TISA

CASS Best Practice Guide

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About TISA

The Investing and Saving Alliance (TISA) is a unique, rapidly growing membership organisation for UK financial services.

Our ambition is to improve the financial wellbeing of all UK consumers. We do this by focusing the convening the power of our broad industry membership base around the key issues to deliver practical solutions and devise innovative, evidence-based strategic proposals for government, policy makers and regulators that address major consumer issues.

TISA membership is representative of **all sectors of the financial services industry.** We have **over 250-member firms involved in the supply and distribution of savings, investment products and associated services**, including the UK's major investment managers, retail banks, online platforms, insurance companies, pension providers, distributors, building societies, wealth managers, third party administrators, Fintech businesses, financial consultants, financial advisers, industry infrastructure providers and stockbrokers. Find out more here>>

As consumers, the financial services industry and the economy react to and recover from the effects of the pandemic, the importance of the three key pillars of work that TISA prioritises has never been more apparent:

- **Strategic policy initiatives that influence policymakers** regarding the financial wellbeing of UK consumers & thereby enhancing the environment within which the industry operates in the key areas of **consumer guidance, retirement planning, later lifetime lending, vulnerable customers, financial education, savings and investments**.
- TISA is recognised for the **expert technical support provided to members** on a range of operational and regulatory issues targeted at improving infrastructure and processes, establishing standards of good practice and the interpretation and implementation of new rules and regulations covering **MiFID II, CASS, ESG/RSI, operational resilience, Cyber Risk, SM&CR** and a range of other areas.
- **Digital transformation initiatives** that are driving ground-breaking innovation and the development of industry infrastructure for greater operational effectiveness and revenue promoting opportunity for firms. TISA has become a major industry delivery organisation for consumer focused, digital industry infrastructure initiatives – **TISAtech** (a digital marketplace that brings together financial institutions and FinTechs for greater collaboration and innovation) and **TURN** (TISA Universal Reporting Network – a digital platform providing a secure data exchange for financial services using blockchain technology) – alongside projects **Digital ID** and **Open Savings & Investment**. This reflects TISA's commitment to open standards and independent governance.

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V1.5 October 2022 – Sections 1-16 reviewed and updated where necessary.

Introduction

This Best Practice Guidance documentation was originally provided following the extensive CASS rule updates introduced by PS14/09. This updated guide supersedes the previous version and provides guidance on a far wider scale.

The TISA CASS Best Practice Group, consisting of representatives from a wide range of firm types, has produced this updated Guide in the form of a number of separate documents, on discrete topics. Each document was written by one or more members of the group and reviewed by all members of the group, to provide a balanced view of each key area of the CASS requirements.

Please remember that the information contained within these statements is for informational purposes only and is not intended as a substitute for the need of each firm to understand the CASS requirements and determine its own CASS policies and procedures that are relevant to its business. The information contained is for general guidance only, is not exhaustive and may change from time to time.

1. Selection, appointment and review of banks who hold client money

1.1 Background

This section refers to CASS 7.13.8R to 7.13.11G.

Under CASS 7.13.8R where a firm places client money with a CRD credit institution, bank or qualifying money market fund ('QMMF') it must exercise all due skill, care and diligence in their selection, appointment and periodic review.

This section of the Best Practice Guide will focus on the selection, appointment and periodic assessment of banks which hold client money. However, the general principles could be applied to QMMFs, but does not intentionally focus on them, or give them any special considerations.

1.2 CASS 7.13.10R and CASS 7.13.11G - considerations

CASS 7.13.10R requires a firm to consider the following criteria when making a selection, appointment or conducting a periodic review:

- 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.

CASS 7.13.11G adds further guidance on what should be considered when making an assessment:

- The capital of the CRD credit institution or bank;
- The amount of client money placed, as a proportion of the CRD credit institution or bank's capital and deposits, and, in the case of a QMMF, compared to any limit the fund may place on the volume of redemptions in any period;
- 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;
- The credit-worthiness of the CRD credit institution or bank; and
- To 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.

1.3 Specific legal entity

CASS 7.13.9R requires firms to ensure that the CRD credit institution, bank or QMMF under review focuses on the specific legal entity that holds the client money deposits and not the bank's parent and/or consolidated group as a whole. Where only group information is available, e.g. a credit rating, the firm should clearly document within the report why the parent has been considered.

However, where the specific legal entity is consolidated into a larger group it is recommended that a high-level review of the ultimate parent group is also undertaken and formally documented as part of the annual review. It is recommended that this incorporates reviewing the consolidated annual report and accounts, credit rating, fines, internet searches for adverse indicators and any cross guarantees provided to the group by the legal entity which holds the client money.

1.4 Multiple FCA regulated entities

Where a group has more than one FCA regulated entity holding client money with the same bank it is recommended that each legal entity clearly documents the conclusions drawn from the periodic review/initial assessment. This is to ensure that each FCA regulated entity can demonstrate compliance with CASS 7.

1.5 Selection, appointment and periodic assessment - content

- ***Expertise and market reputation***

It is recommended that the report provides a high level overview of the bank, its history, country of incorporation, market share, market capitalisation etc. as part of an introduction in the assessment. This will allow you to demonstrate compliance with CASS 7.13.10R(1)&(2) above.

- ***Credit-rating***

It is recommended that firms set a minimum acceptable level of credit rating prior to selecting or appointing a bank to hold client money. Firms should obtain the credit rating from a reputable independent third party e.g. Moodys or Fitch. Firms should compare the current and prior year ratings as part of the assessment. If credit rating reports are available from multiple reputable agencies then they should all be used rather than just one. Where adverse movements are noted the firm should document their conclusions/ thoughts within the report.

It is recommended that the credit rating of each bank that holds client money is monitored on a frequent basis by the relevant governing body e.g. CASS Oversight Committee.

- ***Financial statements review – capital and creditworthiness***

The review of the annual report and accounts is a key element in the selection, appointment and periodic assessment. Under CASS 7.13.11(1)G and 7.13.11(4)G the assessment should include a review of a bank's capital and credit-worthiness which is generally ascertained from the annual report and accounts. Due to the complexity of these reports it is recommended that where possible the annual review is undertaken by someone who has the appropriate expertise and experience e.g. someone in your Finance department. It is recommended that this individual formally attests that they have

undertaken the review and they provide a brief summary of the conclusions they have drawn which is incorporated into the assessment.

- ***Amount of client money deposited as a proportion of a banks' capital***

Under CASS 7.13.11(2)G, the assessment should include reference to the amount of client money deposited with the bank at a point in time, e.g. month end, based on the banks capital from the latest financial information.

- ***Depositor protection***

Under CASS 7.13.11(3)G, firms are required to consider the depositor protection available to client money deposits when the bank is incorporated outside the UK.

- ***Level of risk in the investment and loan activities***

Under CASS 7.13.11(5)G firms are required to consider the level of risk in the investment and loan activities. There is no further guidance on the types of risk, investments and/ or loans which should be considered. However, annual report and accounts contain a significant amount of information regarding a firms activities, principle revenue streams and risk appetite so firm's will be able to make a reasonable assessment from the disclosures made. This assessment should be more straight forward where the client money deposits are held within the ring-fenced part of the bank due to the nature of services which are allowed.

- ***Internet searches (expertise and market reputation)***

It is recommended that internet searches are undertaken on the specific legal entity to identify any adverse indicators which may impact on the firm's expertise or market reputation e.g., frauds, regulatory fines or data breaches. Evidence of the searches undertaken should be retained, and having drawn conclusions based on the internet searches, the rationale behind the conclusions should be documented and retained. Any conclusions should be included in the assessment itself.

- ***Regulatory fines***

It is recommended that the FCA's or the equivalent regulators, where the bank is incorporated in a third country, website is checked to see whether the bank has been subject to any fines or enforcement actions. Evidence of the check undertaken should also be retained e.g., via screenshots.

Additional considerations such as Credit Default Swap rates and equity prices which are also good indicators of potential issues with banks, can be considered on a more frequent basis as part of a comprehensive monitoring process.

1.6 Performance of the bank

Whilst it is not a specific requirement of CASS 7.13.11G, it is recommended that firms summarise the banks performance over the previous 12 months as part of the review. In particular, firms should document the frequency of system outages when reconciliations and/ or physical movements of client money could not take place. Other examples if whether a bank has performed adequately may be the frequency of errors, such as posting charges and interest to incorrect accounts such as the Client Money accounts.

1.7 Third party administrator ('TPA') views

Where a firm uses a TPA it is recommended that their opinions on the bank are also sought, with respect to the performance of banks.

1.8 Acknowledgement letter annual review

Under CASS 7.18.12(2)R firms are required to review each acknowledgement letter periodically, being at least annually, and more frequently where any changes e.g. change of name has taken place. Firms may want to consider performing the acknowledgement letter review as part of the annual due diligence process.

1.9 Format and supporting evidence

Firms should consider the format and structure of the report which summarises the findings from the assessment undertaken. In order to demonstrate compliance with the CASS 7 rules it is recommended that firms have a standard due diligence template which covers all of the requirements of CASS 7.13.10R and CASS 7.13.11G. Firms should document the conclusions on each section within the report.

It is also very important that firms retain all of the supporting documentation that accompanies the summary assessment e.g., internet searches, annual report and accounts. This information should also be retained for a minimum of five years after the firm ceases to use that bank or QMMF.

1.10 Periodic reviews frequency

It is recommended that the formal periodic reviews are undertaken at least annually. However, bank due diligence should be ongoing, and firms should also consider any adverse publicly available information throughout the year which would have a material impact on the conclusions drawn from the periodic review e.g., a change in credit rating. Where these are noted, the firm should consider performing an additional review to ensure that it can demonstrate that consideration has been given to the new information. The analyst should report any adverse opinions on any bank of interest to the firm to appropriate person, so that any actions can be considered before the risks materialise.

1.11 Record retention

Under CASS 7.13.25R firms must retain the grounds upon which it satisfies itself as to the appropriateness of its selection and appointment of bank or qualifying money market fund from the date it makes the selection or appointment for a period of five years after the firm ceases to use that bank or QMMF.

This rules also applies to the periodic assessments and the diversification reviews required under CASS 7.13.22R.

1.12 Governance and oversight

It is recommended that the firm's COM/Senior Manager reviews the conclusions drawn from the initial assessment and/ or periodic review. Where practical it is also recommended that the firm's governance body, e.g. a CASS Oversight Committee, formally approves each initial assessment and/ or periodic review. Where this isn't practical due to the large number of banks who hold client money it is recommended that the firm's governing body receives monthly management information on when each review is due to take place, the status of the reviews and when the next review is due. Reviewing this management information should be a standing agenda item of the CASS Committee and included in its Terms of Reference.

Section Reviewed by CASS Best Practice Drafting Group February 2022

2. Diversification

2.1 Background

The key CASS rule in respect of client money diversification is CASS 7.13.22R. The rule requires the firm to periodically assess the appropriateness of its arrangements for diversifying the client money that it holds. CASS 7.13.22R states:

> Subject to the requirement at CASS 7.13.20 R, and in accordance with Principle 10 and CASS 7.12.1 R, a firm must:
>
> (1) periodically review whether it is appropriate to diversify (or further diversify) the third parties with which it deposits some or all of the client money that the firm holds; and
>
> (2) whenever it concludes that it is appropriate to do so, it must make adjustments accordingly to the third parties it uses and to the amounts of client money deposited with them.

2.2 When to Diversify

Diversification is not compulsory for a firm, unless it is using a group bank to hold client money, when the 20% restriction referred to below will apply. It is up to the firm to assess, based on the amount of client money it holds, whether it is appropriate to diversify the firm's client money. Although there is no prescriptive decision-making process, the firm should document and approve via their governance arrangement the basis on which it will diversify. In considering an appropriate basis to diversify, the firm should ensure that any criteria can be easily met. E.g., if review when CM > £Xm it is impossible to do that as firm may not be aware that limit was reached until later. The calculation should be considered over a period of time and not just at a point in time.

This policy should be appropriately disclosed. Whatever assessment is made, the firm must periodically review its decision as to whether to diversify at all or to adjust its third-party banking partners being used to diversify the firm's client money.

CASS 7.13.23G provides some further guidance that firms should consider when periodically reviewing whether diversification (or further diversification) is appropriate. This guidance should be incorporated into a firm's diversification policy and be performed as part of a firm's annual review of its banking partners. Factors that could be taken into consideration when making an assessment as to whether to diversify client money would be:

- The value of client money being held;
- The time period the money is held for;
- Individual client exposure in excess of the FSCS limit of £85k.;
- Whether it would be appropriate to deposit client money in client bank accounts opened at a number of different third parties;
- Whether it would be appropriate to limit the amount of client money the firm holds with third parties that are in the same group as each other;

- Whether risks arising from the firm's business models create any need for diversification (or further diversification);
- The market conditions at the time of the assessment; and
- The outcome of any due diligence carried out in accordance with CASS 7.13.8R and CASS 7.13.10R.

Any considerations made for the purposes of diversification should be recorded in line with CASS 7.13.25R.

2.3 Banking Partners and Lengths of Deposits

For any banking partners chosen to hold client money as part of diversification arrangements, appropriate due diligence must be performed on the bank in line with the requirements in CASS 7.13.8R.

Firms can also diversify client money in unbreakable term deposits (UTD) with terms up to 95 days as detailed in CASS 7.13.13R. If a firm uses a UTD with terms in excess of 30 days then there are additional rules that must be complied with, covered in CASS 7.13.14A-F. These include having an internal written policy which considers the liquidity risks of holding clients' cash in UTDs and also disclosure within the terms and conditions to clients which explains these risks.

Some audit firms may insist that contract must explicitly state that funds are repaid early in the event of redemption date being a non-working day.

2.4 Group 20% Restriction

There is a restriction noted in CASS 7.13.20R that a firm must limit the funds that it deposits or holds with a relevant group entity or combination of entities so that the value of those funds do not at any point in time exceed 20% of the firm's total client money holding. A CASS firm which also has a bank within the same group, for example, would be impacted by this rule.

There is an exception to this, detailed within CASS 7.13.21AR – 7.13.21CR, whereby if a firm is able to demonstrate that the requirements of this rule are not proportionate then a firm can document its assessment and notify the FCA of this assessment. This must be periodically reviewed, and these periodic reviews also shared with the FCA.

Section Reviewed by CASS Best Practice Drafting Group February 2022

3. CASS 6 Due Diligence

3.1 Background

Under the rules, the FCA states that if a firm is responsible for the Safe custody of Assets held on behalf of a client as custodian and chooses to deposit those assets under CASS 6.3.1 with a third party, then the responsibility for due diligence and oversight of those arrangements remains with the firm. the firm doing the DD should look at the reputational risk of the other party, usually via a web search.

An example of a Third Party Custodian is a Global Custodian arrangement, rather than Crest as this arrangement is not deemed a custodian as Assets are still held by the firm in their nominee name.

CASS 6.3.2 requires the firm to establish that the firm has checked and documented the following;

- Capital, Financial resources and credit worthiness of the third party
- Permissions and Arrangements to hold assets and other activities undertaken that could adversely affect the clients rights such as lending under a Title transfer collateral or stock lending arrangements
- Industry assurance reports such as AAF or SOC1 reports on internal controls and systems

The assets being held are subject to an agreement between the firm and the Third Party Custodian, these assets should be kept separate from assets held by the firm and third party.

This section of the Best Practice Guide will focus on selection, appointment and periodic assessment of Third Party Custodians holding client assets.

3.2 Method for conducting Due Diligence

Due diligence questionnaires sent to the third party are recommended in obtaining key and critical responses and documentation required to comply with the CASS 6.3 rules.

When undertaking Initial Due Diligence prior to appointing a Third Party Custodian, It is recommended that a firm undertakes a review of at least the following list of categories, although the list is not exhaustive, these points should be reviewed as a minimum to identify any key information. These should be updated during periodic reviews to ensure that no material changes have been made.

- Group structures – financial and accounts, any conflicts, regulatory permissions and sanctions
- Business structure and Experience- monitoring and oversight, SLAs and KPIs
- Risk management, compliance and internal audit – how business, credit and domestic and international market changes and events are managed.
- IT and systems, dependencies and MI integrity, data security, SOC 1 AAF reporting
- Business continuity and disaster recovery – pandemic arrangements or stress environments such as withdrawal from high-risk markets
- Training and competency – CASS skills matrices
- Change and projects, governance, availability of UAT scripts and regression testing

- Security set up and pricing, Global trade cut offs, process for deal errors or pricing errors/correction
- Custodian services including any sub custodian arrangements and oversight - Custody and fund services, network of markets and service management, oversight and monitoring of performance.
- CASS controls and risk mapping – check that this extends to the TPA arrangements and sub custodian risks
- Data Protection – data security, encryption, access to firm data by non-UK firms and data privacy notices
- Insurance arrangements – firm liability, professional indemnity, third party failures and financial exposure.
- Money laundering and financial crime -Sanctions programmes, Anti Bribery and Corruption policies
- Transaction reporting, AML requirements, restrictions for non-UK markets

Walkthroughs of key processes will enable the third party to demonstrate how policies and procedures are applied, and should cover the approach taken, key areas are:

- Registration of assets in Nominee name or client where applicable
- Dealing, settlement and corporate actions, monitoring of contractual settlement obligations with oversees sub custodians or brokers, processes for managing illiquid stocks and partial settlement
- Asset reconciliation processes, break management and resolution within market
- Use of assets, check that assets are not used as liens.

3.3 CASS 7 Client Money considerations

- If Client Money is held as part of the Custody services, then CASS 7 rules apply - pay particular attention to interest and treasury arrangements, check use of omnibus accounts and Nostros ensuring that any balances of client money is segregated in accordance with CASS.
- The firm should consider the custodian's cash management processes and arrangements for segregated accounts that fall under CASS 7. The processes around these are key for due diligence of a custodian, as well as managing crest caps limits, failed trade exposure and funding processes.
- Where a custodian holds Client Money as Banker, utilising the banking exemption (7.10.16R), firms should consider as part of their due diligence the requirements that apply how these will differ to money subject to the full CASS 7 requirements.
- Cash Reconciliation processes, this is covered elsewhere within the Guide, but it is worth noting that in the case of client transaction accounts, under CASS 7.18.3R a client acknowledgement letter will need to be in place, and cash balances will need to feed into your client money reconciliation and CMAR reporting.

3.4 Documentation Presentation and Retention

Under CASS 6.3.2A (1) Once the firm is satisfied with the due diligence that has been conducted, they must make a record of the grounds and appropriateness of the selection and appointment They should make a note of the appointment of the third party and retain the records for five years.

Each firm should consider how it incorporates due diligence and the oversight of Third Party Custodians into its governance and reporting arrangements. Particular consideration should be given to how this information is shared with the firm's Board to support their ongoing monitoring of third party

arrangements and what the triggers are for ad-hoc reporting e.g. new/changes to custodian arrangements, adverse due diligence conclusions, repeated SLA failures.

3.5 Periodic Review

CASS 6.3.2A(2) States that a firm must make a record of each periodic review of its selection and appointment of a third party under 6.3.1R(1.) Therefore, ongoing oversight is required and further appropriateness reporting to the firms governing body should be made. In order to comply with this rule this should be undertaken at least annually.

Section Reviewed by CASS Best Practice Drafting Group April 2022

4. Cheque Receipts

4.1 Background

There are strict guidelines around what is considered 'prompt' banking as laid out in CASS 7.13.32R. It is best practice to pay cheques into the bank on day of receipt. Current dated cheques that cannot be banked on the day of receipt must be recorded and held securely until the following working day when they must be banked or returned. Post-dated cheques are covered in another section below.

TISA recommends that cheques are deemed to be paid in 'on acceptance' at the bank. 'On acceptance' is defined as successful delivery to and acceptance by or receipt by the account holding bank within the required timeline of 'no later than one business day after [the firm] receives the money' as per CASS 7.13.32R. Examples of when a cheque is deemed to be banked are as follows:

- cheques deposited to the account holding bank via a bank branch;
- a cheque clearing service provided by the account holding bank, or;
- cheques passed to a courier of the bank.

Successful delivery and acceptance/receipt can be evidenced by proof of the delivery, for example, the acknowledgement from a courier of delivery of the cheques. The firm can be considered to have met the requirement even if there might be subsequent delays by the account holding bank with the processing of the cheque/s. However, in the event a delay causes a discrepancy within the external client money reconciliation, firms will need to take appropriate action to satisfy the requirements of CASS 7.15.31R and 7.15.32R.

This could pose issues for firms who are not situated close to their bank branches and might place pressure on firms to use overnight couriers which could prove costly. This could lead to unavoidable breaches where there is a delay by the courier company in delivering the cheque, unless it is a courier supplied by the bank, as referred to in the above paragraph. Should the firm choose to post the cheques, there could be a delay in the bank receiving the post.

Firms should consider their processes and controls carefully, including their contractual arrangements with clients. Funding of transactions may also be required in relation to cheques that are not banked in a prompt manner, depending on the firm's business model.

Cheques received by a firm into the incorrect location must still be banked by the end of the following business day or a breach recorded, therefore it is important to ensure the firm has defined processes and controls in respect of the receipt and handling of client money cheques.

Cheque imaging technology which enables images of cheques to be exchanged between banks through the image clearing system for clearing and payment may result in different banks reflecting this new shorter clearing method on their statements in different ways. For example, HSBC will only reflect the cheque on its statement when it has cleared so will not show the cheque on the day it is banked but it will show on day 2, Lloyds will show the cheque immediately as uncleared on the day it is banked but will then show as a cleared payment on day 2. However, both methods the cheque will be reflected on the internal records of the firm on the day it is received so will show as an external discrepancy until the payment is cleared.

The firm should obtain bank data on any cheques which actually clear later than the expected timescales and consider whether:

- the system works as expected
- the later clearing is significant enough risk to consider prudent segregation

4.2 Appointed Representatives

CASS 7.13.34R refers to Appointed Representatives, tied agents, field representatives and other agents. The rule requires that if they receive a cheque from a client, they can forward the cheque to the firm's specified business address by no later than the business day after they receive it and in such a way that it will be received by close of business on the third day after receipt by the Appointed Representative. This can then be banked in line with other firm client money cheques as above, i.e. the business day following receipt by the firm. The firm would need a strong audit trail, appropriate controls and written procedures to demonstrate a cheque has been forwarded to the firm's specified address in line with the requirements.

Typically, the industry standard for sterling cheque clearance has shortened in 2019 from T+6 previously to midnight on T+1 so practically for businesses this would be T+2. At this point the cheque would be considered to be cleared.

Firms should review their internal processes in light of the changes being made to cheque clearance timescales.

4.3 Unpaid (Bounced) Cheques

Firms should establish a defined process for dealing with 'bounced' cheques, as this may cause a shortfall in the client money pool. The process the firm chooses to manage this risk should be documented in the appropriate policy.

4.4 Unbanked Cheques

Any cheques not banked on the day of receipt should be stored in a secure location overnight, e.g., a safe and recorded in the firms' books and records. The Firm should consider whether to include or exclude cheques in the firm's internal reconciliation, see 7.16.26 G. The intention of this rule is to avoid disagreement between the client records and the bank records.

4.5 Post Dated Cheques

If a firm accepts post-dated cheques, it should store them in a secure location, in line with CASS 7.13.33R, and record in the books and records on the date received. The firm must ensure there are appropriate processes in place to make sure cheques are banked on the day it is dated for and appropriate adjustments made to the books and records to reflect the banking of the cheque.

4.6 Restrictions on Banking Cheques

The CASS rules provide for a scenario whereby a cheque cannot be banked by the end of the following business day due to legal or regulatory restrictions. An example might be delay necessitated by Anti-

Money Laundering checks. In these scenarios the banking of the cheque the firm must hold it in a secure location in line with Principle 10 and the money must be paid in promptly after the restriction is resolved in accordance with CASS 7.13.

Section Reviewed by CASS Best Practice Drafting Group February 2022

5. Payments to Charity of Allocated but Unclaimed Cash and Assets

5.1 Allocated but Unclaimed Client Money & Assets

The CASS rules refer to "allocated but unclaimed client money" from CASS 7.11.48 – 7.11.58 and "allocated but unclaimed safe custody assets" from CASS 6.2.8 – 6.2.16. These provide the basis for how firms should treat any unclaimed balances which are allocated to an individual client.

The key to being able to determine when an asset or money is unclaimed is being able to initiate a start date from when the client is classed as allocated but unclaimed. Some firms refer to these allocated but unclaimed clients they have lost contact with as a gone-away client and mark the clients record as such. It is down to a firm's policy as to how they deal with allocated but unclaimed assets and money, however they need to identify a trigger, examples of what might trigger a firm to mark a client record as an unallocated but unclaimed or gone away include

- Where post has been returned;
- Where all attempts to contact the customer have failed so contact has been lost;
- A death case where parties cannot be located
- Uncashed cheques, where attempts at different channels of communication have failed.

All of the above will lead a firm to being able to determine that a client has been verified as not living at the address held by the firm and therefore a gone-away client.

A key requirement, if paying to charity, is that assets have been held for at least 12 years and client money for at least 6 years since the last movement on the account. Movement means initiated by the client, not dividend payments or fees, etc.

There are three scenarios which could enable a firm to pay client money to charity, these are

- Following a client with unclaimed client money being successfully contacted, the client gives an instruction to make the payment, i.e., a discharge of fiduciary duty (in which case the mechanism in the rules above do not apply).
- By following the steps set out in CASS 7.11.48 – 7.11.58
- When all avenues have been exhausted, apply to FCA for a waiver for payment to charity without further steps.

The FCA allows firms to consider payment of unclaimed custody assets (as assets or liquidated proceeds) and client money to charity however require firms to take reasonable steps to contact the client.

These steps are set out in CASS 6.2.11 and 7.11.52. The rules with regards to client money are less onerous for retail balances below £25 and for professional clients with balances below £100.

Firms should use multiple methods to contact clients, in addition to three attempts by post. Examples may be internet searches, electoral roll, appointing a tracing agency etc.

Once firms are satisfied that they have taken the reasonable steps detailed by the FCA or have obtained a waiver from the FCA, consideration can then be given to paying the balance to charity. Firms must have a full audit trail for each customer of the steps taken and retain details of the waiver.

Some firms may have a charity body or commission to refer the action to. This body could give a steer on the choice of charity. Best practice is to ensure charity is not an in-house charity but is fully independent.

This process should be documented in the prospectus and T&Cs and does not mean that firms are obliged to give money to charity, but they have the option. Many firms have limits over which they keep the money.

Firms may hold charity money within a client money account until a de-minimis amount is reached before paying over to the charity as long as it is clearly marked as such. This should be included within the firms processes and procedures.

In addition to taking and documenting reasonable steps, the FCA set out other requirements;

- the payment has to be permitted by law and consistent with the arrangements under which the client money or assets are held. This would include the firm checking that the product/client terms allowed such payment;
- the firm held the balance concerned for at least six years (client money) or twelve years (custody assets) following the last movement on the client's account (disregarding any payment or receipt of interest, charges or similar items); and
- the firm (or a member of its group) creates a unconditional undertaking 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. This undertaking has to be authorised by the firm's governing body (or by the governing body of the group member), be legally enforceable and retained indefinitely. This undertaking does not need to be in place for retail balances below £25 and for professional clients with balances below £100.

It should also be noted that:

- The firm should not benefit from payments to charity
- It must be a registered charity, and
- The firm must meet any charges.

Firms can pay away small balances or sums held in respect of uncashed and subsequently cancelled cheques in line with CASS 7.11.34 (2)(a) R if the client positively agrees. Retention of the client's positive agreement, whether in writing or via a phone call, is important to evidence this.

A firm may also give themselves the option to convert income shares to accumulation shares to reduce uncleared payments. This should also be document in the prospectus and T&Cs.

5.2 Legacy but Unclaimed Balances

Firms may have legacy product gone away balances which due to their historical nature are unable to satisfy all the CASS rules to enable them to pay away the balances to charity. In this scenario a number of firms have successfully applied to the FCA for a rule waiver to enable them to pay away the unclaimed assets / cash to charity. Feedback from firms seems to indicate this is a fairly quick process as long as you

can evidence you have tried to contact the client and the balances are sufficiently aged in line with the rules.

There is no regulatory requirement to take legacy balances from other firms if no details on the clients exist.

5.3 Gone Away Customer Management

By way of background, the FCA have previously referred to the term gone-away within the Life Insurance Sector. In 2016, the FCA published guidance in FG16/8: *Fair treatment of long-standing customers in the life insurance sector.* This sets out the FCA's expectation that providers "take effective action to locate and make contact with 'gone-away' customers" by, amongst other things, having a "coherent and documented strategy across their range of products" and by "establishing systems and controls to minimise proactively the number of new 'gone-away' customers".

Firms should have a set of principles or a policy on managing gone-away clients. This should be relevant and proportionate to the type of firm, e.g., a platform may have more detailed procedures than an asset manager due to the number of long-term client records on their books. A firm should have a clear definition of what constitutes a gone-away customer, which sets out when they would classify a client as such and a documented method for marking a customer record as gone-away.

When a gone-away is identified it is important to set a customer's record to gone-away to ensure that any future communications are supressed in order to reduce fraud and data protection risks.

The firm should also set out its approach to client identification which could include the use of external tracing firms. Some firms actively review accounts to identify gone away clients as opposed to just relying on returned post.

If a firm issues cheque as a method of client settlement, the policy should also cover the approach to uncashed cheques.

In order to achieve this there would need to be a process in place to try and contact the client to ask them to cash the cheque or whether they need a replacement to be issued.

Section Reviewed by CASS Best Practice Drafting Group February 2022

6. Delivery Versus Payment (DVP) - Transaction Exemption

6.1 Background

CASS 7.11.14 to CASS 7.11.24 and CASS 6.1.12 to CASS 6.1.12E set out the rules in relation to DVP exemptions from CASS 7 and CASS 6 respectively. There are two distinct exemptions:

- Commercial Settlement Systems (CASS 7.11.14 to CASS 7.11.20, and CASS 6.1.12 to CASS 6.1.12E); and
- Collective Investment Schemes (CASS 7.11.21 to CASS 7.11.24).

This section sets out best practice in relation to the first of these exemptions. The second is covered in the next section under 'Delivery Versus Payment (DVP) – Fund Manager's Exemption'.

6.2 Commercial Settlement Systems – Client Money

CASS 7.11.14 (1)R states the following in relation to the application of the exemption:

> Subject to CASS 7.11.14(2)R and CASS 7.11.16R 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 fulfilment 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 fulfilment of its delivery obligation to the firm.

* Further information on agreement of the relevant client is covered in 'Consent'.

The FCA does not provide a list of settlement systems which are deemed to be 'commercial settlement systems.' However, for firms operating within the UK these are generally accepted to be securities which settle on a DVP basis via CREST and Euroclear (other global commercial settlement systems may also fall into this category). As required under CASS 7.11.14(1)R and CASS 7.11.20R firms must ensure that the client consents to the use of the DVP exemption before it is used. One such way would be obtained through a firm's standard terms and conditions.

The application of the DVP exemption under CASS 7.11.14(1)R is conditional on a firm meeting the requirements of CASS 7.11.16R which are:

> 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 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.

Due to CASS 7.11.16R, firms must be a member or sponsored member of the commercial settlement system in order to apply this DVP exemption otherwise money must be treated as client money (CASS 7.11.17R). One benefit of the DVP exemption is that money can be received into and paid out of a non-client money bank account. A non-client money bank account can go overdrawn, or there may be intra-day funding gaps which allows for efficient settlement with market counterparties.

6.2.1 Client money protection requirements

The period of time that the DVP exemption can be applied is limited by CASS 7.11.14(2)R which states:

> 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 CASS 7.11.14(1)R, the firm must stop using that exemption for the transaction.

The three day window period for a purchase starts once the client has 'fulfilled its payment obligations to the firm' CASS 7.11.18(1)G. In other words, if a client has paid for a transaction late, then the three-day DvP window may extend beyond the original settlement date +3 business days.

In relation to a redemption, if firm has not transferred the cash received to the client by close of business on the third day then the firm is required under CASS 7.11.19(2) to 'pay the money received into a client money bank account promptly and in any event by close of business' on the following business day.

Finally, firms are required to treat cash received as client money once the DVP transaction has settled. Therefore, firms should have processes in place to ensure that money is appropriately segregated into a client money bank account on settlement date.

6.3 Commercial Settlement Systems – Assets

CASS 6.1.12(1)R states the following in relation to application of the exemption:

> 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 [CASS 6] 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 fulfilment 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 firm within one business day following the firm's fulfilment of its payment obligation to the client.

As is the case for the equivalent client money exemption, FCA does not provide a list of settlement systems which are deemed to be 'commercial settlement systems.' However, for firms operating within the UK these are generally accepted to be securities which settle on a DVP basis via CREST and Euroclear (other global commercial settlement systems may also fall into this category). As required under CASS 6.1.12(1)R and CASS 6.1.12ER firms must ensure that the client consents to the use of the DVP exemption before it is used. One such way would be obtained through a firm's standard terms and conditions.

The application of this DVP exemption under CASS 6.1.12(1)R is conditional on a firm meeting the following requirements:

> A firm cannot, in respect of a particular delivery versus payment transaction, make use of the exemption under CASS 6.1.12 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 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.

Due to CASS 6.1.12BR, firms must be a member or sponsored member of the commercial settlement system in order to apply this DVP exemption. One benefit of the DVP exemption is that assets do not have to be physically received by the firm before they are transferred out. Shortfalls can arise on custody accounts intraday, which helps facilitate settlement.

6.3.1 Client asset protection requirements

The period of time that the DVP exemption can be applied is limited by CASS 6.1.12(2)R which states:

> 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.

Where the conditions of CASS 6.1.12D(1)G have been met and the firm has not transferred the asset received to the client by close of business on the third day then the firm may, where the necessary permissions are in place, either:

- "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" (CASS 6.1.12(3)R).; or
- Transfer the assets to a CASS 6 environment where it will be appropriately segregated from assets held by the firm, until such time the transaction can be formally settled.

Where a firm chooses to segregate its own money under CASS 6.1.12 (3)R, it must ensure the money is segregated in accordance with CASS 7 and it must keep a record of the actions it has taken, including a description of the asset in question, the client(s) affected and the amount of money which was segregated to cover the value of the asset (CASS 6.1.12(5)R). The firm must assess the value of the amount segregated "as regularly as necessary" and amend the funding in the client money bank account as required, should the value of the underlying asset have changed (CASS 6.1.12AG).

Finally, in respect of a client's purchase, firms are required to treat assets received as custody assets under CASS 6 once the DVP transaction has settled. As noted in the previous section, in respect of a sale, firms are required to treat the money received as client money under CASS 7 once the DVP transaction has settled. Therefore, firms should have processes in place to ensure that assets / money are appropriately segregated on settlement date.

Alternatively, if the firm is unable to or chooses not to segregate its own money into a client money bank account in order to protect the asset in question, the asset will be subject to the custody rules (CASS 6.1.12CG).

6.3.2 Consent

In order to use the exemption, the firm must obtain written agreement from all investors concerned. This is often obtained from the investor by their acceptance of the firm's terms and conditions as part of the account opening process. Firms are expected to retain confirmation of the investor's agreement for as long as they use the exemption in respect of that investor.

Section Reviewed by CASS Best Practice Drafting Group April 2022

7. Delivery Versus Payment (DVP) – Fund Manager's Exemption

7.1 Background

CASS 7.11.14 to CASS 7.11.24 and CASS 6.1.12 to CASS 6.1.12E set out the rules in relation to DVP exemptions from CASS 7 and CASS 6 respectively. There are two distinct exemptions:

- Commercial Settlement Systems (CASS 7.11.14 to CASS 7.11.20, and CASS 6.1.12 to CASS 6.1.12E); and
- Collective Investment Schemes (CASS 7.11.21 to CASS 7.11.24).

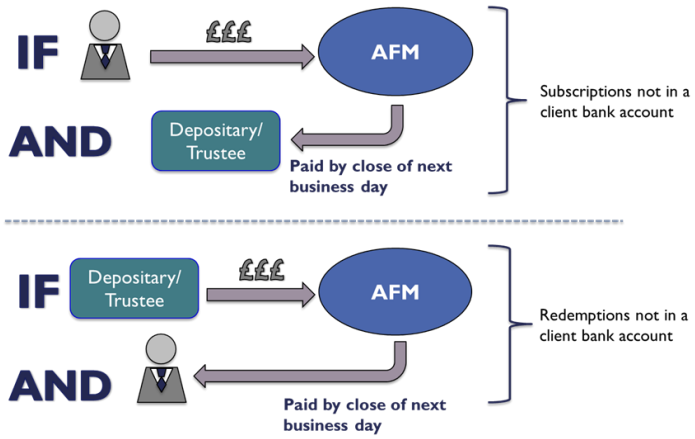
This section sets out best practice in relation to the second of these exemptions. The Commercial Settlement Systems exemption is covered in the previous section under 'Delivery Versus Payment (DVP) - Transaction Exemption'.

7.2 Collective Investment Schemes – the Fund Manager's Exemption

The exemption can be applied by an Authorised Fund Manager (AFM) of a regulated collective investment scheme, provided they obtain the written agreement of the client.

The DVP exemption applies to money which the AFM receives and holds, whether from the client or the depositary or trustee, in relation to DVP purchases or redemptions. It gives an AFM the ability to **not** treat the investor's money as client money, even if it is held up to close of business of the day following receipt. Any client money which has not been paid out (to the trustee/depositary or the client, as applicable) by this deadline must therefore be protected as client money in the normal way at close of business on the day following receipt.

The exemption can be summarised in the diagram below:



There are some timings which would mean that the deadlines above cannot be met. The timescales require the money to actually be paid from the firm's account, not just for the payment to be initiated. Therefore, the rule specifies that any payments made to clients by cheque must still be issued from a client

money bank account. Similarly, any money received from a client more than one day prior to the expected settlement date requires protection in a client bank account, as the deadline cannot be met in this situation. Any cheques received from clients should be banked directly into the client money bank account. Firms should ensure the cheque has cleared before removing it from the client money bank account for onward settlement. Firm's money can be used if clearance has not occurred. CASS7.11.21(2)(b) confirms that the AFM may move any such cleared money back to its corporate account in order to make any 'discharge of fiduciary duty' payments being effected on that same day. This rule imposes no obligation for such a payment discharging fiduciary duty to be delayed until any trustee or depositary settlement due on that day has been effected.

The exemption can be applied regardless of whether the AFM is acting as principal or as agent. The rule does not specifically reference the intended settlement date or due and payable date but is measured from the date the money is received by the AFM.

Settlement with the trustee or depositary will not necessarily coincide with the payment process implied by the wording in the rules, as the settlement may be a net creation when the investor is redeeming or vice versa. One client's redeemed assets (or a box position) may be used to settle another client's subscription. In practice it is accepted that the rule applies in relation to these types of settlements and does not require that a specific payment be traced through to the trustee or depositary for each individual transaction. Firms should therefore be prepared to evidence the overall process to explain how the transactions as a whole are settled on the intended date.

It should be noted that CASS does not specify whether the AFM can use the DVP exemption in respect of monies received on behalf of its client in relation to the cancellation of subscriptions. Therefore, AFM's must determine whether cancellation monies must be protected immediately as client money, which may depend upon whether the AFM is acting as agent or as principal.

Consideration should be given to scenarios where the monies do not reach the client or the depositary within the DvP exemption period, such as:

- Payment system failure
- Shares not priced
- Shares not settled

Special consideration should be given to the use of the DvP exemption in the case of fund mergers and closures. The firm should have a policy and associated procedures and controls in place to account for these scenarios.

7.3 Consent

In order to use the exemption AFMs must obtain written agreement from all investors concerned. This is often obtained from the investor by their acceptance of the firm's terms and conditions as part of the account opening process. Firms are expected to retain confirmation of the investor's agreement for as long as they use the exemption in respect of that investor.

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8. Banking Exemption

8.1 Introduction

The banking exemption applies to credit institutions and approved banks (collectively referred to as the 'banks') who have a UK deposit-taking licence, therefore regulated by the Prudential Regulation Authority, but also have FCA permissions to hold client money and/ or assets. As these firms are dual regulated, they are permitted to hold and receive cash derived from investment business in the client's own bank account as a bank, commonly referred to as the 'banking exemption', rather than as client money in accordance with chapter 7 of the Client Asset Sourcebook.

The following section of the Best Practice guide outlines the CASS 7 rules, within CASS7.10.16 to 7.10.24, with which dual regulated firms who make use of the banking exemption must comply.

8.2 Rules and application

The rules state that cash held by banks in connection with designated investment business is not client money. However, the FCA still requires banks to be able to account for all of the cash they hold for clients at all times. In line with the CASS 7 client money requirements, money derived from investment business which is received/held under the banking exemption should be allocated to the underlying client within 10 business days.

Like all exemptions, firms should use their CASS rule mapping to evidence which CASS 7 rules are not applicable. It is recommended that firms consider whether there are any bank accounts or transactions which fall within scope of the CASS 7 rules.

Client notification that money will be held as banker is required before providing designated investment business services. Per CASS 7.10.19R, clients must be advised that:

- The money held for that client is held by the firm as banker and not as a trustee under the client money rules; and
- If the firm fails, the client money distribution and transfer rules will not apply to these sums and so the client will not be entitled to share in any distribution under the client money distribution and transfer rules.

The FCA does not prescribe how this notification should be made but it is standard industry practice to include a statement in the bank's terms and conditions.

In CASS 7.10.20R, the FCA states that firms must explain to clients when money ceases to be held as banker but instead is held as trustee under the CASS 7 'client money' rules. One example is where client money is set aside to cover asset shortfalls, as explained further below at 8.3. Such circumstances decided on by a firm must be set out in the terms of business.

If firms have a mix of business activities with the client where the client money rules apply to some business activities but not others, this should therefore be clearly explained. In addition, where the client

money rules do not apply, and with that the associated protection of the Financial Services Compensation Scheme (FSCS), this must be clearly explained.

If firms have a number of legal entities where the exemption is applied, money should be held for clients of that entity in an account in that entity e.g., the money of clients of ABC plc should be held in a bank account in ABC plc not a bank account of XYZ plc held within the same banking group.

For example, firms should check that if they are using a bank for Transfer Agency services, that the banking exemption used by another entity within the group is not used by the entity supplying the service.

8.3 Asset Shortfall funding – CASS 6.6.54R

Banks that apply the banking exemption should consider the requirements under CASS 6 'custody assets' regarding shortfall funding. Where a firm has decided to protect clients following a shortfall in client assets held by segregating firm money rather than firm assets, then this cash must be held in a client bank account under the client money rules. Firms will therefore need to make sure that they have the appropriate FCA permissions to hold client money and comply with the full suite of CASS 7 rules for that money. As noted above, if client money is to be held in this way, it must be disclosed to clients in the terms of business.

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9. CASS 7 - Client Money Reconciliations

9.1 Client money record keeping and reconciliations

The Client Money rules (CASS 7.15.5) require each firm to maintain records to enable it to promptly determine the amount of client money it should be holding for each of its clients. This is consistent with Principle for Business 3 that "A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems" (CASS 7.12.2).

In addition, all allocated balances of client money must be capable of being analysed to the individual client level within 2 business days. (CASS 7.15.6 G), so that a firm can produce the "total amount of client money it should be holding for each client". This would include all of the relevant items in the client money reconciliations and calculations. Firms must therefore ensure that they are able to comply with this requirement in addition to integrating with any other data from within the firm. If not done as part of the reconciliation calculations, then firms should test the capability to meet this requirement at least annually as part of any system/process changes.

To achieve best practice in relation to recordkeeping, firms should aim to post all entries on the date they occur or else within one business day of their identification, as applicable. Firms are reminded that they must also keep policies and procedures sufficient to ensure compliance of the firm with the rules (CASS 7.15.8), including policies approved by the relevant governance bodies for:

- The frequency and method of reconciliation to be used;
- The resolution of reconciliation discrepancies; and
- The frequency of review of arrangements made under CASS 7.15.

The decisions on frequency and methodology should also reference the approach to be taken over bank holidays (both UK and overseas) and the currencies in which reconciliations and funding are to be performed, where either of these is applicable.

For each reconciliation, a firm must ensure that it records, (CASS 7.15.7):

- The date of the process;
- Actions the firm took in carrying out the process; and
- The outcome of the calculation of its client money requirements and resources.

The process must be transparent, and evidence must be kept that would be suitable for both auditors and regulators, giving a clear and understandable narrative and audit trail.

As a matter of best practice, firms should also keep records evidencing:

- The reasons for deciding what actions to take, based on the facts available at the time (particularly where there is any lack of clarity relating to the discrepancy);
- The root cause of each discrepancy and actions taken to address both the discrepancy and the cause to prevent re-occurrence as appropriate; and
- Oversight checks performed, in-house or on reconciliations prepared by a third party.

9.2 Internal client money reconciliation data cut-off

All reconciliations must be performed using records as they stand as at close of business on the previous business day. Internal client money reconciliations must use the firm's own books and records and not the records of a third party, such as its bank. The firm should not rely on its bank statements to create its books and records as part of the reconciliation process. There are however exceptions when it is not reasonable to expect that the data can be sourced from the internal records e.g., in the case of unpresented cheques where there is a reliance on the bank statement for confirmation of when cheques are presented/cleared. Items included in the reconciliation where there is reliance on external information should be documented in the firms processes and procedures.

It is best practice for firms to define what it considers 'close of business' to be, either by reference to a specific point in time or by references to processes which must be completed before cut-off (or a combination of the two). This provides clarity of the point at which the firm's books and records are to be closed and therefore the data which will be used in the internal reconciliations. It also provides a clear separation between the internal reconciliation and the external reconciliation, as it makes clear what the cut-off point is between them.

9.3 Methods of internal client money reconciliation

There are two standard methods of performing reconciliations in accordance with the CASS rules, these are:

- Individual Client Balance Method; and
- Net Negative Add-back Method.

Any method other than these, or a combination of standard methods within the same legal entity, is considered to be non-standard. Further detail on non-standard methods is provided below in Section 3.4.

The net negative method can only be used as a standard method by a CASS 7 Asset Management Firm or CASS 7 Loan-based Crowdfunding Firm (as defined in the FCA Glossary) and only by a firm that does not undertake any margined transactions for or on behalf of its client.

The net negative add back method gives provision to a fund manager to calculate the amount of client money that a firm should be holding in each of its client bank accounts, as per the internal accounting records, rather than each of its clients. It is therefore best practice to perform these reconciliations on a bank account by bank account basis. The reconciliations can be combined to give an overall requirement for the firm.

One of the key aims of the internal client money reconciliation is to compare the resource against the requirement to ensure the accuracy of the firm's books and records. It is essential that the firm should not rely entirely on external statements or external reconciliations in order to create these records. In the net negative add-back process described below, the firm's record of the client money held at bank is being used as the starting point in both cases. This process does not identify the individual clients to which the money belongs.

It is necessary, under CASS 7.16.18 G (1) that a firm utilising the net negative add back method of reconciliation must ensure that it can "promptly determine the total amount of client money it should be holding for each client (see CASS 7.15.5R (1))" The guidance attached to this rule, under CASS 7.15.6 G, as noted above, provides that a client by client total should be produced within 2 business days of being required, or deciding, to do so.

9.4 Non-standard Reconciliation Methods

A non-standard method of internal client money reconciliation can only be used following the rules set out in CASS 7.15.17-7.15.19.

A firm must use the same standard method across the whole of a single legal entity otherwise it is considered to be operating a non-standard method, even if it is using two different standard methods. (CASS 7.16.13 (4)).

Before using a non-standard method, the firm must:

- Document its reasons for concluding that the non-standard method will check that the firm's records of client money held will meet the firm's obligations to clients;
- Notify the FCA of its intention to use a non-standard method; and
- Send an independent auditor's written report stating its opinion of whether the method will achieve the above requirement.

Any material changes require the firm to re-perform the steps above.

Though the non-standard method of reconciliation is available to all firms, it should generally only be considered where it is not possible for the firm to utilise a standard method of reconciliation. The most frequently cited reason for using this method is where two standard methods of reconciliation are utilised, often where a range of products and associated business models are operated by a single legal entity.

A firm making the decision to adopt a non-standard method of reconciliation should take into account the increased cost of operating this method, reflecting the increased auditor costs and the greater regulatory scrutiny that operating this method often brings.

Due to the openness to interpretation of the outcomes noted as needing to be achieved, there is also the potential for regulatory/auditor expectations to evolve over time, with the potential for an auditor to refuse to re-approve a non-standard reconciliation. This can create significant difficulty for a firm, as it leaves then in breach of CASS until such time as they can enhance their non-standard reconciliation to satisfy these enhanced expectations, or make the changes required to adopt a standard method of reconciliation.

9.5 The Individual Client Balance Method

Firms using this method need to ensure that they maintain two different records, one being client by client and the other being bank account by bank account. While the same transaction may generate a posting to each of these records, the two must be kept separately and then reconciled. Analysing a single record in two different ways does not meet this requirement.

The individual client balance method can be performed across a whole legal entity or may be split by products or business lines. Reconciliation must be performed as at close of business on the previous business day.

The calculation of the client money requirements follows detailed provisions in CASS 7.16, which are not reproduced here. However, the following should be noted:

- The client money calculation must be performed client by client, not as a global figure.
- To meet best practice, the calculation should be set out so as to clearly reference the items included in the table in CASS 7.16.22 (2).
- It is also best practice to provide explanatory notes in relation to each of the possible adjustments set out in CASS 7.16, identifying which are potentially applicable to the firm, which are not and the reasons in each case.
- Any negative balance not included in the total should be a net negative figure i.e. the figure remaining after offsetting any positive balance for that client in that product/business line or across the legal entity, as applicable.
- Prudent segregation forms part of the client money requirement and should be included.
- There should, as best practice, be evidence of the consideration of all other potentially applicable items noted in CASS 7.16.25 as possible adjustments.
- The firm's record of client money held with third parties must also be included in the calculation of the client money requirement (CASS 7.16.27 (2)).
- Multi-currency reconciliations can give rise to penny roundings and these should be accounted for in the requirements.
- The total margined transaction requirement, if applicable, should be separately calculated and shown in the reconciliation, as set out in CASS 7.16.32.
- All figures in presented in as part of the reconciliation should be clearly labelled so that what they represent can be easily understood, not only by staff familiar with the process, but by external reviewers such as auditor, regulator or insolvency practitioner, e.g. the total balance or the movement from the previous calculation, as per the example shown overleaf:

Individual client balance calculation				
	Free *money* (sums held for a *client* free of sale or purchase (eg, see (3)(a)) and			A
	sale proceeds due to the *client*:			
	(a)	for principal deals when the *client* has delivered the *designated investments*; and		B
	(b)	for agency *deals*, when:		
		(i)	the sale proceeds have been received by the *firm* and the *client* has delivered the *designated investments*; or	C1
		(ii)	the *firm* holds the *designated investments* for the *client*; and	C2
	the cost of purchases:			
	(c)	for principal deals, paid for by the *client* when the *firm* has not delivered the *designated investments* to the client; and		D
	(d)	for agency *deals*, paid for by the *client* when:		
		(i)	the *firm* has not remitted the *money* to, or to the order of, the counterparty; or	E1
		(ii)	the *designated investments* have been received by the firm but have not been delivered to the *client*;	E2
Less				
	money owed by the *client* for unpaid purchases by, or for, the *client* if delivery of those *designated investments* has been made to the *client*; and			F
	proceeds remitted to the *client* for sales transactions by, or for, the *client* if the *client* has not delivered the *designated investments*.			G
Individual client balance 'X' = (A+B+C1+C2+D+E1+E2)-F-G				X

An illustrative layout for the Individual Client Balance Method reconciliation is shown overleaf.

9.6 Example Individual Client Balance Method:

(The following is illustrative only. Each firm needs to consider how best it meets the requirements in the context of its business.)

Client Money Requirement	Ref:	£ Amount
Client entitlement at entity level	**7.16.22 (2)**	6,320,365.96
Negative CM balances	**7.16.27 (3)**	0.00
	7.16.22 (2)	
Free money held for Clients	**A**	**6,320,365.96**
Sales proceeds due to the client for principal deals when the client has delivered the designated investments	**B**	-
Sales proceeds due to the client for agency deals when the sales proceeds have been received by the firm and the client has delivered the designated investments	**C1**	-
Sales proceeds due to the client for agency deals when the firm holds the designated investments for the client	**C2**	0.00
Cost of purchases for principal deals, paid for by the client when the firm has not delivered the designated investments to the client	**D**	-
Cost of purchases for agency deals, paid for by the client when the firm has not remitted the money to, or to the order of, the counterparty	**E1**	-
Cost of purchases for agency deals, paid for by the client when the designated investments have been received by the firm but have not been delivered to the client / Insured funds	**E2**	1,018,906.27
Less: Money owed by the client for unpaid purchases by, or for, the client if delivery of those designated investments has been made to the client	**F**	0.00
Less: Proceeds remitted to the client for sales transactions by, or for, the client if the client has not delivered the designated investments	**G**	-
Individual Client Balances 'X' = (A+B+C1+C2+D+E1+E2)-F-G		**7,339,272.23**

In the previous example a – means that the answer is not possible, for example if the firm is acting as principal then values for agency deals should not be possible. A zero means that the answer is possible but there is no value in the reconciliation today.

The calculation is confirmed in CASS 7.16.22E. Where steps of the calculation do not apply e.g. where the firm operates an agency model only, then technically parts of the calculation do not need to be completed and could be removed. We however strongly recommend that the full calculation be included in the reconciliation to evidence full consideration of each stage, or a simplified calculation be presented with the rationale for any removed steps fully documented within a supporting procedure (or equivalent).

Other requirements for calculating the client money requirement	**7.16.25**	
Unallocated & Unidentified Money	7.16.25 (1)	
Unallocated Client Receipts		1,172,126.20
Unidentified		656,893.20
Total Unallocated & Unidentified		1,829,019.40
Shortfalls in Assets	7.16.25 (2)	
Short position on Asset Reconciliation	6.6.54	15,921.26
CM Received as Cash, Cheques etc not yet deposited	7.16.25 (3)	
Cash Not deposited		
Unpresented Cheques	7.16.25 (4)	
Unpresented Cheque in Cheque Account		**173,744.22**
Total Unpresented Cheques		173,744.22
Non-margined Transactions	7.16.25 (5)	
Non-margined Transaction Account		
Other Items		
Money held on behalf of, or received from, affiliate Company	7.10.25	
Total Other items		0.00

Total Client Money Requirement		9,357,957.11
Client Money Resources		
CLIENT MONEY Banks Accounts:		
1- Deposit Account		5,352,765.29
2 - ISA Deposit Account		844,710.36
3 - Payment Control Account		5,015.80
Total Client Bank Accounts		6,202,491.45
Unallocated & Unidentified Money	7.16.25 (1)	
Unallocated Client Receipts		1,172,126.20
Unidentified		656,893.20
Total Unallocated & Unidentified		1,829,019.40
Shortfalls in Assets	7.16.25 (2)	
Short position on Asset Reconciliation	6.6.54	15,921.26
CM Received as Cash, Cheques etc not yet deposited	7.16.25 (3)	
Cash Not deposited		**0.00**
Unpresented Cheques	7.16.25 (4)	
Unpresented Cheque in Cheque Account		**173,744.22**
Total Unpresented Cheques		173,744.22
Other Items		
Money held on behalf of, or received from, affiliate Company	7.10.25	0.00
Total Other Items		0.00
Total Client Money Resource		8,221,176.33
Difference between client money required and client money held		
To be Funded (To be Removed from Funding)		1,136,780.78

The format will vary depending upon the requirements of the firm, e.g. the number of bank accounts.

In addition, how the firm does or does not do postings is key to understanding what has to be posted to each side of the reconciliation.

For example, assume that the Pru. Seg. Amount on the previous working day was £10k which has been posted to the ledger and funded. The Pru. Seg for today is £15k which has not been posted or funded yet. The internal client balance for the day is £100,000, (excluding Pru. Seg). The same as the previous day.

Internal Reconciliation			External Reconciliation	
Requirement	£K		Resources	£K
Client Balances	100,000		Bank per Ledger	110,000
Total Pru. Seg.	15,000		Movement in Pru. Seg.	5,000
	115,000			115,000
Resources			External	
Bank per Ledger	110,000		Bank per statement	110,000
Movement in Pru. Seg.	5,000			
	115,000			110,000
Funding	0		Funding	5,000

The internal reconciliation shows the new Total Pru Seg as the requirement, whereas the resources shows the movement in the Pru Seg from the previous day. This is because the previous total has already been paid into the bank account and is therefore part of the existing Bank per Ledger figure.

The external reconciliation uses the same resources figure as the internal reconciliation, compared to the bank account and shows that an additional funding of £5k is required. This is what would be expected as the Pru Seg has gone up by £5k.

9.7 The Net Negative Add-Back Method

The net negative add-back reconciliations can be performed bank account by bank account, as opposed to across the legal entity or per product or business line. (CASS 7.16.19).

CASS 7.16.17 R (1) states the starting point for the requirement when using the net negative add-back method must be 'the amount which the firm's internal records show as held in that account'. As this figure must come from an internal source, this can be reflected by using the cashbook or ledger figure in the firm's books as at the close of business on the previous business day.

An offset of any negative net amount per client, in that bank account record, should then be taken into account as per 7.16.17 R (2) as part of the requirement calculation. This should represent the value of ALL clients in a net negative position at the close of business, not just clients relating to the specific day's transactions. Net negative balances may arise, for example, when a firm's cheque bounces after a purchase has settled and the client has no other money to settle its trade. The net negative should be the figure remaining after offsetting any positive balances for that client in that bank account, according to the firm's records. Positive balances held for that client in another bank account do not form part of this calculation.

To meet best practice in evidencing any other adjustments required, the following should be noted:

- There should be a clear record of the items requiring funding movements (in or out) which makes it clear what the balances are as at the current date, rather than only showing movements since the previous reconciliation, with an audit trail.
- Prudent segregation forms part of the client money requirement and should be included, where not already incorporated as part of the postings to that bank account record. Where possible this should be separately identified or at least clearly identifiable, so it can be checked back to the prudent segregation records.
- There should be evidence of the consideration of all other potentially applicable items noted in CASS 7.16.25 as possible adjustments.

An example of the layout for the Net Negative Add-Back Method reconciliation is shown overleaf.

The following example is illustrative only. Firms should define an approach and format appropriate to their business:

	Net Negative Add-Back Example		
	As at :	02-Jan-18	
	Reconciled on:	03-Jan-18	
	Requirement:	**£**	
	Bank Balance per Firm's Books	151,000.00	
plus	Net Negative Add Back	10,300.85	
minus	Previously Funded Balances	5,000.00	
plus	Unidentified Client Money	0.00	
plus	Unallocated Client Money	0.00	
plus	Prudent Segregation	0.00	
plus	Safe Custody Shortfall	0.00	
plus	Uncleared Payments	251,842.38	
	Total Requirement:	408,143.23	
	Resource:		
	Bank Balance per Firm's Books	151,000.00	
plus	Unidentified Client Money	0.00	
plus	Unallocated Client Money	0.00	
plus	Prudent Segregation	0.00	
plus	Safe Custody Shortfall	0.00	
plus	Uncleared Payments	251,842.38	
	Total Resource:	402,842.38	
	Requirement minus Resource	- 5,300.85	Shortfall to be considered for funding
	Completed By:		
	Checked By:		

Note: As above the method of adding say pru-seg to the balance will depend upon what has been previously posted and paid into the bank account.

9.8 External Client Money Reconciliations

An external client money reconciliation compares the client money resource calculated as part of the internal client money reconciliation with the client money balance confirmed as held at a third party. This should include banks but also custodians or other third parties holding money as client money i.e. not under the banking of DVP transaction or fund managers' exemption. Reconciliation to others holding money under exemptions are still required – the difference is that these will not be client money reconciliations.

Firms may choose the frequency with which external reconciliations are performed, subject to these being at least monthly and 'as regularly as is necessary', given the features of the business undertaken. However, guidance makes it clear (CASS 7.15.25 G) that a daily frequency is expected where there are daily transactions. A policy decision must record the frequency selected and the reasons for this. Any frequency other than daily should be exceptional and requires robust justification plus review at least annually.

Notwithstanding the efforts that are made by many firms to maintain up-to-date records, there will usually be some items identified by the external client money reconciliation which are not in the firm's books. It is essential to ensure that the agreed cut-off for recordkeeping is strictly observed (which should be the same for the external reconciliation as for the internal) and that the internal records and reconciliation are not then updated after cut-off, based on the external reconciliation.

It is important to make a clear distinction between discrepancies which arise due to a timing difference in updating the firm's records versus differences which arise because the event or transaction has actually taken place at a different time. An example of the former would be where bank data is being received from an overseas bank whose systems have not updated on an overnight run at the point the data cut is taken. An example of the latter would be a firm having updated its records to show the assumed receipt of a dividend where the cash has not actually been received. In the former case, no funding movement is required provided the transactions agree. In the latter, funding may be required if the firm is responsible for the non-receipt or payment of dividends is on a contractual basis to their clients.

Not all non-timing discrepancies will lead to a funding movement, for example any difference arising due to unpresented cheques, where the bank records have not yet been updated although the cheque has been issued, but there is no excess to be withdrawn as the protection is still required for the clients.

9.9 Client Money Reconciliation Controls and Analysis

For all methods of reconciliation, best practice is for firms to include controls in the reconciliation which cross check figures between those in the reconciliation and figures, separately sourced where possible, which confirm the accuracy of those figures. For example, checks may be made which confirm that the total client balances minus the net negatives agrees to a separately calculated total of all positive client balances.

Firms must ensure that they understand the daily movements in their client money resource and requirement balances and put in place appropriate oversight controls to identify where further investigation is required.

In particular, where spreadsheets are used for the reconciliation processes, all controls and risks should be considered to mitigate the risks of this methodology. These controls should include validation of cells to ensure, for example, that figures which ought always to be negative are always entered as a negative. Controls should also ensure that all data required has been included in the reconciliation. There should be methods of protecting formulae in reconciliations to ensure these are not changed or corrupted. Once finalised, reconciliations should be stored or saved in such a way as to prevent any alteration and to prove that this is the case.
In addition, analysis of the funding requirements should be undertaken as part of the reconciliation, totalling this by type of funding and whether appearing in the internal or external reconciliation. This should validate the funding total, when calculated, and also provide data which can be readily incorporated

into MI for the purpose of addressing root causes and confirming that the prudent segregation provided is sufficient in amount and type to cover the risks identified.

9.10 Funding Decisions

Any funding movement should be made after considering both the internal reconciliation and the external reconciliation discrepancies together, since one may offset another. It should be remembered that, regardless of accuracy of the records and position, no client money account may be left in an overdrawn position. The funding movement should be checked against the analysis of causes to ensure it is the correct figure.

Funding may be provided in a currency other than that in which the reconciliation is or money is owed to the clients, but only if converted to the other currency at the previous day's closing exchange rate and then updated to the latest rate each day.

The funding movement should be the net movement between the previous business day's position and today's requirement. Gross movements should be avoided, since this could mean the firm has created a temporary shortfall, which is never permitted, even intra-day. However, this can depend upon what is being calculated new total funding or movement and how postings have been made for previous funding. The approach and rationale should be documented in the firms' policies and procedures.

Where, for an external reconciliation, the facts are still under investigation and it is not clear which of two figures is correct, the firm is required to assume that the higher figure in favour of the client is correct and protect accordingly. It may subsequently transpire that the lower figure was correct, but the original provision will still be compliant, as made per CASS 7.15.32. Firms should record the basis for the decision, to ensure clarity on this point.

Best practice is to be able to demonstrate why the funding requirement has arisen. Unless there is a documented reason related to the business model as to why it is not practicable, then the funding requirement should be understood to the nearest 1p.

If the reconciliation is being performed in a different currency to the bank account, then the firm should demonstrate it has understood and considered the currency risk between the asset and liabilities in each currency.

9.11 Client Money Reconciliation Discrepancies

Client money discrepancies can be divided into two categories:

- Cash discrepancies;
- Record Keeping discrepancies.

To take each in turn:

- ***Cash discrepancies***

Cash discrepancies occur as a result of a shortfall or excess within the client money account. This could be the result of a processing error, or an event occurring such as a bank charge or a value that has been paid from an external source incorrectly.

When a discrepancy is identified by the internal client money reconciliation (CASS 7.15.29R) the rules require a firm to fund a shortfall with the firm's own money, or remove any excess to a non-client money account, by close of business on the day the reconciliation is performed.

When a discrepancy is identified by the external client money reconciliation (CASS 7.15.31R) the rules require that, unless the discrepancy arises solely as a result of timing differences, a firm takes all reasonable steps to correct it without undue delay. While a firm is unable to immediately resolve a discrepancy which indicates a shortfall in the bank account identified by an external client money reconciliation (CASS 7.15.32R), the firm must, until the matter is finally resolved, pay its own money into a relevant account.

A shortfall or an excess may not be considered a breach of the client money reconciliation requirements, dependent upon its cause, providing the discrepancy is corrected within the prescribed timescales.

- ***Record keeping discrepancies***

Record keeping errors occur where a firm's books and records do not accurately reflect the values of the client money requiring to be protected, other than as a consequence of the timing differences allowed for under 7.15.32. This will ultimately lead to an incorrect client money requirement and misleading individual client balances. This might occur where a firm relies on journals to process entries through their books and records.

In keeping with rule 7.15.3 R which states that a firm must 'ensure' accurate records, record keeping errors may indicate a breach, which should be recorded and, if material, may need to be immediately reported. In addition, the immediate notification of the breaches set out in CASS 7.15.33 must be borne in mind.

It is important to consider the relative numbers and causes of any errors, particularly if a firm processes a large volume of journals.

- ***Details of Correction***

In cases involving either cash or record keeping errors, it is vital that firms record for each error what has happened, why the error occurred, what actions have been taken to correct the error and what has been done to avoid a future repetition. The client position should always be rectified as soon as possible and not wait for system or other corrections if that will take some time.

9.12 Client Money Identification

There are three categories that relate to all discrepancies which are particularly important for CMAR purposes. It is vital that firms can place items within their books and records into one of the following:

- ***Unidentified***

The firm cannot identify whether the money is client money or firm's money. Wherever it arises, the firm must ensure this amount is protected in a client money account and then investigate within reasonable timeframes, to determine whether or not it is client money. It must then either be allocated or removed from client money and repaid, as appropriate.

- ***Unallocated***

An amount has been received correctly but cannot be allocated to specific clients. An example would be a bulk distribution payment that has been received early. Allocation must take place within 10 business days, in accordance with CASS 7.13.36(1). Best practice is to have an agreed point at which the funds are returned if they cannot be allocated.

- ***Allocated***

An amount that has been received and has been clearly narrated in the firm's books and records as belonging to a specific client. This could include allocation within a firm's system, depending on how client money is held.

9.13 Client Money Reconciliations Governance and Management Information

Client money reconciliations are a core part of achieving and evidencing compliance with the CASS rules overall and a good control environment. Firms must therefore evidence robust governance and oversight of client money reconciliations, whether these are performed within the firm, by another group company or by an external provider. Documentation should include:

- Policies, as outlined in previous sections, setting out the frequency, methodology and other 'in principle' decisions made in relation to the firm's approach to reconciliations;
- Decisions on the cut-off points for record-keeping, which define the close of business point at which data for the reconciliations is to be based;
- Policies on the resolution of discrepancies, including the root causes of discrepancies which have arisen as a result of segregation differences in the internal reconciliation; and
- High quality and well maintaining policies and procedures

Reconciliations oversight should be performed regularly. The frequency and level of detail of the checks to be made should be defined in conjunction with an assessment of the risks and complexities of the processes involved. All oversight checks and their outcomes, including any escalation and corrective actions, should be clearly evidenced in a way which facilitates the gathering of information on trends as well as supporting the reasonable assurance audit work.

The firm should have a comprehensive escalation and oversight process for example for items over X days old, Y in value, or certain transaction types, these values being set in accordance with the business model.

Individuals performing oversight, including second and third lines of defence, should be appropriately knowledgeable, with appropriate training.

Trends and analysis of discrepancies and their root causes and other relevant management information should be reviewed and assessed by appropriate governance bodies. There should be evidence of engagement and challenge of the information by those bodies, together with an audit trail showing that agreed actions have been carried out with an appropriate priority.

Section Reviewed by CASS Best Practice Drafting Group July 2022

10. Internal System Evaluation Method (ISEM)

10.1 Requirements

The ISEM must be applied where the client specific and aggregate level holding are not maintained independently of one another, or where there is only one record rather than two. Firms should look in detail at their systems to establish details of their record keeping.

As the data source for the information is not independently maintained in two separate records, the firm must be able to detect weakness in systems and controls to ensure that the transactional information is being input and maintained correctly to ensure no errors occur on client level holdings and at the aggregate level.

A firm must adopt one method of internal custody record check across its operations. The use of a combination of the Internal Custody Reconciliation and ISEM is explicitly prohibited (CASS 6.6.13R). Where a firm decides to transition from one method to the other, it must continue to perform its checks using a single method until such time as it can transition to the new method for all custody assets held across the legal entity. It should also be noted that a firm eligible to use the Internal Custody Reconciliation method can still choose to adopt the ISEM. This is a decision often made by eligible firms as proving the independence of both records used in the reconciliation can be challenging and time consuming.

It is critical that the firm, who as the regulated entity ultimately own the process, must ensure they have an appropriate level of understanding and oversight in place, particularly if a third-party administrator has been engaged.

As per 6.6.19 R, 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 6.6.4R; and

(ii) readily determine the total of all the safe custody assets that the firm holds for its clients; and

(b) whether the firm's systems and controls correctly identify and resolve all discrepancies in its internal records and accounts of safe custody assets held by the firm for clients;

(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.

The checks performed by the firm in order to meet the requirements of the ISEM may take place daily, weekly or monthly as appropriate to that particular check. However, the overall evaluation of the outcome of these checks, constituting the formal evaluation required by the CASS rules, should be consolidated, and

evaluated by the SMF/CP at least monthly. This formal evaluation should be clearly evidenced, and the outcome and subsequent actions documented.

The evaluation should ensure that the firm meets the requirements of 6.6.19 R, there are a number of steps that can be taken to provide the assurances to auditors and the regulator that the ISEM process they employ is robust, credible and accurate. In each case, evidence is required, to prove that the controls and processes are working so as to provide assurance as to the completeness and accuracy of asset records.

Where a breach has occurred consideration should be given as to whether or not the ISEM needs to be updated and any additional controls/ reports to eliminate or mitigate the error.

10.2 Documentation

- ***Overview of firm's process***

Firms should consider producing an over-arching document detailing how the control check is completed along with the controls around the process. This would also reference any supporting documentation and governance to provide auditors with a consolidated view of the ISEM process. This documentation can then be used to identify the key controls, the evidence of which will need to be evaluated as part of the ISEM.

The ISEM and this over-arching document should at a minimum be reviewed annually and trigger points for more frequent reviews agreed e.g. new product launch, retirement of an old product, automation of controls etc...

As part of this review, the firm should consider opportunities to improve the ISEM process. ISEM's develop organically over time, with small incremental changes often made as process or compliance issues are identified. These changes, though well intentioned and essential, can create inefficiencies and even reduced effectiveness linked to increasing complexity. Opportunities to redesign to ISEM to reflect changes in requirements should be explored.

- ***Evaluation of Outputs***

    - ***Risk Assessment***

    A detailed formal risk assessment of the ISEM process, including the control check and surrounding documentation would help provide confidence to both internal governance and external auditors that the system and reporting used by the firm is robust and fit for purpose.

    The risk assessment should assist firms in identifying any further mitigations required and in further defining the key items to be evaluated as part of the ISEM.

    - ***Process Maps***

Firms may also consider producing process maps detailing each step taken (both systemically and manually) from the arrival of the client's application form to the completion of the internal control check. By producing this map, it allows firms to work through the entire process and identify any confirmed gaps in controls.

This will then ensure that any issues are documented and remediated. Evidence of this may also form part of the ISEM.

- ***Operational Controls***

Details around operational controls would supplement procedures by detailing end of day tasks, sample checking of daily entries and any checklists uses to ensure all tasks have been completed. This could include queue monitoring and reviewing negative balance reports. Confirmation that all key controls remain relevant should form part of the attestation sent by the accountable individual of the controls to the CASS Oversight Manager (COM) each month as evidence that the firm's control framework remains robust.

- ***Attestations***

It is a recommendation that the COM request from all accountable individuals that contribute the firm's CASS processes to attest each month, in line with frequency of the firm's ISEM, that all procedures and controls are up to date and functioning correctly.

- ***Complaints***

A review of any complaints should take place each month to ascertain if any of them had a CASS 6 potential or actual impact.

- ***Risk Events/Near Misses***

A review of any risk events should take place each month to ascertain if any of them had a CASS 6 potential or actual impact.

- ***Breaches/Incidents***

A review of any breaches or incidents should take place each month to ascertain if any of them had a CASS 6 potential or actual impact.

- ***Negative Balances***

Firms should review regularly if any clients have had negative balances (assets and /or cash) within the period and ascertain the reasoning should they occur. This must also include regular reviews of business scenarios that could potentially take clients negative.

- ***Systems and IT Access***

This should be viewed at 2 levels:

- The access of individuals who perform functions (input and verification); and
- The access of IT staff who could potentially amend records.

Controls around individual access and system security (in particular standing data controls) must be clearly defined within a firm's policies and operating procedures. Evidence will be required to show that these controls have been effectively applied.

Where IT amendments are made to client asset records, they must be clearly documented and identifiable in any corresponding reconciliation.

- ***Systems and IT Testing***

Firms could consider creating and carrying out a series of business scenarios to establish whether the core system could move into a negative position. This would then allow the firm to identify these in procedures and either generate a system change or introduce appropriate controls to ensure processors do not allow this to happen. The firm must not assume it can never happen.

Details of this approach, including results and mitigating actions, should be documented within the firm's risk approach. Evidence of the performance and results of such testing should be included in the Internal Systems Evaluation.

- ***System Changes***

Any system changes that are carried out during the course of a year to processes that will ultimately impact custody assets must have sufficient regression testing completed (which should also include the test scenarios described above). Effective change planning and CASS compliance technical reviews are essential steps to providing assurance of ongoing compliance. There is also an increasing expectation that the COM sign off of any change being delivered that affects CASS applicable operations.

Details of such testing must be included in the formal project documentation and can be made available to auditors to prove out system reliability.

Where any changes to the system are in progress or have taken place within the evaluation period, evidence showing these elements should be considered as part of that evaluation.

10.3 Governance

Evidence of strong governance within each firm is vital to add credibility to processes and supporting documentation. To that end, all of the subjects covered above (if used) should be documented and ratified by the firm's appropriate body. This should include the results of the evaluation process and any actions being tracked by the business.

It would be preferable for a firm to delegate the responsibility of ratification to a CASS governing body or equivalent. Providing this has senior representation from the key areas within the business such as Risk and Compliance, it will ensure that the documents presented to it to review the ISEM process get approval from a group with the appropriate knowledge and experience. The final assessment and sign off of the ISEM evaluation should be performed by the COM.

Any meetings of this body must have supporting minutes to provide assurance to the regulator and auditors that the firm has robust governance around the ISEM process and can react and influence the key areas within the business when issues arise.

Section Reviewed by CASS Best Practice Drafting Group July 2022

11. Trade vs Settlement

11.1 Reconciliation of CASS 6 Assets on a 'Held' Basis

CASS 6 rules relate to the assets which a Firm holds for its clients (or ought to hold for those clients). The Firms books and records must be accurate and correspond "…*to the safe custody assets held for clients*…" (CASS 6.6.3R) and "…*enable it at any time and without delay to distinguish safe custody assets held for one client from safe custody assets held for any other client*…" (CASS 6.6.2R).

In respect of the external custody reconciliation, CASS 6.6.34R requires the firm to conduct regular: "…*reconciliations between its internal records and accounts of safe custody assets held by the firm for its clients and those of any third parties by whom those safe custody assets are held*."

11.2 "Traded" vs "Settled"

There has been recent discussion about the use of 'Traded' positions when completing CASS 6 reconciliations, and whether such an approach can be compliant.

Note that COBS 16.4.2R requires a non-MiFID firm that holds client money or safe custody assets on behalf of a client to provide an periodic statement containing: "…*details of all the designated investments or client money held by the firm for the client*…" – yet COBS 16.4.3R grants some flexibility over how "held" might be interpreted: "*In cases where the portfolio of a client includes the proceeds of one or more unsettled transactions, the information in a statement provided under this section 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*." Similar wording is contained within COBS 16A.5.1EU(f) in respect of MiFID Firms.

Therefore, while COBS allows a firm to choose the basis of its client reporting, CASS does not include wording to allow a firm to make a similar choice in respect of its reconciliations. Rather, CASS 6.6.42G confirms a slightly different concept – stating that: "…*a reconciliation of transactions involving safe custody assets, rather than of the safe custody assets themselves, will not satisfy the requirements under CASS 6.6.34R*".

It is important for a firm to recognise that, where a client asset has been sold, the firm remains responsible for holding that asset until it is delivered on the market, and the firm will not receive the cash proceeds of the sale until the actual settlement date.

11.3 "Held" or "Ought to be Held"?

CASS 6.6.34R talks of reconciling the firm's record of assets held against the records of the external party holding those assets. However, CASS 6.6.48G notes that reconciliation discrepancies are resolved only once the firm: "…*is holding (under the custody rules) each of the sale custody assets that the firm ought to be holding for each of its clients*…" and that its internal records correspond.

Therefore, the starting point for the reconciliation should be an extract from the firm's internal records confirming what assets ought to be held for its clients. This distinction highlights the importance of the firm recognising whether it is giving contractual settlement to its clients, or whether it will only consider it ought to be holding a given asset from the date of actual settlement. The firm should therefore consider

how best to extract such a 'held' position from its records – a process which may involve deriving the position, depending on how its records are structured.

Significant care is required when dealing with contractual settlement. Banks generally have a clause in the contract which allows them to reverse the contractual settlement if actual settlement has not happened within a defined time period. In addition, in reality it may be impossible to deliver stock, if not available. See attempted takeover of Volkswagen by Porsche in 2008. Hedge funds went into liquidation when short selling the VW stock, which could not subsequently be bought in the market due to insufficient stock in the whole market.

11.4 Beneficial Ownership across Asset Types

Another important point that the firm must consider when establishing its view on what constitutes an asset which the firm ought to be holding is the point at which legal title / registered ownership is updated within the custody chain, and whether such ownership remains conditional.

To use an authorised collective investment scheme as an example, beneficial ownership of units is updated on the fund's register on trade date. Consider a firm buying units for its clients: review of the fund's register will show that the fund units are "held" by the firm, even if that ownership remains conditional upon the firm paying the purchase proceeds to the Authorised Fund Manager. Similarly, a firm's holding will be reduced on the register from trade date – even though cash settlement might not be paid for a number of days.

A firm should therefore consider market practice for each type of asset it supports and document its policy for determining what ought to be held for each type of asset on any given date – and be ready to explain this to its auditor. For example, in the situation where a Corporate Action is in hand, the firm should set out its internal view as to when the original asset will no longer be viewed as held for the client, and when any resulting new holding ought to be held for the client.

11.5 External Information

The firm must recognise that the external party holding assets on its behalf (including, for this purpose, the AFM of a CIS confirming the units/ shares registered to the firm) might provide the firm with a traded position statement – supported by the flexibility in COBS 16 and 16A (noted earlier).

The firm's reconciliation process may therefore need to compare the firm's derived held position against a traded position received from a third party. FCA has noted that firms should seek to obtain a "held" position from third parties, though TISA has noted that different AFMs may take differing views of what would constitute "held" positions – such that the CASS 6 firm must be able to make a decision about how to complete its reconciliation and recognise where any apparent discrepancies in fact simply reflect that the third party is providing a "traded" position.

For example, the firm's policy might state that where an external party is known to only provide a Traded Position of assets the Firm could account for any pending trades within the reconciliation in order to derive a held equivalent of the external record. If a firm was to take this approach, care should be taken to ensure that there is a clear audit trail back to the external positions provided, as the Rules expect the external

statement records to be used for the purposes of the reconciliation. Again, the firm's policy should make clear what actions would be taken and in what scenarios.

11.6 Corporate Actions

Another specific consideration relates to corporate actions. The firm's written policy should make clear the point at which it considers any given type of corporate action should best be reflected in its books and records as an asset which *ought to be held*. In some cases the firm might conclude that the asset ought to be available with effect from a specified date, and may update its internal records accordingly (thereby recognising any shortfall if the external party has not yet provided that asset as being available). In other cases, the firm might not know of any specific date on which the asset ought to become available (for example, if it is awaiting the receipt of a physical share certificate having materialised a holding previously held by their custodian) and will therefore reflect the action as a pending item until its custodian confirms that the action has been completed. Operational business-as-usual processes should then recognise this information and cause the firm to update its records, and any reconciliation discrepancy arising in the meantime should be recognised as such and managed according to the firm's policy for discrepancy management.

As with all aspects of this subject, the firm must determine how best to determine what assets ought to be held for its clients on any given date and should maintain its books and records so that such a position can be recognised without delay and reconciled accordingly. The firm's policy should clarify that its "Held" reconciliation is achieved by comparing this internal view of what ought to be held against the corresponding external record (being either a "held" position provided by that third party, or a position derived by the firm as a "held" position in the light of a traded position being provided by the third party concerned).

11.7 Summary

Although in the past many firms have produced asset reconciliations on a traded basis, the FCA has made it clear that they expect reconciliations to be on a settled basis. The firm therefore must consider what basis the data from third parties is on and make any adjustments required to make them on a settled basis.

The reconciliation must consider the policies mentioned above, however, they do not alter the principle that the FCA has stated. It is likely that any reconciliation not on the settled basis may be considered to be a breach by external auditors.

Section Reviewed by CASS Best Practice Drafting Group July 2022

12. Shortfalls and Transactions

12.1 Funding of Custody Asset Shortfalls

Firms are required to take appropriate steps to resolve discrepancies identified in its custody asset reconciliations without undue delay. Whilst the discrepancy remains unresolved, the firm must consider what appropriate steps are required to mitigate the risk to clients, which may include the firm covering any identified custody asset shortfall itself. A firm may cover the shortfall using its own assets, or by holding a cash equivalent sum in its client money accounts.

Examples of asset shortfalls would include:

- Purchasing of an incorrect asset if considered a custody break requiring funding
- Failed Trades – only where the firm has contractually settled on the client's side
- Duplicate transfer out or sale

Where it has been established that the firm is not responsible for the discrepancy and there is sufficient evidence to support this conclusion (the firm must be able to prove they are not responsible; not just believe they are not), then it is not mandatory for shortfalls to be covered. Firms should establish what is considered to be evidence in this regard and document the approach in an appropriate policy. Although as per 6.6.54R(3), the firm should consider if it would still be appropriate to cover the shortfall.

Consideration of responsibility for shortfalls must take into account timing differences, particularly where there is a delay in updating internal records. The firm is also required to keep the position under constant review, as until the discrepancy is resolved the firm must consider whether it would be appropriate to start funding the shortfall and also consider notifying the affected client(s) of the situation. It is therefore advisable for firms to establish a process for reviewing the circumstances and where there is a delay to resolving the discrepancy, reconsider funding. One approach to this would be to establish timeframes for what a firm would view as an undue delay to resolving the discrepancy and apply funding after that date. Firms should also consider when a provision should/can be released. Any approach the firm takes should be documented in an appropriate policy**.**

12.2 Impact on Client Money Reconciliations and CMAR

When funding a shortfall using the firm's own cash, firms should represent the amount funded in both the resource and requirement. The amount funded should have a record backing it up with reference to the underlying clients that the funding relates to. The method and detail of this record will depend on the individual firm's processes.

As a result of funding using firm's cash it will potentially have an effect on the CMAR. An element of double counting will arise as the asset position and cash position recorded per the CMAR is the amount per the firm's records. This must be clearly documented in the firm's documentation as back up to the CMAR.

12.3 Use of Firm's Own Assets

In order to deal with shortfalls, firms can, as per CASS 6.2.5R hold a small balance of assets for operational purposes, providing they are clearly identified separately from the client's safe custody assets within the firm's records.

Clear guidance is provided in respect of the scenarios where these assets can be used under CASS 6.2.6G.

Where a firm uses its own assets to make good the shortfall, it must ensure that it uses an applicable asset or the equivalent value of a different asset to cover the shortfall, update the books and records in a manner that clearly identifies the asset(s) as belonging to the client and ensuring this is reversed when the discrepancy has been corrected.

12.4 Use of Firm's Own Money

When covering a shortfall using a firm's own money or an asset different to that in which the shortfall arose, a firm will have to revisit the valuation each day to ensure it is segregating the right amount of client money or assets. Any adjustments should then be made to ensure the cash held continually reflects the value of the asset, allowing for both stock price and currency movements. A consistent method for calculating the value should be applied and documented accordingly.

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13. Temporary Handling

13.1 Introduction

It is recommended that Firms carefully assess how and when temporary handling rules can be applied and has an appropriate policy. The guidance rules should not be relied upon to provide an exemption for the majority of transactions undertaken for clients where a firm is responsible for safeguarding and administering those assets under CASS 6.

The exemptions in CASS 6.1.16B R to CASS 6.1.16D G do not apply to a MiFID investment firm which holds financial instruments belonging to a client in the course of MiFID business.

This section has not been written to cover all of the situations where the temporary handling rules could apply.

13.2 Temporary handling of safe custody assets – key requirements of CASS 6.1.15G:

The key elements of the guidance requirements under CASS 6 'custody assets' are summarised below:

- A firm should temporarily handle a safe custody asset for no longer than is reasonably necessary;
- Reasonably necessary is deemed to be 'no longer than one business day', but it may be longer or shorter depending upon the transaction in question;
- In the unlikely event that safe custody assets are in bearer form, the firm is expected to handle them for less than one business day;
- When applying the temporary handling rules a firm is reminded that it is still obliged to comply with Principle 10 (Clients' assets).

13.3 Recordkeeping guidance requirements when applying the temporary handling rules CASS 6.1.16G:

CASS 6.1.16G states:

When a firm temporarily handles a safe custody asset, in order to comply with its obligation to act in accordance with Principle 10 (Clients' assets), the following are guides to good practice:

- *a firm should keep the safe custody asset secure, record it as belonging to that client, and forward it to the client or in accordance with the client's instructions as soon as practicable after receiving it; and*

- *(2) a firm should make and retain a record of the fact that the firm has handled that safe custody asset and of the details of the client concerned and of any action the firm has taken.*

13.4 Practical guidance on applying these guidance rules

Due to the nature of these rules it is recommended that firms have a policy in place which states how the firm applies the rules and guidance to its particular business model and transactions, and provides guidance to employees about how these rules can be applied in practice e.g. what is a 'secure location'. A few examples of points to consider within a temporary handling policy are provided below. These scenarios typically arise where you are providing safeguarding and administering to retail clients and may not be relevant to every type of financial services firm:

(i) Physical assets received from a potential client – whilst it is preferrable that physical assets are only received from clients who have completed all of the necessary paperwork or AML checks this may not always be possible. Firm's should consider whether the holding of physical assets for pending or potential clients falls into the category of temporary handling;

(ii) Reasonably necessary – the guidance rules state that this is typically no longer than one business day. However, this isn't practical in the majority of scenarios under 1 above. Firms should consider defining the 'reasonable period necessary' for each scenario, therefore setting a standard timeframe where the rules can be applied in practice e.g. 10 business days;

(iii) Interaction with front office/ investment managers – similarly to client money cheques, the first point of contact with physical share certificates is typically with the front office or client relationship contact. It is recommended that firms have clear guidance on when the temporary handling rules apply to avoid any confusion which may arise, especially where the physical certificates were received for a client who the firm is already providing safeguarding and administration;

(iv) Investment management/ front office attestations – it is recommended that a monthly attestation process is put in place from the business areas responsible for receiving and handling physical assets. This attestation could include confirmations relating to the following areas: all physical assets have been held in a secure location, all assets where the firm has applied the temporary handling rules have been recorded on the log, and there have been no instances where the temporary handling rules have been misapplied as per the rules and the firms policy;

(v) Extensions - Firms should also consider implementing a process for providing extensions to the initial period referred to in 2) above. This is because it may be in the client's interest for a firm to retain these physical assets rather than return them. It is recommended that the individual responsible for CASS forms part of the approval process, where practical, and an audit trail is retained of the rationale for the extension and approvals granted;

(vi) Secure location – Whilst it is always preferrable that physical certificated assets are held in fire-proof safe, this may not always be possible e.g. they are received outside of normal business hours or the client is located where it is not possible for the individual who received them to return to the office before the end of the normal business day. Firms should also consider the implications on insurance cover of any assets which are not returned to the normal secure location on the day they are received and include guidance to employees in their policy and procedures of how such assets should be handled whilst in their care;

(vii) Recordkeeping – it is recommended that firms keep an electronic record of assets which are held in secure locations under these rules. This record should cover all geographical locations where these assets may be held. It is also recommended that the electronic records are sent to the individual who is responsible for CASS, where practical, to ensure visibility on the assets which remain under the temporary handling rules. This record should be circulated periodically e.g. weekly. It is recommended that even where the temporary handling rules are not applied, e.g. if the assets are returned immediately, a log is still kept of the assets showing when it has been received and returned. If this record is not kept the firm may have no record of the asset in the event that it is not received back by the owner.

13.5 Unintentional receiving/holding of client money

All firms are required under the Financial Services and Markets Act (FSMA) and by extension by the FCA to obtain the necessary regulatory permissions/authorisation before carrying out any regulated activity. A firm that has obtained the relevant client assets permissions from the FCA may still choose to structure it's operations in such a way as to avoid holding client money. This could for example include where a firm operates under an exemption from the client money rules, or where the firm ensures that it does not handle any client money on behalf of an investor e.g. transacts under a mandate.

There are however recurring examples where firms have found themselves unintentionally holding client money:

- **Compensation –** where compensation becomes payable to a client from the firm, it must be treated subject to CASS 7.13.39R, with it either being paid promptly to the client (no later than one business day after it becomes due and payable), or if this is not possibly, treated as client money and segregated within a client money account. Please note that the application of the client money rules can depend on whether the payment is considered compensation, or 'goodwill'. Goodwill payments are defined as discretionary payments that are due and payable directly from the firm and to which the client money rules do not apply. An example of where compensation would become due is a financial loss suffered by a client due to a firm failing to carry out an investment instruction, or where they have been overcharged fees. An example of where a goodwill payment may be made is where the client has been inconvenienced but not suffered financial detriment.
- **Fund manager rebates –** where a client agreement is silent, or confirms that rebates become due and payable to client's on receipt of the payment from the fund manager, they must be treated as client money and segregated in a client money account.
- **Invoice/Fee Overpayments –** This can arise due to client error e.g. paying too much, or too early. It can also arise due to firm error e.g. requesting/taking too much. Any amount held in excess of what was due and payable to the firm must be treated as client money and segregated in a client money account.
- **Cheques received that are incorrectly made payable to the firm –** A client may unintentionally provide a cheque payable to the firm, rather than the third party it is intended for. This could for example arise where there is an intermediary who is arranging, or advising on investment business but does not handle client money.
- **Payments received in error –** a client/market participant e.g. fund manager, may incorrectly pay investment monies into the firm's bank account, rather than into the client money account of the firm who holds the client assets, or paying it directly to the client.

There are also scenarios where a firm may suspect that they have received client money into the firm account but are unable to confirm conclusively. For instance, an unexpected/unidentified payment into a firm account where the payer is unknown. Firm's must ensure they investigate all such payments and where the payer cannot be identified, look to return the money to source promptly.

The unintentional holding of client money can in many scenarios be avoided by ensuring that client agreements make it clear when money becomes due and payable and from whom it is specifically payable from. Considering the above examples, this could be by ensuring it is clear in the client agreement when compensation becomes due and payable and confirming that any rebates received will be payable to the client by the firm, rather than directly from the fund manager. The firm must also ensure that they understand where the risk of unintentionally holding client money can arise and put in place controls to avoid, or at least greatly mitigate the risk.

Where scenarios cannot be avoided, the firm must review its operating model and its regulatory permissions. There should be no appetite for breaches of this type. In all instances where client money was unintentionally held a regulatory breach should be recorded.

13.6 Client Assets Limited Assurance Engagements and regulatory notification

Subject to the firm category and regulatory permissions (see SUP 3.1.2R for more details), a firm that claims to not hold client money will be subject to a Client Assets Limited Assurance Engagement. This, as the name suggests, is a more limited form of the full Client Assets Assurance Engagement, aka 'CASS audit', requiring the auditor to confirm whether anything in the course of their audit activity caused them to believe that the firm held client money.

Full details of what the auditor will consider as part of their Limited Assurance Engagement is detailed within the FRC's CASS Assurance Standard. Key areas of focus are the firm's operating model, how it ensures client assets are not held, compliance with any exemption requirements and an assessment of any relevant regulatory notifications in relation to the holding of client assets.

Where the firm identifies, or is made aware, that it has unintentionally held client money over the period, it should consider whether the FCA should be immediately notified. Details should also be shared with the firm's auditor where it was not identified by them, as the breach will need to be included within the Client Assets Limited Assurance Engagement report.

If the firm has permission to hold client money but chooses not to, then the decision may be made to record the breach (subject to materiality) and report it to the FCA via the Limited Assurance report. Essentially this breach would represent a failure to segregate client money within a client money account, though as it is an activity they were authorised to undertake, may not represent a material/immediately notifiable breach.

Where the firm does not have the required regulatory permissions, then it is recommended that they notify the regulator immediately. They should also consider whether they have breached FSMA, which may constitute a criminal offense, particularly where the firm failed to obtain the required regulatory permissions and also failed to notify the regulator that it would be holding client money. The firm will need

to consider whether a variation of its permissions is required and the operational changes needed to mitigate the risk of future breaches. The firm should expect considerable regulatory scrutiny and challenge.

It should be noted that if the auditor identifies that client assets have been held when completing their limited assurance engagement, they will expect the firm to notify the regulator. Failure of the firm to do so will result in the auditor being obligated to notify the FCA directly.

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14. Prudent Segregation

14.1 What is Prudent Segregation?

All firms must ensure that they are able to properly account for the client assets they are responsible for, ensuring that appropriate steps have been taken to minimise them from the risk of loss or diminution. This includes ensuring that firm's assets are segregated from the assets held on behalf of its clients.

Prudent Segregation however allows a firm to pay its own money into a client money account to mitigate the impact of a potential client assets shortfall in the event of a specific risk crystalising. In the event of firm failure, that money would remain client money and be available to cover any shortfalls in the client assets held by the firm. There are however a number of requirements that must be met by firms in order to comply with the associated rules.

This section does not cover the requirements that must be met in calculating alternative approach mandatory segregation.

14.2 Purpose of Prudent Segregation

Firms are required to have adequate "organisational arrangements" to minimise the risk of a client assets deficit arising. These organisational arrangements should first consider how the risk of a deficit can be avoided and then (but only then) how it can be mitigated. Prudent Segregation is one of the steps a firm can take to mitigate this risk.

14.3 Prudent Segregation Policy

A firm must establish a written policy that is approved by its governing body, irrespective of whether a firm intends to pay its own money into a client bank account or not. The policy should be retained for a period of at least five years after the date it ceases to retain such money in a client bank account. Where firms have decided to use prudent segregation, the policy should include (as per CASS 7.13.43R):

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.

Where firms have decided that they do not require to prudently segregate, the following rationale should be included:

1) clear statement as to why there are no 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 does not consider that the use of such a payment is required in order to protect client money; and
3) confirmation that this position will be reviewed on a regular basis.

In the event that a risk arises that the firm had not anticipated, a Prudent Segregation payment can still be made into a client money account to mitigate the risk. The firm however is required to promptly update its policy to record this risk and how it met the requirements noted above. The updated policy must then be reapproved by its governing body.

Money paid into a client money account as Prudent Segregation should not be considered a 'buffer' to cover client asset deficits caused by inadequate systems, processes or controls. If a firm includes within its Prudent Segregation policy risks that arise solely due to any of these inadequacies, then a breach of CASS will still have occurred if the risk were to crystalise and Prudent Segregation be required.

For example, if the firm experienced a system failure that resulted in a risk crystalising e.g. reconciliation software stopped working and so reconciliations could not be completed, then Prudent Segregation could be used to mitigate the risk of a client assets shortfall going unidentified but the firm will still have failed to comply with CASS and a breach will still need to be recorded.

Prudent Segregation should also not be used as an alternative, or in any such way as to contradict, with any specific requirements detailed in CASS. For example, a firm could not choose to use Prudent Segregation to avoid the requirement to bank a cheque no later than the business day after it receives it, even if it can evidence that the amount held as Prudent Segregation exceeded the cheque value.

It is down to the firm to perform a risk assessment of its own business and identify which risks that it is unable to mitigate. The examples provided in CASS for the types of risks that Prudent Segregation is appropriate for are as follows:

- 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 accounts.

Generally, however, most firms use Prudent Segregation to mitigate risks that they cannot prevent, such as those caused by external events

14.4 Prudent Segregation Record

When a firm utilises Prudent Segregation, it must maintain a record that meets the requirements detailed in CASS. This record must accurately record at all times how much firm money is held as Prudent Segregation and provide an audit trail for when payments were made into and out of the account. Full details are as follows (per CASS7.13.51R):

(1) the outcome of the firm's calculation of its prudent segregation;

(2) the amounts of prudent segregation paid into or withdrawn from a client bank account;

(3) why each payment or withdrawal is made;

(4) in respect of the firm's written prudent segregation policy the firm must record, as applicable, either:

(a) that the payment or withdrawal is made in accordance with that policy; or

(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 requirements; and

(6) the up-to-date total amount of prudent segregation held in the client money account.

Money held as Prudent Segregation must be accounted for in the firm's client money reconciliation. This includes ensuring that it is captured in the client money resource and requirement calculations. Many firms present Prudent Segregate as a separate item in their client money reconciliation to ensure full visibility of the values held, though it should be noted that the inclusion of Prudent Segregation as an item in the client money reconciliation in isolation does not meet all of the requirements noted above. It is recommended that a separate record be maintained alongside the reconciliation.

14.5 Prudent Segregation in Practice

As noted in previous sections, Prudent Segregation is not a 'buffer' and the amount paid into the account must be calculated in-line with the methodology detailed in the Prudent Segregation policy.

A firm is expected to have processes in place to identify when a deficit in the client money bank account has occurred and to promptly transfer the funds to resolve the deficit. This action is not affected by the operation of Prudent Segregation i.e. where Prudent Segregation is utilised to mitigate the risk of a client money shortfall in the event of a bounced cheque, the deficit in the client money bank account that arose from the bounced cheque must be separately funded, it is not funded from the amount held in Prudent Segregation.

When a firm no longer considers it necessary to retain money as Prudent Segregation in its client bank account, it must be withdrawn as an excess as part of its next client money reconciliation.

Payments of Prudent Segregation into and out of each of the firm's client money accounts must be recorded in-line with the requirements detailed in the Prudent Segregation Record section. This record must be updated promptly where changes to the amount of Prudent Segregation are made.

14.6 Prudent Segregation vs Transaction Funding (Pre-Funding)

Transaction Funding is a term that represents payment from the firm into a client money account as a result of money being deemed to become due and payable. It is client money, is allocated to a known client and can only be removed from the client money account when the firm is able to discharge its fiduciary duty over the money.

The following table provides a quick reference guide to the differences:

	Prudent Segregation	Transaction Funding
Known clients	Unlikely	Yes
Known amounts	Unlikely	Yes
Held for a client	No	Yes
Specifically identified on the client money reconciliation?	Yes	No (held as part of the client balances)
When is cash transfer to CM made?	In line with the firm's policy. This can be before the risk is expected to crystalise.	As required, in line with the money becoming due and payable to clients (supporting by client agreements)
When is cash transfer out of CM made?	As per policy and at next reconciliation	CASS 7.11.34 – on discharge of fiduciary duty
Specific rules?	Yes (in order to hold firm's cash in the client account)	No

Though the table provides a useful guide, there are nuances in certain scenarios where an assessment of the type of funding being undertaken is more complex and reliance on the table alone could result in the wrong conclusion. For example, a scenario where a payment from a collective investment unit sale is expected from the market but the firm is made aware that it may not be received on the expected day. If the firm owes contractual settlement to the client, it may choose to make a payment into the client money account as Prudent Segregation to mitigate the risk of a shortfall arising within the client money account. In this scenario the firm will know the clients and amounts that relate to these payments. This would however not be Transaction Funding as it will not be funding the 'Transaction' it will be funding the risk that settlement monies are not received from the market.

It is recommended that firms document their rationale supporting any Transaction Funding they undertake to provide visibility and support why it should not be considered Prudent Segregation.

14.7 Interpretation of Prudent Segregation requirements

The requirements to comply with and the application of Prudent Segregation has and continues to be a highly debated area.

What is set out in this guide is based on the CASS rules and supporting guidance provided by the FCA through industry engagement. 'House views' within audit firms however do differ from the industry and even between the audit firms.

Two key examples where differing interpretation has been brought to TISA's attention:

- Audit firms not considering there to be any difference between Prudent Segregation and Transaction Funding; and
- Firms not being required to remove amounts held as Prudent Segregation as part of the firm's client money reconciliation.

Ultimately firms will need to work with their auditor to ensure they are in agreement on the firm's approach to Prudent Segregation, which must be set out within the policy document. Where a difference of opinion arises, the firm may need to engage directly with the FCA for firm specific guidance.

Prudent Segregation should not be used to address known weaknesses in the operational processes on a long-term basis. The underlying issues that give rise to the risk of shortfalls should be addressed.

However, there are some events that occur on a fairly regular basis and are outside of a firms control that give rise the risk of detriment to the client money pool. The risks of such events happening may be addressed by an ongoing amount of prudent segregation. For example, the risk of cheques returned unpaid leading to a shortfall in the client money account.

This type of prudent segregation funding would usually be undertaken as the result of a calculation based upon past experience. Care must however be taken to ensure that high value infrequent events are not used to create an unrealistic result, and due consideration should be given to the frequency of such events. Whatever factors are taken into account within the calculation, these must be carefully documented and rationalised within the prudent segregation policy and reviewed on a regular basis.

There are occasions where prudent segregation may be used to address an event that has already occurred, and the amount is known to the penny. In this instance a firm can use its own money to prudently segregate against the risk that this event will cause a shortfall in the client account. As soon as the position is rectified, the prudent segregation should be withdrawn.

Section reviewed by CASS Best Practice Drafting Group October 2022

15. CASS 8 – Mandates

15.1 Introduction

In the course of investment business there is often a requirement for a firm to obtain a mandate from their clients to allow them to control assets held by a third party. This could for example be where the firm needs to collect money from the client's personal bank account to enable investment e.g. a direct debit, or where the firm needs to be able to manage a client's investments day-to-day without deferring to the client to approve each trade e.g. discretionary investment management agreement.

The purpose of CASS 8 is to ensure that where a firm operates a mandate that it establishes and maintains records and controls to prevent its misuse.

15.2 Application

The CASS 8 Mandate rules apply in the situation where a firm receives and retains a "means" by which it can issue instructions that affect assets or client money of a client (or the indebtedness of the client) that the firm itself does not hold.

For example, if the firm has the ability to instruct collections from a bank account in the name of the client via a direct debit mandate. CASS 8 rules apply to the "means" that enables that collection (i.e. the bank account details retained by the firm) and the control / use of that "means" by the firm, while CASS 7 would apply as normal once the firm has received that money.

Importantly, the CASS 8 rules are not applicable where the firm uses the client's bank account details in order to make payments to the client from a client money bank account as this activity would be subject to CASS 7 'client money' rules.

If the firm holds an authority that enables it to re-register, transfer, purchase and/ or sell a client's assets which are held outside of the firm's own custody accounts, the CASS 8 rules apply to the "means" by which the firm could issue such instructions. The CASS 6 'custody asset' rules would apply from the point at which the asset is received into the firm's custody.

15.3 CASS 8 overarching objectives

CASS 8 is designed to ensure that the firm who has been granted the 'means' has an accurate record of:

- All Mandates; and
- All the transactions entered into under the conditions of the Mandate; and
- Appropriate controls over passing instructions.

15.4 When does a CASS 8 Mandate exist?

CASS 8.2.1R records five conditions that must be satisfied if the "means" obtained by the firm are to constitute a CASS 8 Mandate. Note that if the firm's arrangements are such that any of these five conditions are not met, the "means" in question will not be defined as a CASS 8 Mandate (even if it is sufficient to enable the firm to complete some operational process).

Condition	Implication
1	The "means" is obtained from the client, and with the client's consent. (i.e. if the client is unaware that the firm has the "means", that "means" would not constitute a CASS 8 Mandate).
2	If the firm is performing insurance mediation activity, the "means" must be in written form. Note: for other forms of designated investment business a CASS 8 Mandate may be in non-written form. (i.e. even if an insurance mediation firm collects a "means" in non-written media, that "means" would not constitute a CASS 8 Mandate).
3	The "means" must be retained by the firm.
4	The "means" must enable the firm to control a client's assets or liabilities e.g. through issuing an instruction to another Person, the result of which instruction would be to transfer, move, sell and/ or purchase an asset/ liability held by that Person on behalf of the firm's client (i.e. any "means" that does not enable any of these types of outcome would not be a CASS 8 Mandate).
5	The Person receiving the firm's instruction (for condition 4), could act on that instruction without referring to the client. (i.e. the third party must obtain confirmation from the client of any instructions issued, that "means" does not constitute a CASS 8 Mandate).

Note that the Guidance in CASS 8.2.2G states that a CASS 8 Mandate can be written or verbal and be in any form e.g. documentation does not need to explicitly state that it is a CASS 8 Mandate. The guidance also indicates that the Mandate will usually be expressed in terms of a document granting authority to control assets, or a specific provision within some broader document, or an oral authority for the firm to act.

Guidance in CASS 8.2.3G(1) confirms that if the firm performs a transaction immediately upon receiving the "means" from the client, and having done so deletes or destroys the "means" (rather than retaining the specific information), condition 3 is not satisfied and consequently no CASS 8 Mandate exists.

15.5 Books and records – CASS 8 Mandates

- ***The List of CASS 8 Mandates***

Every CASS 8 Mandate that the firm retains must be included in an "up-to-date list of each Mandate that the firm has obtained" (CASS 8.3.2R(1)). This list may be requested by Auditors when performing a CASS Assurance review. Each new CASS 8 Mandate (i.e. each "means" that satisfies the five conditions noted in the table above) should be a discrete line in "the List'' typically an electronic record.

For each CASS 8 Mandate, "the List" should record any conditions on the use of that Mandate, whether determined by the client or the firm's management. Note that CASS 8 uses the word "condition" in two distinct ways: firstly, to refer to those conditions listed in the table above (that define whether a "means" received by the firm constitutes a CASS 8 Mandate); and separately to describe any limitations on the ways in which that "means" should be used by the firm. An example, would be a Direct Debit Instructions that a client might provide to enable regular investments in a fund:

- The bank account details are the "means" giving rise to the CASS 8 Mandate;
- The amount to be collected is a "condition" imposed by the client on the use of the "means";
- The frequency and/or next/first collection date is similarly a "condition"; and
- The investment purpose to which the money will be put is outside the scope of CASS 8 (as the asset purchase occurs within the firm's care, and CASS 8 relates only to the control of assets held by an external party – such as the client's bank).

Another example would be where a discretionary investment mandate has been granted over assets held by a third party pension provider:

- The Discretionary Investment Management Agreement ('IMA') details the 'means' which give rise to the CASS 8 Mandate;
- The ability to buy and sell investments and related cash movements without further interaction with the client, trustee or other third party provides the 'conditions'; and
- A firm will also have documentation, signed by the third party custodian, which outlines which individuals are able to pass instructions, who may be from a separate legal entity within the group. The documentation should be worded such that the individuals do not have the 'means' to control the assets, they are only passing on instructions.

It is worth noting that CASS 8.3.3G states that terms within the IMA which relate to the nature and circumstances e.g. investment restrictions or exposure limits for managed portfolios, are not caught by the records section under 8.3.2R and therefore are not breaches of CASS 8 if they are not complied with.

Where a CASS 8 Mandate is received in non-written form, CASS 8.3.2CR specifies certain fields that must be included in "the List" (though it is acceptable for the firm to include such data for all CASS 8 Mandates held):

- The nature of the Mandate (i.e. what type of information the "means" is, though not reproducing that actual data);
- The purpose of the Mandate (why it would be used);
- How the Mandate was obtained (type of media / interaction);
- The name of the relevant client; and
- The date on which the Mandate was obtained.

It should be noted that "the List" would not contain the actual "means" information held by the firm (i.e. the bank account details being used to effect a cash collection would not be reproduced in "the List"). However, Guidance in CASS 8.3.2F(3)G does require the firm to identify for each Mandate on "the List" every location in which that "means" information has been retained by the firm.

The firm must have a mechanism by which amendments or corrections to "the List" can be identified and demonstrated. This might include building functionality into "the List" itself or might be achieved by retaining periodic copies of "the List" which can be compared to identify change (which the firm would then substantiate against its business records).

The rules do not state that the list must show any changes and amendments, however, in order to comply with CASS 8.3.2A (2), corrections and amendments must be "easily ascertained".

- ***Other records and internal controls***

"The List" is a specific mechanism required by CASS 8.3 – but the firm must also ensure that it maintains the following (note: these items exist *outside* of "the List"):

- An internal record of each transaction entered into under each Mandate; (Note: the transaction under the Mandate is the movement of money or asset occurring outside of the firm's own accounts. Where a DDI is used to collect money into the firm's records so an asset transaction can be settled, the transaction relevant to the CASS 8 Mandate is only the collection of money and not the asset transaction settled by the firm's CASS 7 activity.)
- Internal controls to ensure that the Mandate is used in line with the applicable conditions;
- Procedures and internal controls around the making of instructions under the Mandates held; and
- Controls over the security of any physical tokens / passbooks held by the firm in respect of a Mandate.

Firms must also record that a Mandate was created/ closed and of the transaction that was entered into. firms should also be mindful of the requirements to retain telephone records before deleting verbal Mandates where the 'means' is no longer required.

15.6 Passing instructions between group entities

It is recommended that firms have documented clearly which entity within the group retains the CASS 8 Mandate. The document should also clarify the role of any other group entity where they are responsible for passing instructions. This is to avoid multiple legal entities being caught by CASS 8 and therefore having duplicate records**.**

15.7 Record Retention

CASS 8 includes a specific record retention obligation (CASS 8.3.2G R), which relates to the records that the firm is required to maintain in respect of its use and control of the CASS 8 mandate held. In respect of the "means", the firm must only retain that information for as long as it has a valid business purpose to do so (per data protection rules). i.e. at any point the firm may conclude that it is no longer appropriate to retain a given "means". Each firm will reach its own decision as to the circumstances in which "means" data will be deleted – and having deleted the "means" data, the CASS 8 Mandate ceases.

There are scenarios where the 'means' may be retained by the firm, though with no authority/consent for it to be used. This for example could apply to bank details provided to enable a one-off payment. This was discussed with the FCA and it was acknowledged that in specific circumstances there are valid reasons for a firm to retain the 'means', such as to facilitate future client instructed payments without the need for the client to provide details again, or where they have been provided alongside other information, such as when included within an application form. In these circumstances CASS 8 should not apply as the client has not provide consent to the firm. Firms should however where possible look to delete/destroy the 'means' to remove all risk of them being used in error.

Where the firm was using the CASS 8 Mandate in respect of MiFID business, CASS 8.3.2G R requires the firm to retain records of the control and use of that CASS 8 Mandate for a minimum of five years after the firm ceases to hold that CASS 8 Mandate. For non-MiFID business (such as a firm acting as AFM) this minimum period is one year after the firm ceases to hold that CASS 8 Mandate. The firm's documentation of "Other records and internal controls" noted above must be retained for the relevant period after the firm no longer holds a "means" that satisfies the conditions listed in the table above.

Once the "means" has been deleted and thus the CASS 8 mandate has ceased, the "List" need no longer include a "means", but a record of the mandate, together with a clear record of the mandate having ceased should be retained for the minimum period as referenced in the above paragraph. CASS does permit the firm to continue to include the "means" on its "List" until the expiry of applicable record retention periods – provided the firm clearly distinguishes ceased mandates within "the List".

As noted above, the firm might generate and retain its "List" periodically – in which case the fact that the CASS 8 Mandate was previously held would simply be demonstrated with reference to those prior "List" files. Where this approach is employed the frequency, the list is generated is likely needed to be daily where the list is derived from underlying records which are maintained independently of the list.

15.8 External CASS audit: CASS 8 Mandates

Firms are reminded that if they hold client money and/ or custody assets that a 'reasonable assurance report' will be required from an external auditor annually and that compliance with CASS 8 will also be assessed.

All firms are advised to engage with their auditor to understand how they interpret the application of CASS 8, specifically where there are scenarios where firm retains the 'means' though does not consider it to fall within the scope of CASS 8 due to the firm having no authority to use them. As noted, the FCA confirmed that it was not their intention for CASS 8 to apply in these circumstances, though this interpretation is not shared by all auditors.

Section Reviewed by CASS Best Practice Drafting Group October 2022

16. CASS Breach Management and Reporting

16.1 Breach Identification

All firms must understand the circumstances within their business models where breaches of CASS can occur and ensure that they have adequate systems and controls in place to identify non-compliance. Firms must also ensure that an appropriate level of CASS awareness exists across all levels of staff to support the effective operation of these systems and controls.

Reliance must not be placed on the annual external CASS Assurance audit to identify areas of non-compliance. Where instances of non-compliance are identified by an external party, the firm should investigate why it was not identified through the systems and controls it had in place at that time.

The requirements set out in this guide apply to all firms carrying out regulated activities where CASS applies, regardless of any outsourcing arrangements. A firm that has outsourced CASS operational functions to a 3rd party service provider retains full responsibility for compliance with CASS. It must ensure that effective processes and governance arrangements are in place to allow it to oversee and challenge the performance of their appointed 3rd party in order to discharge its regulatory obligations.

It should be noted that though it is not our intention to set out each scenario where breaches of CASS can occur, breaches can occur irrespective of cash value or any other variable. In the event that any requirement of CASS is not met by the firm, then a breach of CASS should be recorded.

16.2 Breach Escalation

All firms must ensure that they have a documented CASS breach escalation process and that all relevant business areas are aware of it. This should include:

- Defining who is responsible for escalation at each stage;
- When escalation to a CASS SME is required;
- When escalation to the Senior Manager/CASS Oversight Manager or their team is required;
- When escalation/engagement with 2nd line Risk and Compliance is required;
- When immediate ('without delay') notification to the regulator is required; and
- When escalation is required to non-CASS specific Risk Committees, or to the firm's Board.

Each firm is likely to have a generic breach/event management process that considers the impact of any identified breach, such as the impact to customers, financial loss, regulatory impact, financial reporting and/or to reputation. It is recommended that firms put in place sufficient guidance to support those who are responsible for managing breaches in their assessment of breach materiality and their understanding of their responsibilities under the CASS breach escalation process.

It should be noted that the requirements detailed in CASS are highly prescriptive and the thresholds for a breach to be considered material (see below for guidance on assessing materiality), or immediately notifiable may be lower than those that apply for breaches of other regulation. Firms must ensure that this is taken into account in their breach escalation processes to ensure that appropriate internal and external escalation is undertaken.

Materiality Assessment

It is best practice for firms to have a documented method of assessing the materiality of a breach, that this is performed for every breach and the outcome recorded. The approach should cover both the quantitative aspect of the breach and qualitative aspects. Items that firms could consider are:

- Value of client money or assets impacted - this is commonly assessed against a hard % parameter e.g. 3% of the average client money pool over 12 months. A set figure, which will likely be lower than the % parameter, should apply when a single client is impacted to ensure that appropriate trigger points are used for the materiality assessment e.g. if a breach impacted 20 clients, and the value falls within the percentage parameter, the materiality trigger would not be reached. But, if one or a few single clients are each over the set figure limit, this should trigger materiality escalation.
- How many clients did the breach impact
- How pervasive was the breach, over what period did it persist
- How quickly was the breach discovered
- How quickly was the breach resolved
- How many similar breaches have occurred in the last year
- Does the breach indicate systemic control failures
- Was there any detriment to the client

Firms can apply a score against the items above and set a threshold based on the total score, which deems the breach to be reportable and/or be escalated for further consideration. Firms should keep in mind the requirement to be open and honest with the Regulator, and as such there may be instances where a breach does not hit the threshold but nevertheless (using instinct/common sense) the breach should be reported.

All materiality assessments and subsequent escalations should be recorded, and firms should keep their documented materiality assessment method under review to ensure it remains fit for purpose – thresholds should not be set too low or too high.

16.3 Corrective Action

In the event that a breach is identified, it should be resolved promptly and without delay. In the event of client financial detriment resulting from the breach, the client should be put back into the position they would have been if the breach had not occurred, to penny accuracy.

Firms should also ensure that they capture all issues that may result from a failure to comply with CASS e.g. if a firm failed to deposit a cheque in-line with the requirements in CASS and subsequently made a payment from its client money account on the assumption that the cheque has cleared, it would have failed to comply with two separate CASS requirements; the first when failing to promptly bank the cheque and the second when making the payment out of the client money account before the cheque had cleared for withdrawal.

If it is not possible to promptly resolve the breach, for example where further investigation is required to confirm the correct client level remediation, the reasons for the delay, actions required to close the breach and steps taken to minimise the risks to clients in the interim should be formally documented and

approved; this should include appropriate engagement with the CASS Oversight Manager as applicable to your firm.

In the event that corrective action cannot be completed promptly, such as where the calculations to determine correct investor allocation to be completed, then the firm should consider whether funding is required to mitigate the risk of a client assets shortfall in the event of the firm's insolvency.

A breach may be considered to have two distinct points that are required to address the issue:

1. The client position must be rectified as soon as possible.
2. Action to prevent reoccurrence.

The breach should be left 'open' until action has been taken to prevent re-occurrence. This may be as simple as additional staff training on a procedure but may take considerably longer if a system change is required. If an interim manual prevention can be implemented pro tem, it may be appropriate to close the breach on that basis. Delay to implementation of measures to address the root cause of the breach should not prevent the client position being rectified as soon as practicable.

If the breach is likely to remain open for some time, pending action to prevent re-occurrence, it may be appropriate to log one breach and all subsequent occurrences of the issue be logged under that breach until the underlying issue is rectified. If there are further occurrences of the same issue once preventative actions have been completed a new beach should be logged and the root cause re-investigated.

16.4 Root Cause Analysis

In the event that a CASS breach is identified, appropriate root cause analysis should be performed, and actions set where appropriate to prevent reoccurrence. Effective root cause analysis is crucial to support firms with identifying any areas of systemic non-compliance or control weakness.

Firms must ensure that they identify the true root cause; this is the underlying cause of the breach e.g. in the event that a breach is caused by a colleague following a CASS compliant, though overly complicated process, the root cause is not the failure to follow the process. Instead, the root cause is more likely poorly documented procedures, inadequate training, lack of effective controls, or just generally the design of the process itself.

16.5 Risk Appetite

All firms are required to have adequate organisational arrangements to minimise the risk of the loss or diminution of client assets, or the rights in connection with those client assets, as a result of their misuse, fraud, poor administration, inadequate record-keeping or negligence.

Firms must define for themselves what is 'adequate… to minimise the risk'. In support of this, it is recommended that all firms document their risk appetite for non-compliance with CASS, including setting expectations for the appropriate level of corrective and preventive action that should be taken when

breaches are identified. This will support the management of CASS risk within the firm's risk tolerance and also provide guidance to those responsible for managing breaches within the firm.

There are scenarios where firms could identify a risk of CASS breaches occurring where the action to prevent reoccurrence entirely is not practicable, for example:

- Manual processes where an automated solution is not feasible; and
- Low risk processes where the monitoring required to prevent breaches occurring is disproportionate to the risk it would address.

These types of scenarios should be documented by the firm to evidence awareness and acceptance of the risk they represent.

The documented risk acceptance should be formally agreed by the CASS Oversight manager, via CASS governance and by 2nd line Risk. This should then be periodically reviewed to ensure any risk acceptance remains appropriate.

16.6 Record Keeping

A record of all breaches should be maintained by the firm. This should include as a minimum:

- Breach description;
- Root cause;
- No. of clients affected;
- Value put at risk;
- Data occurred;
- Date identified;
- Date client position rectified;
- Date closed;
- Details of the CASS rule/s breached;
- Materiality assessment and, where the breach is considered material, record that it is reportable to the FCA;
- Whether it is an FCA notifiable breach;
- Whether the breach has been escalated;
- Area of business where breach was caused;
- Action taken to close breach; and
- Action taken to address root cause.

The breach record provides evidence of the firm's management of breaches and supports the firm's annual CASS Assurance audit.

All breaches are eventually notified to the regulator vis the CASS Reasonable Assurance Report, but a firm will need to decide, in line with its documented materiality policy, whether a breach should be notified to the FCA immediately. A materiality assessment of the breach should also be undertaken as retained as part of the breach record. Firms should consider both qualitative and quantitative aspects of a breach in considering whether it is appropriate to notify the regulator immediately. The quantitative aspect of the breach should be proportionate to the firm's business and client money pool. They should also consider the

circumstances under which the breach was identified, how many clients were impacted and how long the issue persisted.

16.7 Governance

It is recommended that all breaches be reviewed, and appropriate challenge provided and documented as part of the firms formal CASS governance framework. For most firms this will be via their legal entity specific CASS Committee, or equivalent.

The types of areas of challenge and discussion in relation to breaches are likely to include:

- Repeat areas of non-compliance;
- Increases or decreases in the volume of breaches being reported by business areas;
- Trend analysis results both on a year-on-year and month-on-month basis;
- Breaches being recorded for areas reporting effective controls;
- Material breaches of CASS or SUP;
- Age profile of open breaches including missed/extended closure dates;
- Output from root cause analysis performed;
- Action plans to close breaches and identified root causes; and
- Breaches identified by external parties e.g. auditors, FCA or consultants.

These discussions should be documented formally as evidence may be required to support the effectiveness of the firms CASS control environment.

In November 2015, the FRC issues a Standard that required CASS audit firms to understand the controls that are in place to address each CASS risk when undertaken the Reasonable Assurance review. Although this Standard is not directly appliable to firms, it has become an expectation that firms will have a CASS Matrix to assess risk and controls applicable to CASS in order to demonstrate their own understanding and awareness of their CASS risk framework. The assessment of likelihood and impact within the matrix should be compared to the actual breach data to determine if the assessments made are realistic.

16.8 Regulatory Reporting

There are four key elements of regulatory reporting in this area:

- ***External Auditor CASS Assurance Report***

  Breaches of CASS are reported to the FCA on an annual basis by the firms appointed external auditor on completion of the CASS Assurance audit.

- ***FCA notifiable CASS breaches***

  The circumstances where the firm must promptly notify the FCA of a breach of CASS are detailed in CASS 6.6.57R, CASS 7.15.33R and CASS 10.1.16R. These broadly reflect scenarios where material breaches of CASS have occurred.

- ***FCA reportable CASS breaches***

Where the firm has determined that a CASS breach is material based on their own internal materiality assessment criteria, the firm must promptly inform the FCA of the breach.

- ***Client Money and Asset Return (CMAR)***

In the event that an FCA notifiable breach has been identified in the CMAR reporting period, this should be recorded in section 8 of the CMAR.

Section Reviewed by CASS Best Practice Drafting Group October 2022

17. CASS Resolution Pack

17.1 Background

The CASS Resolution Pack ('RP'), covered under CASS 10 of the FCA's Custody Asset rules, now forms a key element to a firm's overall compliance as well as helping to demonstrate appropriate governance. The CASS RP requires a significant amount of information about the firm's business, including key documentation that will help an Insolvency Practitioner ('IP') complete the task of distributing client money and assets quickly and efficiently in the event of the firm's insolvency.

The full requirements of the CASS RP are detailed in CASS 10.2 and 10.3, and these include (this list is not exhaustive):

- List of firms appointed to hold client money or assets (e.g. banks, custodians).
- Acknowledgement letters, contracts and details of bank accounts.
- Latest due diligence on banks, etc.
- List of senior managers/directors and any key staff involved in CASS processes (this may include external staff where functions are outsourced).
- Copies of latest client money and custody reconciliations.
- Internal policies and procedures relating to handling client money or assets.
- Client categorisation.
- Client agreements (e.g. T&Cs).

As well as meeting the content requirements, firms will also be expected to provide evidence of other processes, such as governance, controls and testing.

The CASS RP receives significant focus from the regulator and auditors, and this section is designed to provide firms with guidance on how best to meet the requirements of these rules.
The person who is responsible for CASS oversight will ultimately be responsible for ensuring that appropriate arrangements are in place for the maintenance of an accurate and up-to-date CASS RP. For the purposes of this document this person will be referred to as the CASS Oversight Manager ("COM").

17.2 Introduction

There is no prescriptive guidance as to how the CASS RP should be presented and maintained. However, the regulations require a "master document" which acts as a central point of reference and contains sufficient information to allow each document to be retrieved. Depending on the firm's complexity, the contents of the RP may consist of hundreds of separate documents. Firms must therefore consider the most appropriate solution for their requirements. Dedicated software packages are available to assist in this regard, or common industry practice is to use a document management and sharing system such as SharePoint. This assists the IP in retrieving the required information as quickly as possible via links to other documents or file locations in the event of insolvency.

Whatever solution is utilised, firms must have in place a defined process to ensure that the IP can access the firm's RP as quickly as possible, and ensure that the information will still be available within the prescribed timescales in the event of insolvency, potentially outside of business hours.

17.3 Master Document

Firms are required to maintain a master document which contains sufficient information to allow the IP to retrieve the contents of the CASS RP. This opening section of the CASS RP should be used by the firm to provide the IP with an overview of the business undertaken by the firm and its legal structure. The following points are taken from the FRC Client Asset Assurance Standards (link) and are suggested as useful guidance for a firm to consider for inclusion:

- The nature of the services it provides to clients.
- How it is remunerated for those services and other ancillary services.
- The nature of any transactions which it undertakes with or on behalf of, or facilitates or advises on, for clients and how those transactions are executed or settled.
- The nature of relationships within a group and with other related parties.
- The sources and destinations of cash and other asset inflows and outflows in its own accounts and any accounts it holds or controls on behalf of clients and other parties.
- The role of sub-custodians and third party administrators.

As with all CASS requirements firms must consider their arrangements at a legal entity level and should therefore consider whether it is appropriate to maintain a consolidated (group) RP or separate RP per entity.

Although there is no prescribed format for the master document it is good practice to format this in a table or similar, such that each rule is clearly mapped against explanatory text and/or links to the supporting documentation. This structure makes it easier for users to locate the required information, as well as providing a simple means for auditors and regulators to cross-reference the contents of the RP against the rules.

A link to the firm's governance document can be included here, as this may already contain key information that also covers some of the CASS 10 requirements. If this is the case, this section should also detail which areas of the CASS RP are covered within the governance document.

Where the RP links to other documents or folders, or where there is any potential ambiguity, it must be made clear how to access the information being referred to. For example, if linking to a folder which contains several files (e.g. many days' worth of reconciliations) it must be made clear which is the latest. Where groups of clients are subject to different versions of the Terms and Conditions (e.g. non-standard or older versions) then it must be made clear which Terms apply to which clients. Some information may only be available from the firm's core administration system, in which case clear log-in and access instructions should be provided.

17.4 Key Contacts and Information

Certain information, detailed within CASS 10.2.1R, will be vital to an IP in the early stages of insolvency. A list of all key contacts must be maintained within the document and must clearly differentiate between senior members of staff responsible for firm governance and CASS oversight and key technical staff who can assist the IP (for example, in producing a final client money reconciliation or obtain the necessary system access). Firms should consider whether the staff listed would actually be able to perform the

required functions and whether therefore just to include senior/management level or to list the actual team members. The level of detail will depend on a number of factors such as the firm's size and complexity, and whether other parties (e.g. TPA) are involved.

Firms must ensure that the staff named in the RP understand their responsibilities and that they may be contacted by the IP in the event of insolvency.

As well as including details of all third-parties relating to CASS functions (including banks, custodians, TPAs and Trustees) it is suggested that specific contact details are included of the key contacts at each institution (e.g. the Relationship Manager). For each third-party the RP must include SLAs and contractual arrangements where appropriate. Contracts and legal agreements must be the latest authorised/executed versions. Firms which are part of a larger group will need to consider any intra-group arrangements and ensure that appropriate documentation is also included, including ensuring that such arrangements will remain in force post-insolvency.

17.5 Additional Information

As well as the information as prescribed by the rules there may be further information firms wish to include, such as:

- Details of all systems: This should cover all systems that relate to the firm's CASS processes, and any other systems that may influence these. Where functions are outsourced firms may wish to consider including the key systems used by their TPA;
-
- Non-CASS information: Although not a formal requirement, firms may wish to consider including pertinent information relating to their arrangements outside of CASS (e.g. details of non-client bank accounts). It is suggested that firms discuss this with their auditors prior to changing their approach.

17.6 Access to the CASS RP

As discussed above firms must ensure that all information in the RP will be available in the event of the firm's insolvency. The regulations require certain information to be retrievable immediately, but "immediately" is not formally defined. It is recommended that firms consider defining their interpretation of "immediately" within their CASS policies in order to demonstrate that this has been considered, as well as ensuring that all documentation can be retrieved as set out in CASS 10.1.7 R.

Contractual arrangements should be reviewed to ensure that access to external software or network storage will still be available post-insolvency (including outside of usual business hours). It is essential that the firm provides a clear, documented process explaining how to log in to the firm's systems and find the appropriate file locations (including the location of the master document). Firms should consider retaining hard copies of critical information in order to expedite availability in the event of systems being unavailable, including the arrangements for where these will be stored. It is recommended that the RP is included in the firm's business continuity plan as a critical system, and where there is a reliance on inter-group arrangements firms should ensure that there is equivalent contingency in place.

Firms should also consider the sensitivity of the information contained in the RP and ensure that access rights are in line with the firm's IT and information security protocols. For example, it may not be appropriate for the team producing the client money reconciliation to also have access to the contractual arrangements relating to custody, so firms should consider how to manage this. The person responsible for maintaining the RP may require access to all areas of the business network, and this will need appropriate control.

Similarly firms should consider how the IP will actually access the CASS RP. Where the Master Document is linking to files or folders elsewhere on the network the IP may need equivalent unrestricted access. Firms may consider setting up a dummy "Insolvency Practitioner" logon ID which has the appropriate system access and would be available to the IP when required. This will be dependent on the firm's security protocols and may require occasional testing to ensure that the logon ID is still working as expected. It may be appropriate for the COM to retain the logon details in a secure manner.

17.7 Oversight and Control

Evidence of oversight and control of the RP is critical for a firm when reviewing with an auditor or the regulator. Details of how the firm achieves this could be detailed within the RP document. Firms are also reminded that the COM is required to report to the firm's governing body on at least an annual basis to demonstrate compliance with the rules regarding the RP (CASS 10.1.14 R).

A firm's governance structure should include oversight of the RP document and process. Although the COM is ultimately accountable for the accuracy of the RP it may be that ongoing maintenance of the document is delegated to an appropriate resource. Depending on the size and complexity of the firm the maintenance of the RP may be too onerous for a single person, and firms should consider an appropriate balance between resource and ensuring controlled oversight of the RP.

Also dependent on a firm's size will be the level of oversight which the COM is able to have over the actual contents of the RP. It may be appropriate for the COM to allocate business owners who are responsible for ensuring that their documents within the RP are kept up to date in line with the regulatory timescales. Where this approach is taken it is common for the COM to require the business owners to provide an attestation on a regular basis that their documentation is current, accurate and that the owner is aware of the need to correct any inaccuracies or material changes as a matter of urgency (CASS 10.1.11 R (2)). Although this does not remove the ultimate accountability of the COM it does assist in demonstrating how the COM and the firm ensure compliance with the rules, and these arrangements should be documented. It is essential that those involved fully understand to what they are actually attesting, and that they have the appropriate training and knowledge to fulfil this.

17.8 Testing and Quality Assurance

As well as reviewing the contents of the RP, a critical element of oversight and control is to provide evidence that the RP process has been tested. As explained above this should include a test to ensure that the RP is accessible via the same means which the IP would be expected to use in the event of insolvency.

Where the RP relies on hyperlinks to documents and folders the firm should regularly test these to ensure that the links remain accurate and current. There should also be a regular review of the process against the

CASS 10 requirements. All elements of this testing should be presented to the appropriate management body. Firms should determine the frequency of these tests based on their complexity and risk appetite, and this should be documented within the firm's governance document.

Firms should also consider carrying out a full independent test of their RP process, either internally or utilising an outside party. This could include a check as to whether the critical staff can be contacted outside of usual business hours.

18. Governance

18.1 Background

The FCA rules in CASS 1A require a **CASS medium firm** and a **CASS large firm**[1] to allocate to a single director or senior manager of sufficient skill and authority the function of:

- oversight of the operational effectiveness of that firm's systems and controls that are designed to achieve compliance with CASS;
- reporting to the firm's governing body in respect of that oversight; and
- completing and submitting a CMAR to the FCA in accordance with SUP 16.14.

The first two requirements are also true of a **CASS small firm**.

Where a firm is categorised as a **UK Relevant Authorised Person** for the purposes of CASS 1A.3, overall responsibility for compliance with CASS rests with the person holding the **Senior Manager Function** ('SMF') allocated this responsibility under the **Senior Manager & Certification Regime** ('SMCR') for UK Relevant Authorised Persons. There are two roles within this regime; the **Senior Management Function**, and the **CASS Oversight Function** as required by the SMCR. This is because the FCA makes a distinction between responsibility for CASS oversight from an operational perspective, and overall accountability for a firm's compliance with CASS obligations. In many firms these two sets of duties and responsibilities will be held by the same person. If they are separated (i.e. held by two people) the firm should clarify, in the individuals' Statement of Responsibilities, how the two roles interact the demarcation between them.

Where a firm is *not* categorised as a UK Relevant Authorised Person for the purposes of CASS 1A.3 it falls into the certification regime and the CF10a will have both sets of duties and responsibilities.

Whatever rules apply the firm should document and explain its governance structure and processes, showing how CASS risks are measured, controlled and reported on a day-to-day basis.

When appointing CASS oversight responsibilities to a director or senior manager, the firm must not normally allocate any additional responsibilities to that person unless the firm is satisfied that he or she will nevertheless be able to discharge the CASS oversight responsibilities effectively, and that the firm's compliance with CASS will not be compromised.

18.2 Financial Reporting Council

In November 2015 the Financial Reporting Council ('FRC') published its **Standard for audit firms on Providing Assurance on Client Assets to the FCA.** This was updated in November 2019[2]**.** The Standard prescribes the work auditors should undertake when reporting to the FCA on a firm's CASS compliance. (Please see the separate FRC Best Practice guide.)

[1] See CASS1A.2.7R for the classifications

[2] https://www.frc.org.uk/getattachment/7b2329e7-5035-416d-a19c-7e2e11e08731/CASS-Standard-Nov-2019-With-Cover.pdf

18.3 Providing assurance to the CASS Oversight Manager or Senior Management Function

It is important to document how the person with responsibility for CASS oversight (for the purposes of this document they will be referred to as the CASS Oversight Manager or 'COM') meets his or her responsibilities. The approach will be influenced by the size of the firm. For smaller firms, the COM may be part of day-to-day CASS operations (e.g. reconciliations, breach monitoring, CMAR population and submission). The usual requirement to evidence robust processes and controls for each applies. Please see other Best Practice Guides for these other key CASS requirements.

In order to assist the COM in discharging their responsibilities firms should consider the creation of a specialist **Client Assets Team**. Reporting to the COM this team will be responsible for ensuring that controls are appropriate and effective in mitigating CASS risks appropriate to the nature, scale and scope of the business activities undertaken by the firm and its relevant suppliers or business partners.

18.4 Seeking assurance from the CASS Oversight Manager or Senior Management Function

As for all risks the governing body of a firm will require assurance that CASS risks are being adequately managed. CASS risks will therefore be a standing agenda item for any general **Risk & Compliance Committee** (or similar forum) established within the firm.

Larger firms, or smaller firms where CASS risks are a complex matter, may also wish to establish a dedicated **CASS Committee**, either as a sub-committee of a broader Risk & Compliance Committee or as a standalone sub-committee of the Board. This Committee must have clearly defined Terms of Reference, approved and kept under consideration by the Committee or Board to whom it reports. The ToR should require the Committee to demand and consider evidence-based assurance from the COM regarding the effectiveness of the firm's CASS-related controls, and from time to time assurance from other internal sources such as Internal Audit, Business Risk, Compliance, Legal, Operations and Finance. It should also where appropriate seek additional and more independent assurance from external auditors and specialist consultants.

Matters for consideration by the Committee could include:

- CASS awareness training provision and results;
- A summary of the results of the MI to evidence CASS KPIs on CASS functions of assets or money held or where this is outsourced to third party administrators (TPAs);
- Breach data including number of breaches, CASS rules breached, trends month on month and root cause analysis, together with actions being taken to rectify breaches;
- Reconciliation checks including Internal System Evaluation Method (ISEM) checks;
- A summary of the CMAR submission and items addressed during its compilation and submission;
- A summary of CASS RP changes and attestations;
- A summary of the results of CASS monitoring and due diligence activity. This should include resulting actions tracking;
- An update on regulatory and business change;
- Contact with the external auditor and regulator. This would include the stage of the external CASS audit;
- IT updates on key projects which impact the CASS environment; and
- A summary of any work conducted to trace and contact gone away customers.

Papers to support any item should be submitted for approval or noting as appropriate. Minutes and Action Points should be kept, circulated to all attendees, and agreed.

18.5 Wider governance considerations

Within the firm, there may be a number of forums to consider a wider range of risks and issues. The COM should consider which forum attendance is required by them or a member of their team. If not the COM, there should be a vehicle to report / escalate any CASS specific issues to the COM.

The governance framework structure should be documented, supplemented by Terms of Reference approved by and in place for each governance meeting including the CASS committee. It is best practice for the ToRs to be reviewed regularly and evidence of the review and subsequent changes documented. Firms should consider a calendar of events to ensure such reviews are conducted. This calendar could include other items required on a regular basis.

As per the CASS 1A rule detailed above, there is a requirement for the COM to report to the firm's governing body on CASS oversight. The approach to this reporting to a 'governing body' will vary from firm to firm but CASS needs to have appropriate senior management engagement at a firm's Board or equivalent. This engagement should also allow the COM to escalate issues to this body. A CASS dashboard summarising CASS oversight could be considered as the method by which the oversight is presented and evidenced to these senior forums. This should be a standing agenda item. CASS should also be included at a firm's audit committee, if there is such a forum. The COM should receive a copy of the minutes (or extract) to ensure that the CASS coverage has been accurately reflected.

Firmer evidence of governing body attestation is for the COM to provide a formal attestation to them. This could include a summary of how the firm has complied with CASS. This would be particularly key if the COM was not a member of the firm's Board. Firms may consider creating a standard template to ensure consistency year on year and if it is used for different legal entities. The COM must report at least annually to the firm's governing body in respect of compliance with the rules of CASS 10, the CASS Resolution Pack.

18.6 Monitoring documentation requirements

A key control for the CASS Oversight Function is to ensure appropriate procedures are in place for each of the chapters in the CASS sourcebook which are applicable to the firm. Detailed processes may be held and managed by TPAs but the firm should still consider the need to document the high level approach to meeting the CASS requirements and the oversight that the firm has in place over local process and controls. All of the CASS procedures should be subject to a periodic review.
Firms should consider their controls to ensure all key CASS activities are carried out. Examples include the attestation described above, confirmation of the periodicity of reconciliation checks, summary of procedure checks, and annual issue of client money statements. These could be included in the calendar of events previously referred to.

These reviews would be supplemented by the external auditors' annual review. When considering their own monitoring programmes, the firm's internal compliance and internal audit teams should consider how CASS should be included. This would follow the monitoring methodology of the firm which may use a risk based approach.

18.7 Contract (third party) management

Responsibility for setting up new third party relationships may sit outside the CASS team but it is important for the COM and the CASS team to be involved where any new supplier's activities will be relevant to the firm's compliance with CASS. Outsourcing does not permit transference of any compliance responsibilities from the client to the supplier. The CASS team should therefore review and agree any new contracts and associated service level agreements and service schedules.

It is vital that any third party contract includes an obligation on the supplier firm to provide regular assurance on all relevant risks, CASS included. The contract should also give the client firm the right to test the supplier firm's controls, given reasonable (short) notice. The contract should give the client firm the right to demand urgent action from the supplier, where the client has any concerns regarding compliance. It should also allow for early termination of the contract by the client, given reasonable grounds.

The COM should review on a regular basis all existing relevant third-party relationships to ensure that CASS requirements continue to be understood and met. Where appropriate this assurance should include control testing, either by the COM's own team, and/or by the firm's Internal Audit function, or any other appropriate resource.

The COM should take particular care where any relationship is proposed or developed in which a supplier is permitted to pass its obligations and activities to another external supplier. This should only be with the end client's firm's permission, and the client firm should have the same oversight and audit rights over the external supplier as it has for the primary supplier.

18.8 Change management

Firms should have in place controls to ensure the CASS team is aware of and involved in all appropriate regulatory and business change and that CASS is considered when contemplating any service or product or systems' changes. This could be supplemented with membership and participation of industry bodies.

18.9 CASS training

The COM has responsibility for ensuring that his or her colleagues understand CASS requirements as they apply to their roles. Training is an important means to ensure this understanding and it is the COM's responsibility to ensure it is delivered to all relevant colleagues as soon as possible after joining the firm, and at appropriate times after that.

The training can be either classroom-based (delivered by the COM or a member of his or her team, or by specialist external suppliers), or computer-based. The training should as far as possible be relevant to the delegates' roles within the firm, explaining each individual's responsibilities towards CASS compliance and how to meet those responsibilities. Where possible delegates' understanding of the training should be assessed, the assessment results forming important MI for the COM.

The training material should be refreshed from time to time, ensuring that it is kept relevant and up to date. Delegates should be invited to provide feedback on the relevance and effectiveness of the training material.

Colleagues with any special responsibility for CASS should be required to re-sit the training material from time to time. The COM and his or her team are not exempt from this obligation. The COM should also consider the training requirements of members of the CASS Committee, and wider senior management; seniority is not an exemption.

The training needs of staff employed by relevant third-party suppliers and business parties should also be taken into consideration, the COM seeking assurance that these needs are met to his or her satisfaction.

The T&C scheme, as it covers CASS, should also be monitored to ensure adherence to the scheme.

18.10 Other engagement

The COM should consider holding regular one-to-one meetings with the following to ensure there is opportunity to discuss current and future issues which may affect CASS:

- Head of business
- Risk
- Legal
- Compliance
- Operations
- IT (where applicable)
- Product development teams

18.11 Management information

For any MI received (and covered in the governance forum) the COM or their team the MI should be appropriately checked and validated. For any MI produced by the team controls must be in place to ensure its generation and accuracy.

18.12 External auditor engagement

The COM (or a member of their team) should ensure engagement with the auditor throughout the CASS audit process. This should be from the planning stage to agreement to the management letter and breach schedule.

18.13 Attestations

Larger firms should consider the use of senior manager attestations for key processes and controls. This is a process in which senior managers with particular compliance responsibilities are required, normally on an annual basis, to attest, via a signed written document, that they have met in full all of their key compliance (and other) responsibilities, and have reported any concerns. Obviously, the effectiveness of an attestation is dependent upon the attestor's honesty and understating of his or her responsibilities, but if nothing else it can help to reinforce a culture within a firm in which compliance is seen as of primary importance.

The attestations should be received and reviewed by Compliance, and appropriate actions taken as a result of content of the attestations.

18.14 Record keeping

As every other part of the CASS rules, documentation is key. All aspects of governance should be clearly recorded and retained to meet both the CASS regulatory and business standards.

19. Training & Competence Requirements

19.1 Introduction

This section addresses the training and competency requirements that are particularly relevant to the FCA's CASS rules. There is no 'one size fits all' approach that will meet the training and competency needs of all firms. Firms are required to risk assess their businesses and identify to what extent their employees require training to competently operate, manage and oversee CASS applicable processes. They must also be mindful that the FCA may request evidence supporting the performance of this risk assessment, of the training and competence framework they have in place and how they oversee its effectiveness.
An effective CASS training and competency framework will provide employees of all experience levels (including contractors) with a risk appropriate level of CASS awareness and the technical knowledge they require to mitigate the risk of non-compliant procedures being introduced, or CASS issues going unidentified.

Where a firm has outsourced CASS operational procedures, it must ensure that the 3rd party who provides these services also has an effective training and competency framework in place, ensuring at a minimum that it meets the firm's own internal standards.

The purpose of this document is to highlight the mandatory requirements that must be met by all firms who are subject to CASS and to provide practical guidance on how firms can deliver and manage their training and competence requirements.

19.2 High level regulatory requirements

The FCA repeatedly stress throughout the FCA Handbook the requirement for regulated businesses to be managed and operated by competent staff. Noted below are a few key examples:

- ***Principles for Business (PRIN) – Principle 2***
  'A firm must conduct its business with due skill, care and diligence'.
- ***Systems and Controls (SYSC)***
  'A firm must employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them' (SYSC 3.1.6 & 5.1.1R – competent employees rules).
- ***Supervision (SUP)***
  When assessing 'culture and governance' and 'individual and firm accountability', the FCA will assess the firm's oversight and the competence of its employees (SUP 1A.3.2A G (3) & (4) – supervisory principles).
- ***Training and Competence (TC)***
  'A firm must not assess an employee as competent to carry on an activity (defined in TC) until the employee has demonstrated the necessary competency to do so and has (if required) attained each module of an appropriate qualification. This assessment need not take place before the employee starts to carry on the activity' (TC 2.1.1R).

All firms should consider the provision of appropriate training and the oversight of employee competence levels as an essential part of how they manage risk.

19.3 The Senior Managers and Certification Regimes (SMCR)

A Senior Manager within every firm subject to CASS will need to be allocated the Prescribed Responsibility for the firm's compliance with CASS. It is the FCA's expectation that the firm will assess/vet whether the employee is 'fit and proper', which includes an assessment of their competence prior to being put forward for FCA approval. Guidance provided on what should be considered as part of this assessment includes checking whether they have obtained a qualification, undergone training and ultimately whether they can objectively be considered competent to carry out the responsibility. The FCA will then undertake their own assessment and will only approve the application if they also deem them competent. Pre-approval from the FCA is required prior to an employee taking on this responsibility and once approved the firm must at least annually reassess the Senior Manager.
The Certification Regime requires firms to certify those employees completing certain functions within their business. Prior to certification and in-line with the Senior Managers Regime, there is a requirement for the firm to assess whether the employee is 'fit and proper' to carry out that function, including an assessment of their competence. The key difference is that the FCA do not need to approve those employees falling in-scope of the certification regime, it is solely the firms responsibility. The firm must re-certify the employee completing the function at least annually.

The key functions for the purpose of this guide that are subject to the certification regime are as follows:

- the CASS Oversight function (SYSC 27.7.3R (1)); and
- functions requiring qualifications. (SYSC 27.7.3R (4)).

The CASS Oversight function is equivalent to the CF10a role under the previous Approved Persons regime. There are no mandatory qualification required for certification under this regime, though the firm should consider their formal qualifications as part of their assessment for certification.

The functions requiring qualifications are defined in the Training and Competence rulebook (TC App 1.1.1R). For example, activity 16 'overseeing on a day-to-day basis the safeguarding and administering of assets, or the holding of client money' is captured by the certification regime. In order to perform this activity and be considered competent the employee would need to obtain a qualification, though an employee could still be considered 'fit and proper'.

It should be noted that a single individual could perform all roles noted above, in which case there is no requirement to assign the CASS Oversight function as the Senior Managers regime takes precedence. There could also be a single Senior Manager with responsibility for the firms CASS compliance, a separate employee certified as carrying out the CASS Oversight function and multiple employees certified as overseeing on a day-to-day basis the safeguarding and administering of assets, or the holding of client money. Each firm must take care to ensure that they allocate all responsibilities and functions applying to them.

19.4 General Training and Competence Requirements.

As noted above, it is down to the firm to risk assess their business and identify to what extent its employees require training in order to competently operate, manage and oversee CASS applicable business processes. Often the approach taken is to break the training down into tiers:

- ***Tier 1 – General CASS Awareness training***
  The expectation is that all employees operating in a 'CASS environment' would be expected to complete this training. Due to the number of employees that are likely to require this training, it is often delivered via a computer-based training module. It is considered best practice for this tier of training to be delivered at least annually.
- ***Tier 2 – Specialist/ job specific training***
  Applicable where general CASS awareness training alone is not sufficient. Often this is focussed at those staff who complete complex/technical CASS critical processes e.g. CASS reconciliations, technical specialists, or those who perform compliance oversight.
- ***Tier 3 – Training provided to senior staff***
  This is intended to support their understanding of the CASS landscape across their business, clearly setting out the expectations on them as leaders for overseeing and managing CASS risk.
- ***Formal/structured training requirement***
  Whether required by the TC sourcebook, or set as a requirement by the firm, formal recognised qualifications that provide technical knowledge in CASS specifically, or related specialist knowledge.

The firm must ensure that for each tier of training there is appropriate evidence retained of when it was completed and how it was assessed e.g. via an end of training quiz, ongoing assessment and sign off by trainer or by a certificate confirming attainment of a formal qualification.

The requirements on employees, such as which who in the firm is required to complete which tiers of training, should be set out in a formally agreed training and competence scheme. Employees should be provided appropriate resources and support to ensure the scheme is followed and achievable.

19.5 Industry Engagement

It is an expectation that firms will keep informed of CASS specific industry developments e.g. interpretation of technical requirements, where enforcement action has been taken by the FCA, compliance challenges/themes etc…

CASS industry events and forums hosted by audit firms, consultants, the FCA and industry groups exist that allow for the sharing of this information and the development of best practice. Engagement with the industry should be considered as part of the firms training and competence scheme.

19.6 Oversight

Oversight and formal review of the effectiveness of the firms training and competence scheme is essential if it is to continue to mitigate the risk of non-compliance with CASS. Noted below are a few suggestions:

- Periodic reporting to the firms Client Asset Committee on the effectiveness of the firms training and competence scheme. It is suggested that this take place at a minimum twice-yearly.
- A formal review of the effectiveness of the training and competence scheme should be completed annually, or more frequently if required. For example, if breach management continues to identify 'human error' or competence more generally as a root cause, it should be considered whether the

training and competence framework is operating effectively and action taken to enhance it if appropriate.

- Where operational processes have been outsourced, evidence of the effectiveness of the 3rd parties training and competency scheme should be requested and formally accepted or challenged. This should be supported by periodic independent assessments undertaken through 1st/2nd line compliance monitoring reviews, or by internal audit.

Where a Senior Manager with the Prescribed Responsibility for compliance with CASS, or the certified person for the CASS Oversight function do not have formal qualifications, it should be considered whether this should form part of their development plans as part of their annual reassessment/re-certification.

20. Oversight & Due Diligence of Third Parties

20.1 Third Party Administration

Under their systems and control rules (SYSC 8), the FCA allow firms to outsource regulated activities. This has become common industry practice.
When outsourcing, the responsibility for CASS compliance remains with the firm who has contracted with the outsourced provider. It is therefore necessary for firms to put in place robust oversight of the outsourced provider/ third party administrator (TPA). The requirements apply whether the provider is external to the firm or part of the same group.

The basis for the firm's CASS oversight arrangements will be the legal contracts and service levels agreed between itself and its TPA, specifically the elements within those legal contracts and service levels that are required to be compliant with the CASS rules These arrangements are dependent on the type of business conducted by the firm, which may include, but not be limited to, any of the following elements of CASS:

- Client money
- Allocation of client money
- Segregation of client money
- Client and corporate bank accounts
- Client money resource
- Client money requirement (regardless of method used, Net Negative Add Back, Individual Client Balance method, or non-standard method)
- Production and dispatch of periodic and ad hoc mailings, including trade confirmation and CASS 9 statements
- Mandates (CASS 8) - written and non written
- Safe custody assets –ISEM and reconciliations
- Diversification
- Prudent segregation
- Resolution packs.

A firm must have an appropriate governance structure in place in order to have adequate oversight of the outsourced CASS arrangements at a TPA. This should include specific committees which cover CASS including the performance of the TPA in relation to CASS activities and also CASS representation on other committees upon which CASS could have an impact. Any significant CASS issues at the TPA should be escalated up to the committees which cover CASS, discussed under an agenda item and minuted accordingly. Additionally, CASS should be given appropriate senior management engagement at a firm's Board level.

A firm should have full documentation of its CASS arrangements with a TPA. This should include which CASS functions the firm has outsourced, which TPAs are utilised for different business areas and what governance and BAU oversight arrangements the firm has in place to monitor these CASS functions. A firm should also have access to and be able to explain a TPA's approach and procedure documentation relevant to its outsourced CASS functions. Additionally, a firm must have formal policies in place as required by the

CASS rules in areas such as diversification and prudent segregation that a TPA will need to understand if it performs CASS functions relevant to these areas. If one exists, firms also need to interact with their TPAs with an active and engaged user group run by the TPA which focusses on CASS or a similar forum with which the TPA participates. This would supplement the regular engagement with the TPA on CASS matters.

The following are common methods of oversight which firms should consider, all of which should be evidenced:

- ***Regular Client Service Review Meetings***

A firm must be able to evidence the frequency, participants and topics of discussion held during meetings with the TPA. The frequency of meetings should be considered in relation to the risks and complexities within the operating model, and participants should include those with influence over the decisions and actions carried. Terms of Reference, agendas, minutes (which reflect challenges and actions) and progressed actions evidence the success of such meetings. CASS agenda items to include:

  - Performance against CASS activity;
  - Breaches;
  - Complaints;
  - Results of the TPA monitoring; and
  - Change (if no separate change forum) both business and regulatory.

These may need to be supplemented with focus on incidents which have occurred during the review period.

- ***Onsite Visits***

A firm should be able to articulate working knowledge of the outsourced administrator. Regular visits to significant operating locations are essential and will assist with full understanding of the high level process flows, operating challenges and successes. Onsite visits will also be required for monitoring and testing purposes. The availability of the TPA will need to be negotiated. Methodology of monitoring should be developed, a report of the review should be issued and actions tracked through to completion.

- ***Process Documentation***

It is key that firms understand the risks and controls of the services outsourced to the TPA. A firm should develop and gather documentation (Procedures, visual diagrams etc.) to support and share knowledge internally of the TPA. These documents should cover key aspects of the CASS rules such as method of reconciliation, frequency of reconciliation, shortfall funding, payments in and out, breaches, resolution plans, risk/controls framework, for example. Where a TPA has produced a CASS controls matrix covering controls operated by the TPA, a firm must conduct an initial review to assess whether the TPA's CASS controls matrix is relevant, accurate and complete for the specific firm. On an ongoing basis, the firm must ensure that it understands all the controls documented and is able to explain these to others (for example auditors). It should also incorporate the TPA's CASS controls matrix (including any subsequent changes made by the TPA) into the firm's own CASS controls matrix and include the

TPA's CASS controls matrix in the firm's CASS testing programme. Preferably the TPA's CASS breach reporting should link back to the TPA's CASS controls matrix.

- ***Management Information (MI)***

As part of the relationship, it is important for the firm to agree CASS KPIs with the TPA to supplement other MI. MI which illustrates performance against these will then be required in a format agreed with the TPA. These KPIs should include performance against key part of the CASS rulebook. A firm should ensure it analyses this information (duly evidenced) and demonstrates how the MI informs how the business is run, oversight is applied and how action is taken

- ***Reconciliations***

Reconciliations provide an insight into the effectiveness and overall health of the operating activity. These should be performed at a frequency in line with the CASS rules and agreed with the TPA. Review of reconciliations demonstrates a firm's oversight of the outsourced provider and can independently identify issues, themes, risks etc. The firm should have access to the reconciliations performed by the TPA. The firm should understand and review these including that the narrations reflect the requirements of 6.6.8 and 7.15.7. A firm must be able to demonstrate how a reconciliation is conducted. As for all oversight, evidence of the firm's review of the reconciliations should be maintained. As a result of reconciliation oversight, policy-based decisions can be monitored, for example, regarding Prudent Segregation or Diversification, and potentially highlight the need for any re-consideration of such policies.

- ***CMAR***

Where a TPA provides the firm with some or all of the information in order for the firm to complete the CMAR, the firm must conduct a comprehensive review of this data to ensure it is accurate and complete before submitting it to the FCA. A firm must ensure that the data is consistent with its client money reconciliations and any other CASS reporting, and is in line with the firm's interpretation of the CMAR fields. A firm should consider including the accuracy and timeliness of CMAR data provided by the TPA within its KPI's

- ***CASS Resolution Pack (RP)***

The CASS RP, covered under CASS 10 now forms a key element to a firm's overall governance and requires a significant amount of information in respect to the firm's business, including its key members of staff and documentation that will help an Insolvency Practitioner (IP) complete the task of distributing client money and assets quickly and efficiently in the event of the firm's insolvency. A firm should have documentation that outlines the information that it expects the TPA to contribute to its CASS RP and arrangements to ensure the TPA provides this. The firm should ensure that any documentation that the TPA provides is practical and that the TPA is able to maintain documents that form part of the firm's overall CASS RP in accordance with the requirements of CASS 10. To enable firms to comply with the requirement to maintain an accurate and up to date CASS RP, firms must agree with the TPA a process for them to provide updates to the firm. This needs to include the TPA understanding

what changes are considered material. Similarly the firm needs to work with the TPA so that the TPA understands the retrievable timescales for each item. The firm should also ensure it documents any agreement with its TPA about its capability to test its CASS RP. Firms are reminded that the overall content of the CASS RP is their responsibility and should not be solely reliant on the TPA documentation.

- ***Training***

A firm should be able to review and assess the suitability and effectiveness of an outsourced provider's CASS training. This may include a review of TPA's material and the audience to whom the material is delivered to (operational staff and Management/Board members). This should be in addition to ensuring its own oversight staff and management/board members are equally trained to understand how CASS impacts their business and the risks mitigated.

- ***Change activity***

Dependent on the structure of the Client Review Group meetings and the volume and nature of change, it may be appropriate to hold separate meetings with the TPA to cover this to ensure CASS compliant implementation. This should include consideration to changes of the TPA's procedures and wider strategic approach. Whatever method used to cover change with the TPA, changes and agreement to these must be documented.

- ***IT controls***

For business and regulatory change, the TPA may need to make changes to their IT systems. A firm should have sufficient oversight to understand these changes to be able to demonstrate they will result in the required outcome. This is also true of the reporting that the TPA delivers to the firm. .

- ***Attestations***

In addition to the oversight points, the use of attestations within the industry is a method of ensuring adherence or accountability within an outsourced provider where shared evidence may not be an option. Where this is the case a firm should consider having regular attestations in place.

20.2 Auditor engagement

The firm needs to ensure that when its CASS auditor engages with the TPA, the timelines and deadlines are clearly agreed as part the legal contracts and service levels agreed between the firm and TPA. This is to ensure that the TPA can diarise meetings with auditors in advance and any information requests, access to staff, samples etc. can be provided as promptly as possible with minimal direct impact on BAU.

20.3 Second and third lines of defence relationship with TPA

The firm should formally agree and document with its TPA, second and third lines of defence interaction with the TPA. This may be via the first line or some form of direct access. The firm's second line may require access to the TPA's compliance monitoring programme and outcome of these reviews and want to perform its own monitoring onsite at the TPA in additional to the first line oversight visits. This may also be true of third line for any internal audit reviews it undertakes.

21. Financial Reporting Council (FRC):
Providing Assurance on Client Assets to the Financial Conduct Authority (FCA)

21.1 Introduction and Background

The FRC is responsible for promoting high quality corporate governance and reporting. It sets the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work.

The FRC Client Asset Assurance Standards (hereafter referred to as the 'Standards') were introduced as a direct result of the tightening of the FCA Client Assets Regime (particularly the enforcement of the Regime through the work of its Client Assets Unit) following the financial crisis of 2008.

21.2 Purpose

The Standards establish requirements and provide guidance for Client Assets (CASS) auditors reporting to the FCA in accordance with its SUP (Supervision Manual) rules in respect of engagements that involve evaluating and reporting on regulated firm's compliance with the CASS rules.

For the purposes of the Standards, the term 'Client Assets' refers to both client money and safe custody assets as defined by the FCA's Glossary of Terms.

The Standards became effective for all reports to the FCA with respect to Client Assets for periods commencing on or after 1 January 2016.

21.3 Objectives

The key objectives of the Standards are to:

- Improve the quality of CASS audits and other CASS assurance engagements;
- To define the nature and extent of the work required by CASS auditors to complete assurance engagements on regulated firm's compliance with the CASS rules;
- Support the FCA's Client Asset Regime regarding the effective safekeeping of client assets and in particular to guard against systemic failure of the CASS Regime;
- Manage the expectations of;
  - The management of firms that hold client assets; and
  - Third Party Administrators

  when a CASS auditor is engaged to provide assurance to the FCA on client assets that they handle or account for.
- Help to establish realistic expectations regarding the integrity of the UK Client Asset Regime with the beneficial owners of client assets; and
- Underpin the effectiveness of the FRC's enforcement and disciplinary activities with respect to CASS engagements.

21.4 Expectations and Requirements for Regulated Firms

Where the firm holds custody assets and/or client money, the SUP rules require the CASS auditor to provide a Reasonable Assurance Client Assets Report to the FCA.

The underlying subject matter of a reasonable assurance report confirms (or otherwise):

- The adequacy of the systems maintained by the firm to enable it to comply with the relevant CASS rules throughout the period since the last date at which a report was made;
- The firm's compliance with the relevant CASS rules at the period end date; and
- The Breaches Schedule appended to the CASS auditor's report. (The CASS auditor is required to provide the FCA with a schedule appended to its report which lists each CASS rule in respect of which a breach has been identified. The breaches schedule is required to include every breach of a rule that is within the scope of the Client Assets Report of which the CASS auditor is aware, whether identified by the CASS auditor or disclosed to the CASS auditor by the firm or by any third party.)

In order to satisfactorily address both CASS auditor expectations and the required evidence of compliance with the relevant CASS rules, regulated firms must ensure that provision of the following information is readily achievable:

- Detail of the nature of services the firm provides to clients;
- How the firm is remunerated for those services and any other ancillary services;
- The nature of any transactions the firm undertakes on behalf of or advises on for clients, and how these transactions are executed and/or settled;
- The sources and destinations of cash and other asset inflows and outflows in its own accounts and any accounts it holds or controls on behalf of clients and other parties;
- Confirmation of the means by which the firm segregates client money and safeguards custody assets so that both are legally effective and, in the event of the firm's insolvency, client assets would be returned on a timely basis to their beneficial owners;
- The role of sub-custodians and third party administrators (NB: the firm retains full and ultimate responsibility for compliance with the CASS rules in respect of functions outsourced to third party custodians and/or administrators);
- Detailed assessment of the firm's business processes and their application or otherwise to the CASS rules. This 'mapping' must also document the risks of non-compliance with the CASS rules associated with each process, and the controls in operation to mitigate those risks;
- Firms must be able to demonstrate the effectiveness of Key CASS Controls across their business with regular assessments and reviews of the CASS Risk Framework;
- In case where firms outsource services to third parties, Key CASS Controls relating to those services must also be assessed for effectiveness and the firm's oversight controls must be included in their CASS Risk Framework maps;
- Consideration of any waivers or modifications to the CASS rules granted to the firm by the FCA, and how any waiver or modification granted impacts on the rule mapping referred to above;
- Full detail of the CMAR (Client Money and Asset Return) submitted monthly to the FCA (intended to give the FCA an overview of the firm-specific client money positions and custody asset holdings);

- Records of the internal and external client money and custody assets reconciliations performed at the frequencies determined by the CASS rules and forming the basis for the firm's organisational arrangements to protect clients' assets;
- Compliance monitoring and internal audit reviews and outcomes;
- Monitoring and reporting to the firm's governing body in respect of the adequacy and effectiveness of the firm's internal controls intended to ensure compliance with the CASS rules;
- Records maintained by the firm of any rule breaches and notifications to the FCA (in respect of immediately reportable breaches) that may have occurred during the audit reporting period;
- The results of any inspection visits made by the FCA during the audit reporting period;
- The register of client complaints; and
- Any Section 166 Skilled Persons Reports or other relevant external/internal reviews that may have been performed.

21.5 Special Reports

The CASS rules permit, in certain circumstances, firms to operate:

- An ''alternative approach'' to client money segregation; and
- A ''non-standard method'' of internal client money reconciliation.

In both cases the FCA expect the firm to obtain, before carrying out the proposed approach/method, an auditor's report prepared on the basis of a reasonable assurance engagement to the effect that the proposed approach/method will achieve the desired regulatory outcome. The Client Asset Assurance Standard has a separate section of requirements relating to the provision of reasonable assurance with respect to such Special Reports.

21.6 Disclaimer

The information contained within the sections above is non-exhaustive and is a summary of the main considerations in respect of the FRC Client Assets Assurance Standards and their application to regulated firms. In the event of any conflict between this document and the content of the FRC Client Assets Assurance Standards, the latter will prevail.