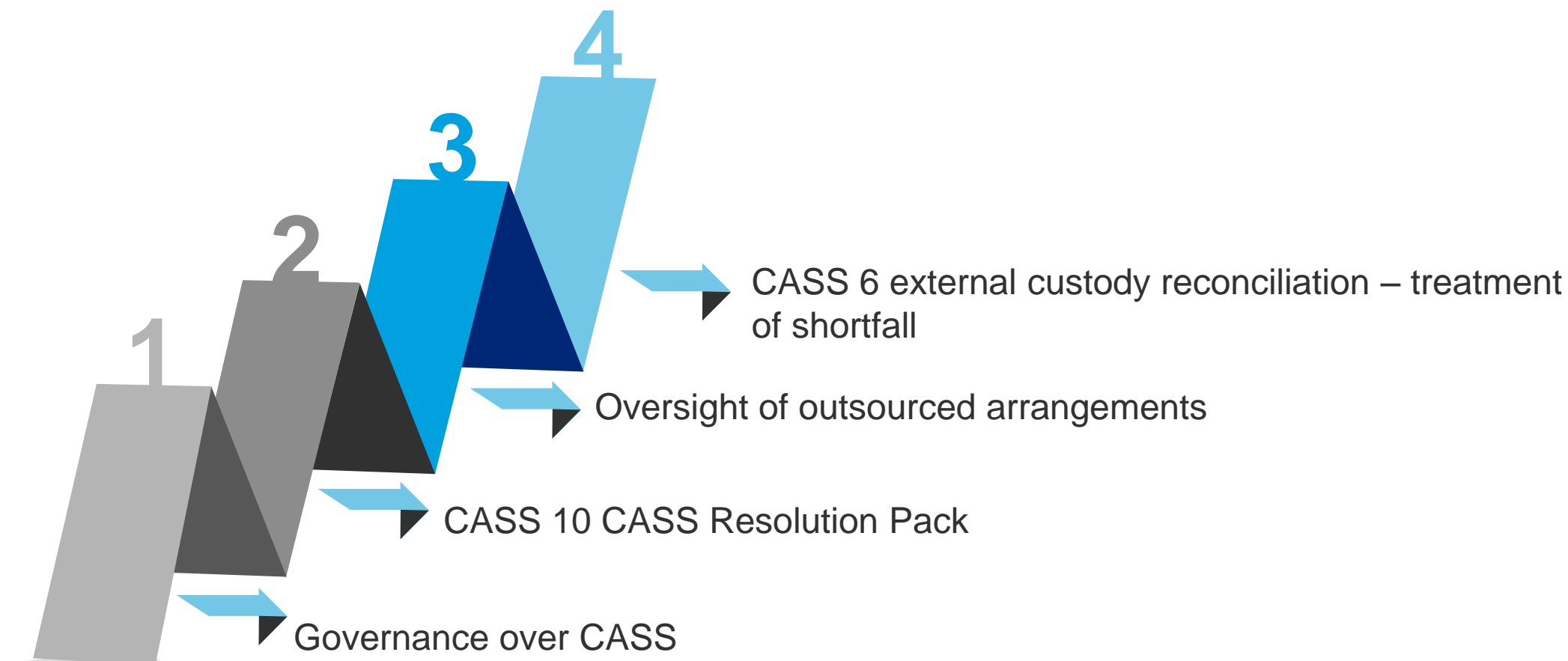
- Inappropriate reliance on exemptions, e.g. incorrect application of banking exemption

- Over-reliance on third parties and lack of oversight

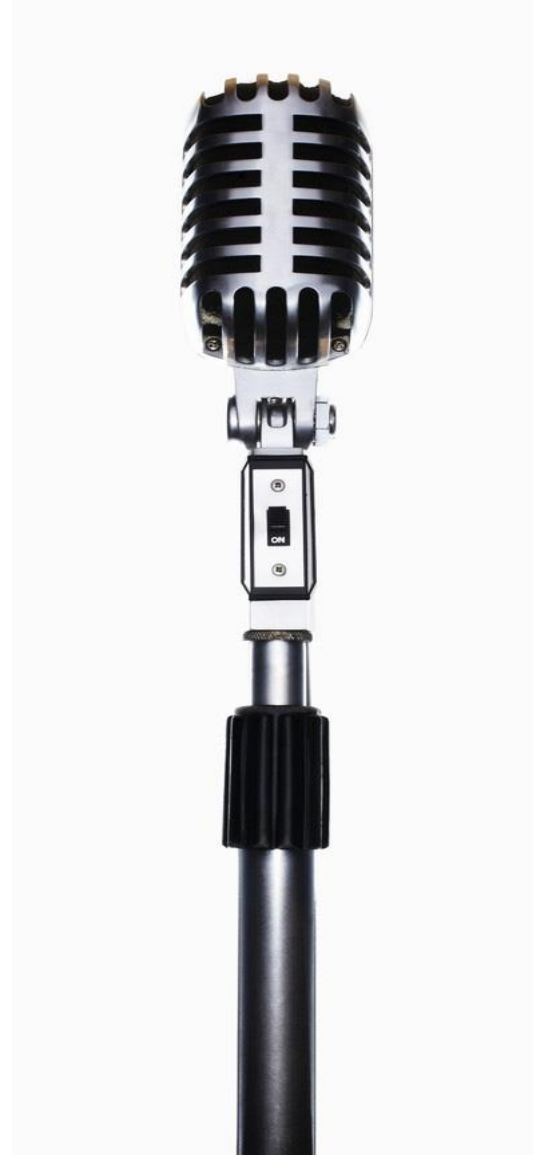
- Inadequate risk assessment over third parties

- Incomplete / incorrect acknowledgement letters

FCA Client Assets Hot Topics for 2015



Q&A





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