

# FCA Proposes Minor Amendments to CASS and CONC

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Financial Services and Regulation

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On July 12, 2013 the Financial Conduct Authority (“FCA”) published its much-anticipated Consultation Paper (CP13/5), covering its root and branch review of the client money and client assets regime for investment business. In doing so, the FCA published one of the most controversial Consultation Papers that the industry had seen in a very long time. The following year, in June 2014, the FCA published its Policy Statement PS14/9, which set out the FCA’s policy and final rules regarding the client assets regime for investment business.

Since the Policy Statement and final rules were published, the FCA has identified that four rule changes that were due to take effect on June 1, 2015 may not fully achieve the policy outcome that was intended. In Chapter 2 of Quarterly Consultation No. 8 published in March 2015 (CP15/8), the FCA is consulting on various minor amendments to the custody rules (CASS 6) and the client money rules (CASS 7). The CASS 6 requirements that the FCA is proposing to amend affect:

- external custody reconciliations; and
- registration and recording of legal title.

The CASS 7 requirements to be amended affect:

- the use of the normal approach to client money segregation in relation to certain regulated clearing arrangements; and
- the delivery versus payment rules applicable to authorised fund managers and relating to regulated collective investment schemes.

Mostly, the Consultation Paper simply provides some helpful and much needed clarification, particularly in relation to the ability of Authorised Fund Managers (“AFMs”) to pay depositaries and trustees from corporate accounts. The proposals are as follows.

## **External custody reconciliations of client assets**

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Under the new rules which will apply from June 1, 2015 the third parties whose records and accounts a firm is required to reconcile its own internal records and accounts with must include:

- the third party with whom the firm has deposited the relevant client assets; and
- where the relevant assets have not been deposited with a third party, the third parties responsible for registration or recording of legal title to the relevant assets.

The FCA observes in the Consultation Paper that under the rules as currently drafted, firms would not be able to use certain third parties' system records to carry out external custody reconciliations relating to Irish, Jersey, Guernsey and Isle of Man securities, as these third parties are not responsible for the registration of legal title to these securities. The FCA is therefore proposing to amend the rules to allow CASS 6 firms to perform external custody reconciliations against these third parties' systems records for uncertified units of securities governed by the relevant uncertified securities regulations in those jurisdictions.

## **Registration and recording of legal title to client assets**

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The new rules set out how a firm is expected to register or record legal title to a client's safe custody assets. Firms may deposit client assets with a third party, or arrange for client assets to be held by a third party, subject to certain requirements. However, the FCA observes that the perimeter between the registration and recording of legal title (CASS 6.2.3R) and depositing assets and arranging for assets to be deposited with third parties (CASS 6.3) is unclear. The FCA is therefore proposing to clarify that where a firm deposits a client's safe custody assets with a third party, the firm need not be the party responsible for registration and recording of legal title to those assets deposited with the third party.

## **Use of the normal approach to client money segregation for certain regulated clearing arrangements**

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PS14/9 contains specific rules covering the flows of client money between a central counterparty ("CCP") authorised under the European Market Infrastructure Regulation ("EMIR"), and the clearing members of that CCP. Under the new rules, where clearing member firms are required by their arrangements with a CCP to receive mixed payments of house and client money into (and make mixed payments out of) a single bank account, the firm must use a house bank account for the purpose. However, this does not cover the situation in which money is purely client money (rather than a mixture of house and client money), because it relates purely to client positions, rather than house and client positions. Accordingly, the FCA proposes to amend the relevant CASS 7 rules to ensure that when clearing member firms have entered into arrangements with a CCP and use a single house bank account to receive payments from and make payments to the CCP, that house bank account may also be used by the firm to receive payments of pure client money.

## **Delivery versus payment rule for regulated collective investment schemes**

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The final rules in PS14/9 give Authorised Fund Managers ("AFMs") a one-day "window", known as the "DvP window", during which they need not comply with the client money rules when receiving money when subscribing for or redeeming units in regulated collective investment schemes, for clients whose money would, but for this window, need to be treated by the AFMs as client money.

The FCA has been asked that where AFMs are required to segregate client money because they hold it for longer than one day, whether the AFM is required to make any payments to third parties directly from the client bank account, or whether such monies can be transferred through a corporate account. Whilst the FCA believes that it had already made the position clear in PS14/9, it is proposing to clarify that AFMs would not be in breach of the client money rules if they transfer client money (except cheques) from a client bank account into a corporate account before the money is transferred to a third party.

## **Amendments to the client money distribution rules to make clear the constitution of the client money pool**

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The FCA observe that in certain circumstances, the effect of the rules could be to exclude “identifiable client money” in house accounts from the constitution of the client money pool formed on a primary pooling event under CASS 7A. This could result in the client money pool being limited to sums held in client bank accounts and client transaction accounts at the time of the firms’ failure. This could exclude any identifiable client money held in house accounts, despite the fact that these amounts would fall under the statutory trust under CASS 7, as they constitute client money. This is not the FCA’s intention. It is therefore proposing to amend CASS 7A to make the constitution of the client money pool clear. The client money pool should include any client money in client bank accounts and client transaction accounts and any client money identifiable in any house account held by the firm into which client money has been received. The rules relating to client money sub-pools remain unchanged.

## **Loan-based crowdfunding and CASS**

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The FCA wishes to clarify that loan-based crowdfunding firms are subject to CASS. Accordingly, the FCA is proposing to amend the transitional provisions to the Consumer Credit Sourcebook (“CONC”), so that they do not exclude the application of CASS (or related parts of SUP) for loan-based crowdfunding firms. Firms holding an interim permission to carry out loan-based crowdfunding and which qualify as CASS medium or large firms will not be able to appoint a CF10a (CASS operational oversight function) because they will not have employees exercising significant influence functions. Such firms must allocate the relevant functions to a suitably senior person, even if that person is not actually a CF10a.

Firms with interim permission to carry out loan-based crowdfunding and which qualify as CASS small firms will similarly not have any employees exercising significant influence functions during the interim permission period. Similarly, the firm must allocate the rules and tasks that would normally be carried out by a CF10a to a suitably senior person.

Firms with interim permission only do not have access to GABRIEL, in order to submit CMAR data. In the interim, the FCA intends to make the return available to these firms “by other means”, but it does not specify what these are.

## **Next steps**

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The Consultation Paper provides some very helpful clarification of some problematic areas of the new rules. Of particular assistance is the provision allowing AFMs to pay depositories and trustees from a corporate account, a move which should be welcomed by AFMs.

Comments on the amendments to CASS and CONC set out in Chapter 2 of the Consultation Paper should be submitted to the FCA by April 6, 2015.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Financial Services and Regulation practice group:

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