Neutral Citation Number: [2010] EWCA Civ 917

Case No: A2/2010/0113,0114,0119,0121

IN THE HIGH COURT OF JUSTICE
COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
(CHANCERY DIVISION)
BRIGGS J
[2009] EWHC 3228 (Ch)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 02/08/2010

Before :

THE MASTER OF THE ROLLS
LADY JUSTICE ARDEN
and
SIR MARK WALLER

- -

Between :

(1) CRC CREDIT FUND LIMITED **(2) LEHMAN BROTHERS INC.** **(3) LEHMAN BROTHERS FINANCE AG** **(4) LEHMAN BROTHERS HOLDINGS INC.**	**Appellants**
- and -	
(1) GLG INVESTMENTS PLC SUB-FUND: EUROPEAN EQUITY FUND **(2) HONG LEONG BANK BERHAD** **ADMINISTRATORS OF LEHMAN BROTHERS INTERNATIONAL (EUROPE)**	**Respondents**

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Mr Robert Miles QC & Mr Richard Hill (instructed by **Messrs Simmons & Simmons**) for the 1st Appellant
Mr John Jarvis QC, Mr James Evans & Mr Richard Brent (instructed by **Messrs Norton Rose LLP**) for the **2nd Appellant**
Mr Jonathan Russen QC (instructed by Messrs Field Fisher Waterhouse LLP) for the **3rd Appellant**
Mr Antony Zacaroli QC, Mr David Allison & Mr Adam Al-Attar (instructed by **Messrs Allen & Overy LLP**) for the **1st Respondent**

Mr Nicholas Peacock QC & Miss Catherine Addy (instructed by **Messrs Baker McKenzie LLP**) for the **2nd Respondent**
Mr Richard Snowden QC & Mr Ben Shaw (instructed by **Messrs Weil, Gotshal & Manges**) for the **4th Appellant**
Mr Iain Milligan QC & Miss Rebecca Stubbs (instructed by **Messrs Linklaters LLP**) for the **Administrators**
Mr David Mabb QC & Mr Stephen Horan appeared for the **Financial Services Authority** (**Interested Party**)

Hearing dates : 21-24 June 2010

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Approved Judgment

Lady Justice Arden :

1. This appeal addresses important issues concerning the ownership of client funds held by Lehman Brothers International (Europe) ("LBIE") at the date of its entry into administration. Those funds were subject to a statutory trust imposed by Chapter 7 of the Client Asset Sourcebook, known as "CASS7", made under section 139 of the Financial Services and Markets Act 2000 ("FSMA") and applying to client money obtained by an investment firm from clients for the purposes of its investment business, but it is in dispute when that trust arose. The principal issues in this appeal are therefore: (1) the exact point in time when in the conduct of its investment business LBIE became a statutory trustee of client money for its clients, and (2) the manner in which such funds are to be distributed following the entry into administration. The resolution of these questions may have important implications for the clients involved since as beneficiaries under a trust they will be entitled to exclude any other creditors of LBIE from any claim on those assets.

2. LBIE was the principal United Kingdom trading subsidiary of Lehman Brothers Holdings Inc. ("LBHI"), which is now in Chapter 11 proceedings in the USA. LBIE provided a wide range of investment services to clients and held considerable amounts of money on behalf of its clients. That money was held by LBIE and with third parties, such as clearing systems. LBIE's business was regulated pursuant to FSMA. At 7.56am on 15 September 2008, administrators were appointed pursuant to the Insolvency Act 1986. This meant that a "primary pooling event" ("PPE") then occurred for the purposes of CASS7, triggering a requirement to distribute client funds in accordance with section 9 of CASS7.

3. Briggs J, in a masterly and comprehensive judgment handed down on 15 December 2009, supplemented by a further judgment dated 20 January 2010, essentially held that CASS7 imposed a statutory trust on the funds that LBIE received from or for its clients as soon as they were received. He further held that CASS7 provided for the pooling of client funds. The pool of monies resulting from the rules was called "a client money pool" or "CMP", though this term does not appear in CASS7 itself. Briggs J concluded that the rules on pooling only applied to client funds in segregated accounts. The only persons entitled to share in this pooling were persons for whom funds had been placed in segregated accounts. Clients whose funds had, for example, remained in the firm's accounts had to pursue such remedies, if any, as were open to them under the general law.

4. The striking point about these conclusions is that, on the assumption that pooling represents a higher level of protection for client monies than that available under the general law, this higher level of protection is only achieved to the extent that the firm actually effects segregation of client monies, and that the safeguards provided by CASS7 for clients for whom monies were not segregated are materially different from those provided for clients whose monies were segregated. This is so even though the judge concluded that client monies were held on the statutory trust whether or not they had been segregated. Thus, if the firm has weak financial controls or misappropriation occurs, so that money is not duly segregated for clients, then, under the judge's ruling, clients are at risk of having no proprietary claim of substance or even no proprietary interest at all in the event of the firm's insolvency. Furthermore, if the judge is right, clients with segregated accounts will not have to share the monies

in those accounts with those for whom no segregation took place; only those for whom relevant monies were segregated have claims on the CMP.

5. In this judgment, after describing the parties appearing on this appeal, I will summarise the factual background, the regulatory background and the principal conclusions of Briggs J, before turning to consider the issues to be decided.

REPRESENTATION

6. Numerous parties have appeared on this appeal. Very briefly, the positions taken by Counsel were as follows. Mr Richard Snowden QC, for LBHI, argues that the judge was wrong to hold that the statutory trust was imposed with effect from receipt of client monies. His arguments thus relate mainly to Issue 1 below[1]. Mr Robert Miles QC, for CRC Credit Fund Limited, as the representative of non-segregated clients, argues that the judge was right on this point but wrong to exclude clients without segregated accounts from the pooling. Any monies representing client monies were to be paid into the pool and any client with an entitlement to client monies was entitled to a share in the pool. Mr Miles' arguments thus relate to issues 1, 2[2] and 3[3] below. Mr Jonathan Russen QC, for Lehman Brothers Finance AG, takes the same position as Mr Miles. Mr Antony Zacaroli QC, for GLG Investments PLC sub-fund: European Equity Fund, submits that there is a pooling only of the monies in the segregated accounts for the benefit only of segregated creditors (Issues 2 and 3 below). Mr John Jarvis QC, for Lehman Brothers Inc. ("LBI"), adopts the arguments of Mr Miles but in addition submits that the statutory trust of client monies applies to any debt which LBIE became liable to pay to a client so that the holders of any such debt were entitled to claim in the pool (Issue 4 below[4]). Mr Nicholas Peacock QC, for Hong Leong Bank Berhad, an ordinary unsecured creditor of LBIE, opposes the arguments of Mr Jarvis. Mr David Mabb QC, for the Financial Services Authority ("the FSA"), and Mr Iain Milligan QC, for the Administrators of LBIE, present submissions to assist the court.

7. To avoid repetition of oral submissions, Counsel sensibly divided the issues among themselves for the purposes of the hearing even though their written submissions dealt with each issue with which their client was concerned. This was very welcome as there were some 14 skeleton arguments with a certain amount of duplication. In the interests of simplicity and without intending any discourtesy to Counsel, I will not in general refer to all the written submissions of Counsel who when making their oral submissions adopted earlier oral submissions of other Counsel. However, all their submissions, whether referred to in this judgment or not, have been carefully considered, and Counsel in their oral submissions have also ably assisted us. The level of argument that we have received was exceptionally high and we are very grateful for all the assistance we have received from Counsel and those instructing them.

THE FACTUAL BACKGROUND

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[1] Issue 1: *Trust on segregation, not receipt?*

[2] Issue 2: *Does CASS7 pool identifiable client money wherever found or only segregated client money?*

[3] Issue 3: *Do clients participate in the pool if they have claims to client money or only if they have contributed to the pool?*

[4] Issue 4*: When does money which the firm owes to a client become "client money"?*

8. Both Briggs J and this court have proceeded on the basis of a statement of assumed facts, which is set out in paragraphs 46 to 49 of the judgment of Briggs J dated 15 December 2009. I do not propose to set that statement out again in this judgment. This shows that LBIE provided services for clients wishing to invest in securities and that it operated an "alternative approach", which was permitted by CASS7, for the receipt of client funds. This meant that monies received from clients were paid into an account or accounts of LBIE and then segregated into client accounts each day according to a reconciliation of client monies conducted as at the end of the close of business on the preceding day. In other words, to the extent that the aggregate client entitlement to client monies exceeded the aggregate of the net amount which LBIE held for each client to the credit of that client's bank accounts and transaction accounts, the balance would be transferred to the segregated client bank accounts held by LBIE for its clients. If the balance was the other way, the relevant client bank accounts would be debited and the money would be transferred to the house accounts of LBIE. Client funds were not therefore paid directly into segregated client accounts.

9. LBIE carried out its last reconciliation of client funds on Friday morning, 12 September 2008, as at the close of business on Thursday 11 September 2008 ("the point of last segregation" or "PLS"). That means that LBIE received client funds into its house accounts after the PLS which remained there at the PPE.

10. There is little more that I need to say about the facts, other than that, inevitably, there were errors and discrepancies in the movements of client monies, which meant that in some cases there were over-segregations or under-segregations of assets. In addition, there were "unapplied credits", "fails" and "depot breaks". "Unapplied credits" were segregated amounts held by the firm but not allocated to the clients entitled. A "fail" was a sum set aside for a client representing the value of stock purchased but not delivered. A "depot break" was a sum set aside for clients where there was a shortfall or perceived shortfall in securities which the firm should be holding for clients. Since certain affiliates of LBIE are represented on this appeal, it perhaps needs to be explained that LBIE's clients included affiliates, for whom segregated client accounts were not maintained. We are not concerned with why this happened though LBHI contend that the FSA supported this approach. It is, however, common ground in these proceedings that LBIE should have segregated client monies even if the client was an affiliate.

CLIENT ASSETS: THE REGULATORY REGIME

11. FSMA gives the FSA wide powers to make rules. These rules have the force of law and impose binding obligations upon those who are subject to them. The general rule-making power is in section 138 of FSMA. This provides that the FSA may make such rules applying to authorised individuals and firms as appear to be necessary or expedient to protect consumers' interests. The FSA also has specific powers to make rules in certain areas. These powers are conferred by section 139. The power to make rules includes rules regarding the conduct of client business. Sections 138 and 139 provide in material part as follows:

> "138. *General rule-making power*

> (1) The Authority may make such rules applying to authorised persons—
>
> > (a) with respect to the carrying on by them of regulated activities, or
> >
> > (b) with respect to the carrying on by them of activities which are not regulated activities, as appear to it to be necessary for the purpose of protecting the interests of consumers.
>
> 139. *Miscellaneous ancillary matters*
>
> (1) Rules relating to the handling of money held by an authorised person in specified circumstances ("clients' money") may—
>
> > (a) make provision which results in that clients' money being held on trust in accordance with the rules;
> >
> > (b) treat two or more accounts as a single account for specified purposes (which may include the distribution of money held in the accounts);…"

12. With immaterial exceptions, a contravention by an authorised person of a rule is actionable at the suit of a private person who suffers loss as a result of the contravention but does not constitute a criminal offence (FSMA, sections 150, 151). A breach of the rules may also lead to disciplinary action under Part XIV of FSMA.

13. In addition to its rule-making powers, the FSA is "the competent authority" designated by the United Kingdom for the purposes of the Markets in Financial Instruments Directive (2004/39/EC) ("MiFID") as defined at paragraph 14 below. Since the entry by LBIE into administration, the Financial Services and Markets Act 2010 has been passed. This makes amendments to FSMA and extends the regulatory activities of the FSA to maintaining stability in the financial system. We are not concerned with that Act, and accordingly references to FSMA are to that Act as originally enacted and not to that Act as amended by the 2010 Act.

14. In pursuance of its rule-making powers, the FSA produced a large Handbook. Chapter 7 of this Handbook, known as CASS7, dealt with client money and came into force on 1 January 2004. MiFID came into force on 1 November 2007. In consequence of MiFID, and also Commission Directive (2006/73/EC) dealing with the implementation of MiFID, known as "the MiFID Implementing Directive" (together "the MiFID Directives"), CASS7 was revised. The provisions of CASS7, as in force at the date of the administration of LBIE, are, so far as material, are set out in Appendix 1 to this judgment.

15. Rules creating binding obligations have the suffix "R". Where "G" follows a provision, that provision is normally guidance under section 157 of FSMA, which need not be followed and which does not create any presumption of non-compliance

(see *The Readers' Guide* in Chapter 2 of the *Handbook*). The FSA has also published a *Glossary*. At the end of Appendix 1, I have included relevant extracts from the *Readers' Guide* and the *Glossary*. There are separate parts of the Handbook dealing with client money and physical property belonging to clients. The rules provide mechanisms for the protection of assets belonging to clients. In Appendix 2 I have set out the relevant provisions of the MiFID Directives.

16. It is a fundamental rule of CASS7 that firms are to keep client money separate from their own money and the rules are intended to prevent a firm from using client monies for its own purposes. I would observe that the objective of client protection cannot, of course, be an absolute one, and some account may have to be taken of practicality.

17. It is also a specific aim of CASS7 to facilitate "the timely return" of client money to clients if the firm fails (CASS7.9.2G). Investment firms are regulated in their home state and (within the European Union) insolvency will generally be a matter for the home state. A failure of a third party at which the firm holds client money is termed a "secondary pooling event". Different forms of pooling separately occur on primary and secondary pooling events. There was a secondary pooling event in this case, because (according to the statement of assumed facts facts) clients of LBIE had a client account with Lehman Brothers Bankhaus AG, which also failed. However, that event is of no consequence so far as CASS7 is concerned because CASS7.9.13 provides that where a primary and secondary pooling event both occur, the distribution of client assets proceeds as if there was only a primary pooling event.

18. The interpretation of particular provisions of CASS7 must be an iterative process, but one has to begin somewhere. I propose to summarise the provisions of CASS7 by taking them in the order in which they appear.

19. CASS7 applies to a MiFID investment firm when it holds client money in the course of its MiFID business (see CASS7.1.1). The definition of MiFID investment firm includes persons who carry on the business of providing investment services. I do not propose to refer to the possibility of opting into the client money rules or to situations where a firm carries on MiFID and other business (CASS7.1). Those rules are not relevant to the present appeal.

20. Under CASS7.2.1R, "client money" means any money that a firm receives from or holds for, or on behalf of, a client in the course of, or in connection with, its MiFID business unless otherwise specified. The term "money" includes coins, electronic money and cheques. It is also important to note that the definition of client money applies whenever a firm receives client money or holds client money.

21. CASS7.2.15 spells out when client money ceases to be such. It is headed "Discharge of fiduciary duty" though the statutory trust which gives rise to that fiduciary duty does not appear until CASS7.7.2R. Money will cease to be client money if it is paid to the client or indeed to the firm when it is due and payable. This should be read with CASS7.2.9R which deals with the case where a client becomes liable to pay money to the firm. Client money which becomes properly due and payable to the firm ceases to be client money. CASS7.2.12G deals with commission rebates. Where a client is contractually entitled to rebate of commission, the rebate only becomes client money when the rebate has become due and payable to the client.

22. The next part of CASS7 deals with organisational requirements. These are clearly aimed at minimising the risk to clients of the loss of clients' rights to client money and firm use of client money, whether deliberately or as a result of inadequate record-keeping.

23. CASS7.4 deals with the segregation of client money. It is a fundamental requirement of MiFID that client money should be segregated from the money of the investment firm. The reasons are obvious: to prevent misuse of client assets and to protect funds in the event of insolvency.

24. Accordingly, a firm receiving client money must promptly place it into a bank account with an institution of a particular type (CASS7.4.1R). This account must be identified separately from any account used to hold the firm's own money (CASS7.4.11R). These two rules are known as "the MiFID client money segregation requirements". A firm must consider certain specified matters before selecting the body with which client bank accounts will be placed. A client bank account may take the form of: a general client bank account; or a designated client bank account; or a designated client fund account (though this can only be used where a client has consented to the use of that account and all other designated client fund accounts which may be pooled with it). Where a firm undertakes investment for its clients using an intermediate broker or exchange, it may also need to open a client transaction account.

25. CASS7.4.1R provides that where an investment firm receives client monies, it must promptly pay those monies into a separately identifiable account.

26. CASS7.4 then sets out the two methods which a firm may use for ensuring prompt payment into client accounts. The first of these methods is the normal approach which involves the firm paying client money directly into a client bank account no later than the next business day. The firm must also take reasonable steps to ensure that money is credited directly into a client bank account when it is transferred electronically. The alternative approach may only be used where the firm's auditor is satisfied that the firm has adequate systems and controls to adopt such an approach and has so informed the FSA. Under the alternative approach, a firm may receive all client money into its own bank account and then segregate the client money into a client bank account on a daily basis following a reconciliation of the amount required as at the close of the previous business day.

27. Whichever approach it adopts, a firm must carry out both internal and external reconciliations of client money. These requirements are detailed. CASS7 and Annex 1 to CASS7 set out a method which the FSA deems appropriate for internal reconciliations.

28. CASS7.4.29G deals with money due to a client from a firm. This is the obverse of the requirement in CASS7.7.2R. Under CASS7.4.29G, a firm operating the normal approach which becomes liable to pay money to a client must promptly pay the money to the client or into his account.

29. CASS7.6.13R deals with the reconciliation of discrepancies. When discrepancies are noted as a result of internal reconciliations, the matter must be investigated and shortfalls made good.

30. CASS7.7 deals with the very important matter of the statutory trust. CASS7.7.2R provides that a firm receives and holds client money as trustee for the purposes of the client money rules and the client money (MiFID business) distribution rules. The former rules are in CASS7.1 to CASS7.8. The latter rules are in CASS7.9 (see CASS7.9.1R). It also provides (with certain immaterial exceptions) that a firm is a trustee for the clients for whom that money is held according to their respective interests in it. This provision is stated to be subject to sub-rule (3), which it is common ground should read (4). As CASS7.7.1G states, although client money is in the legal ownership of the firm, its beneficial ownership remains in the client.

31. CASS7.8.1R goes on to provide that where a firm opens a client bank account, it must notify the bank that the account is in fact a client bank account and that accordingly all money standing to the credit of this account is held by the firm as trustee. This will prevent the bank from exercising any right of combination of accounts.

32. CASS7.9 deals with the important subject of client money distribution. As already explained, under CASS7.9.2G, the purpose of the rules is to facilitate a timely return of client money to a client in the event of failure of the firm or (in the case of a secondary pooling event) in the event of failure of a third party with whom client money is held. I have already explained the meaning of primary and secondary pooling events. The key provision is CASS7.9.6R which provides for the pooling of "client money held in each client money account". This provision obliges the firm to distribute that client money in accordance with a statutory trust so that "each client receives a sum which is rateable to the client money entitlement calculated in accordance with CASS7.9.7R."

33. CASS7.9.7R deals with the offset of positive and negative balances. There is then a note which provides that the client's main claim is for the return of client money held in a client bank account. It also explains that a client may have a claim for a shortfall against money held in a firm's own account as an unsecured creditor. This note is highly inadequate. It does not refer in any way to the concept of pooling. Nor does it contemplate that the client may have a claim on a house account of a proprietary nature. It assumes that the client will be an unsecured creditor.

34. Rather unhelpfully, the expressions "client money account" and "client money entitlement" are not defined in the Glossary.

35. CASS7.9 contains detailed provisions for secondary pooling. Unlike CASS7.9.6R, these specifically refer to client bank accounts and not client money accounts. As already explained, if a secondary pooling event occurs as well as a PPE, the secondary pooling event is in effect ignored. If however there is a secondary pooling event alone, in general, exactly as one would expect, monies held with the intermediary are pooled among clients having monies at that intermediary.

36. We have been shown a number of documents issued by the FSA before CASS7 as described above was published. These are not admissible on the interpretation of the rules save to show the mischief to which the rules were directed. We have not been shown any passage that specifically deals with the precise assets to be pooled or the precise clients to benefit from the pooling. Accordingly these materials are of no more than background interest.

37. It is worth noting what CASS7 does not say. Not all clients will be sophisticated or professional investors since CASS7 applies to firms whatever the size or complexity of their business. CASS7 does not provide, for instance, that clients should be informed if the firm they instruct uses the alternative approach so that they could be aware of any additional risk to them that employment of that approach entailed. Moreover, while a client who reads CASS7 would have been in a position to see that this approach was a possibility, there is no requirement in CASS7 for clients to carry out due diligence to find out whether their firm uses that approach or how it will carry out a reconciliation of client and firm monies.

38. Mr Snowden took the court to the Final Notice issued by the FSA to JP Morgan Securities Ltd in June 2010, fining it £33.32m for failure to segregate client monies relating to its futures and options business over a period of some seven years. This clearly shows that the FSA regards client funds in an unsegregated house account as carrying greater risks for a client than money held in segregated accounts. However, it is for this court to determine the interpretation and effect of CASS7, and in that task this Final Notice does not assist.

PRINCIPAL CONCLUSIONS OF BRIGGS J

(a) General

39. The bulk of the main judgment of Briggs J dated 15 December 2009 concerns the main issues, which were eight in number[5]. We are not concerned with the seventh issue or the subsidiary issues. Accordingly, I propose to set out the judge's

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[5] The issues formulated by the judge for the purposes of his main judgment were as follows:

(i) *Does the statutory trust created by CASS7 take effect upon the receipt, or only upon the segregation, of client money?*

(ii) If upon receipt, what duties or restrictions are imposed by the rules, or by the general law, upon the use that the firm can make of client money while mixed with its own money pending segregation under the alternative approach?

(iii) Does the CMP include all identifiable client money held by LBIE as at the PPE, whether or not actually segregated? If not segregated, how is it to be identified?

(iv) If not, what provision do the CASS7 rules or the general law make in relation to identifiable client money which is not part of the CMP?

(v) Do the rules or the general law require or permit a shortfall in the CMP as at the PPE to be topped up, either from other non-pooled identifiable client money, or from LBIE's general assets?

(vi) Is the basis for sharing in the CMP the amount which ought to have been segregated for each client, or the amount which was in fact segregated (the claims basis or the contributions basis for sharing)?

(vii) Upon what date are the clients' respective shares in the CMP to be calculated: the PPE or the date of distribution?

(viii) To what extent, if at all, can the firm's claims against its clients be set off against the clients' entitlements to share in the CMP?

conclusions under the issues with which we are concerned on this appeal cross-referring them to the issues formulated by the judge.

40. Before the judge considered the main issues, he made some general observations about the interpretation of CASS7. He observed that, with the exception of the option to take the alternative approach, CASS7 was intended to apply to firms of all sizes. He also expressed the view that one should interpret the provisions of CASS7 from the standpoint of compliance, rather than non-compliance. Further, he considered that the mere fact that a firm was not expressly precluded from doing something did not mean that it was free to do as it liked. It might be restricted by the general law. He also considered that it was wrong to assume that CASS7 was a coherent scheme. It was patently flawed in material respects.

(b) Client money: trust on segregation or on receipt? (The judge's issues (i) and (ii))

41. The judge's conclusion was that there is clearly a trust from receipt. CASS7.2.1R referred to the receipt or holding of money for clients in the alternative in order to include monies appropriated by the firm to a client. By CASS7.7.2(1)R a statutory trust is imposed where a firm "receives from *or* holds for" a client and the definition of "client money" in CASS7.2.1 refers to a firm receiving *and* holding money. There was no significant difference between these two concepts despite "or" in one and "and" in the other.

42. The judge was satisfied that the imposition of a trust on receipt better achieved the objectives of MiFID. He also held that it was not gold plating (contrary to Article 4 of the MiFID Implementing Directive) because the imposition of a trust was simply a means of producing the result mandated by Article 13(8) of MiFID: a firm was not to be entitled to use client money except under certain conditions. The judge, moreover, thought that that restriction was workable. He held that the firm could have a buffer in its account to cover client monies if it wished to use a house account for its own purposes. He saw no reason why such a buffer could not be calculated. Alternatively, the buffer could be established in a segregated client account. These are the prudential buffers referred to below. The judge recognised that a conclusion that pooling only benefited clients with segregated accounts left clients with client money not in client accounts in a legal "black hole". However, in the judgment of the judge, because there was a trust from the moment of receipt of monies, there would be tracing remedies under the general law. This result was justifiable because of the potential complexity of a tracing claim which might delay distribution of the CMP to clients with segregated monies.

(c) Are the client monies to be pooled at the PPE the monies in the segregated accounts or all the client monies? (the judge's issue (iii))

43. This was the third issue dealt with by the judge (paragraphs 166-198). The judge began by setting out the critical wording of CASS7.9.6 R (1) namely "client money held in each client money account of the firm is treated as pooled….". He made the point that not all client money was to be pooled, only that "held in each client money account".

44. The judge considered the theories put forward by Counsel as to which clients might have a claim on the CMP apart from those with segregated accounts. Counsel put forward three theories:

> (1) a theory that each client whose money had not by then been segregated was entitled to participate in a floating trust over all monies of the firm;
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> (2) a principle (based on dicta of Lord Templeman in *Space Investments v Canadian Imperial Bank of Commerce Trust Company (Bahamas) Ltd* [1986] 1 WLR 1072) that clients whose assets had not been segregated had a priority over unsecured creditors; and
>
> (3) the proposition that clients without segregated accounts could only have a proprietary claim to assets which could then be pooled if they had a proprietary claim arising under the general law.

45. The judge rejected the first two possibilities and they are not pursued on this appeal. He went on to examine the difficulties of tracing and concluded that, given the difficulties of tracing, it was entirely understandable that CASS7 should have limited the CMP to money held in segregated accounts. He considered that there was a "persuasive symmetry" between segregated accounts on the one hand and prompt distribution. For those reasons he concluded that the only clients who could claim on the CMP were clients with segregated accounts.

(d) Do clients participate in the pool if they have claims to client money or only if they have contributed to the pool? (the judge's issue (vi))

46. For the reasons given at paragraphs 227 to 275 of his judgment, the judge held that the basis for sharing in the CMP was the amount which the firm had actually segregated for each client as revealed by the last internal reconciliation account carried out by the firm before the PPE. In the case of LBIE, that last internal reconciliation account was carried out on 12 September 2008 by reference to the PLS on the preceding day. The judge held that this amount was subject to certain adjustments which he considered later in his judgment. The judge did not find any decisive assistance in either the powers of the FSA, which enabled it to make rules for distributions on either the claims basis or the contributions basis, or in the purposes of the MiFID Directives. He did, however, consider that the MiFID Directives tended to support the contributions basis.

47. The judge was particularly attracted by the argument that the contributions basis was to be preferred because it facilitated distribution to those who had contributed to the pool. That symmetry would, as it were, justify the difference in the effect of the statutory trust as between the clients whose money was segregated at the PPE, and those whose money was not then segregated. The judge also considered that the contributions basis would facilitate a speedier distribution of the fund.

48. The judge then turned to a textual analysis of CASS7.9.6R, CASS7.9.7R and CASS7.9.9R. The first of these rules directed distribution in accordance with client money entitlement calculated in accordance with CASS7.9.7R. That required a netting process between a client's individual client balance and a client equity balance. The judge noted that the phrase "individual client balance", as explained in

paragraph 7 of Annex 1 to CASS7, and the phrase "client equity balance", as defined in the Glossary, were not limited to a client's entitlement to a segregated account but to a client's contractual entitlement. However, the judge held that notwithstanding these textual indications, the expression "client money entitlement" had different meanings in different places. Moreover the judge considered it was wrong to impute to the drafter a conscious desire to distinguish between a contractual entitlement and a right to share in the CMP based on contributions.

49. The judge went on to conclude that the intention of CASS7 was that distribution should be achieved promptly and efficiently. In addition a distribution on a contributions basis ensured that the money was distributed to those who actually contributed it, i.e. those for whom the firm had actually segregated client money.

50. The judge considered CASS7.9.7R but accepted the argument of Mr Zacaroli that this was simply a reducing mechanism. It simply had the effect of reducing what might otherwise be identified as a client money entitlement which formed the basis of his participation in the CMP. The judge then examined the provisions of Annex 1. The judge appreciated that CASS7.9.7R was an indicator against the contributions basis. It could result in the release of a sum to the firm and thus to unsecured creditors. It required examination of the clients' contractual entitlements. But the judge did not consider that the distribution rules required this examination. He considered that the amount to be netted was the amount shown by the firm's last internal client money reconciliation account to have been contributed by way of segregation to the fund which became the CMP for that client subject to possible downward adjustment pursuant to CASS7.9.7R where the firm did not take advantage of paragraphs 18 and 19 of Annex 1 and there existed in the account for that client forming part of the last internal reconciliation account a relevant negative individual balance or client equity balance capable of being set off against a positive balance of the opposite type. Such an adjustment would not effect the timely or efficient distribution of client monies.

51. The judge did not consider that it was an objection to the distribution of segregated accounts on the contributions basis that it was inevitable that there would be a short period of time before the PPE when there was no reconciliation and segregation. The judge held that there were other "glitches", such as adverse currency movements after the PPE. The judge noted that where a client had been repaid on the last day, he would not be entitled to share in the pool. The judge considered the transaction accounts were relatively self-adjusting. However, issues of this kind did not match the difficulties which, in the judge's view, would result from adoption of the claims theory.

(e) Topping up any shortfall on the CMP: obligation on LBIE to top up or is a top up to be effected out of identifiable client money outside the CMP?

52. Topping up is significant because it is one of the ways of addressing the potential deficiency in investor protection resulting from the exclusion of non-segregated client money from the CMP. The judge concluded that LBIE was not obliged to make good out of its own assets any shortfall on the CMP or any deficiency on the segregated account resulting from an under-segregation. This would in any event offend insolvency law in the event of a liquidation of LBIE since the assets not subject to the trust created by CASS7 would be required to be distributed in accordance with the statutory scheme for distribution in the Insolvency Act 1986.

(f) When does money which the firm owes to a client become "client money"? (issue within the judge's issues (i) and (ii))

53. The judge distinguished three situations: the receipt of money from the client, the receipt of money for a client from a third party, and the allocation of money to a client by the firm from its own resources. In relation to this third category, the judge held that the client had no proprietary claim unless a sum of money was actually segregated in respect of the debt due to the client (judgment, paragraph 146).

(g) Supplementary judgment of Briggs J dated 20 January 2010

54. The judge dealt with a number of detailed issues in a supplementary judgment. In this judgment, he dealt with client money held in respect of depot breaks which was held in segregated accounts at the PPE but which had not at that date been allocated to particular clients. The judge held that such money should be treated as the entitlement of clients for whom it could be seen from the accounting records of LBIE that it intended to segregate the monies. This was a limited exception to the principle that the client money entitlement could in general be seen from the reconciliation carried out at the PLS. This was so even though LBIE might not have known at the moment of segregation precisely which of its clients would suffer from a depot break. It would at least know the class of potential clients since they were those of its clients for whom the particular stock had been purchased. Under the judge's main judgment, the client money entitlement of a client would be reduced or extinguished upon the securities in question being delivered to it.

55. In his supplementary judgment, the judge also dealt with unapplied credits. He held that, if client money was segregated and held in a general client account to meet unapplied credits, the entitlement of clients was increased to the extent that it could be ascertained from the accounting records of LBIE that the relavant unapplied credits were so held for them. This was so even though the client money reconciliation at the PLS would not have shown which clients were entitled to that cash, and even though LBIE would not itself know at the PLS the group of clients who were the beneficiaries.

ANALYTICAL FRAMEWORK FOR DECIDING THE ISSUES ARISING ON THIS APPEAL

56. I propose to preface my discussion of the issues on this appeal with some general observations about the legal context.

Considerations applying generally to the interpretation of CASS7

57. The issues on this appeal turn upon the interpretation of the statutory rules of CASS7. The process of interpretation of CASS7 involves assessing the provisions as a whole and testing preliminary conclusions on one provision by reference to the rest of the relevant provisions. There must, as the judge recognised, be an holistic and iterative approach to interpretation. There is a danger of compartmentalisation if issues are split up and dealt with separately. Accordingly, I have sought to condense them as far as possible, and to test my conclusions by reference to the rules of the scheme considered as a whole.

58. Although CASS7 looks like, and is, a set of rules for market participants and investors, it is also a set of statutory rules. In my judgment, the presentation of the rules in this form serves to remind a court that the rules must be given a sensible and practical construction. The court must bear in mind the overall scheme of the rules and keep in proportion any drafting infelicities. Since the rules are designed to protect investors (see FSMA section 138(1), set out above), the court should lean against interpretations which result in legal "black holes". The court has at least to start out with the view that the drafter intended to create a coherent scheme even if this is ultimately disproved in certain respects. The rules should also in my judgment be taken to be grounded in reality. FSMA requires the rules to be the subject of detailed and far-reaching consultation in the market prior to adoption (section 155). It is thus improbable that the FSA was oblivious to the fact that mistakes or worse are made by firms in practice, and that serious mistakes have been made in the past. It can be assumed that the FSA as regulator would seek to ensure that the rules ensured investment protection even where mistakes were made.

59. My next point on interpretation relates to the MiFID Directives. It is important to recall the nature of a directive: Article 288 (ex Article 249) of the Treaty on the Functioning of the European Union states that: "A directive shall be binding, as to the result to be achieved upon each Member State to which it is addressed, but shall leave to the national authorities, the choice of form and methods." In interpreting a directive, national courts are required to bear in mind that the different language versions of the directives are equally authentic, but no-one has argued that we should look at any other language version for the purposes of this appeal. The existence of the MiFID Directives necessitates an interpretative exercise of two kinds: that of the Directives themselves in accordance with the principles of European Union law and then the interpretation of CASS7 in accordance with domestic law principles in order to achieve conformity with the provisions and principles of the MiFID Directives: see *HMRC v IDT Card Services Ltd* [2006] STC 1252. The latter stage means that, where CASS7 implements a provision, or principle, in MiFID, the court must interpret CASS7 so as to give effect to that provision, or principle, so far as possible.

60. In my judgment, recital (1) to the MiFID Implementing Directive provides a good introduction to the scope of MiFID. It is a framework document, governing the operating conditions for investment services. The function of the MiFID Implementing Directive is to concretise organisational and procedural requirements for investment firms.

61. So far as the provisions of CASS7 implement requirements of the MiFID Directives, the MiFID Directives reinforce the view which I have already expressed that the correct approach to CASS7 is to see it as essentially a coherent scheme designed to achieve investor protection in line with the requirements of European Union legislation and domestic legislation. There is, however, another point. Consistently with subsidiarity, there are matters mentioned in the MiFID Directives which are not regulated by them. Importantly, the MiFID Directives do not seek to prescribe a particular content for the rights of property under the national law which is its proper law, or to harmonise the content of such rights by prescribing a particular content. Rather, what the MiFID Directives seek to do (among other things) is to make uniform in every jurisdiction within the European Union the rule that client funds

should be kept separate from those of the firm. This can clearly be seen from recital (26) to, and Article 13(8) of, MiFID (see Appendix 2 below).

62. The judge makes the point that "nowhere in either Directive is there imposed an obligation to provide legal protection to clients' securities, funds or their rights in respect thereof in the event of non-compliance by firms, such that those assets or rights are nonetheless still protected from the consequences of non-compliant firm's insolvency arising under the relevant Member State's domestic law" (judgment, paragraph 67). This suggests that the MiFID Directives have set out requirements for firms on the assumption that there will be full compliance (and indeed that the drafter of CASS7 has made the like assumption: see, for example, judgment, paragraph 228). I respectfully disagree with this as a generalisation. The MiFID Directives are concerned with the safeguarding of client assets. That concern assumes that there is a risk that client assets will be lost. In the real world it is unlikely to be assumed that the risk of loss could be entirely eliminated by imposing the organisational requirements of the MiFID Directives. Furthermore there is evidence in the MiFID Directives that that was not assumed and that those Directives contemplated a deficiency in compliance. For example, Article 16 of the MiFID Implementing Directive requires Member States to ensure that firms introduce adequate organisational arrangements to minimise the risk of the loss or diminution in client assets due to various causes, including misuse, poor administration or inadequate record-keeping. Article 16(2) supplements this requirement by reference to Article 13(8) of MiFID (which, among other matters, requires there to be adequate arrangements to prevent the use of client funds by the firm). Article 16(2) provides that, if under domestic law the arrangements made by firms would not be sufficient to satisfy the requirements of Article 13(8) of MiFID, Member States must prescribe measures that firms must take to comply with that obligation. This demonstrates a concern to ensure that a firm takes steps which are effective to ensure that even in an insolvency client assets are not made applicable to the firm's debts, which would involve a breach of Article 13(8) of MiFID. One way in which this might be done is by declaring a trust of client money.

63. Likewise certain provisions of CASS7 expressly contemplate that there might be non-compliance with its provisions: see, for example, CASS7.6.13R. I do not therefore consider that it is in general appropriate to interpret CASS7 on the basis that the drafter assumed compliance.

Role of trust law

64. My second set of preliminary observations relates to trust law.

65. In my judgment, the rules of trust law provide the analytical framework and the principal diagnostic tool for resolving the problems which require to be resolved on this appeal. There is no doubt that CASS7 imposes a trust. The provisions of that trust are, however, rudimentary. The trust is created with little elaboration and so the court is thrown back on general trust law.

66. For the purposes of these observations it does not matter whether that trust arose at the time of receipt of client monies or on their segregation into separate client accounts. CASS7 simply declares a trust without providing all the rules that are necessary for working out that trust. Mr Snowden refers to the dictum of Lord

Hoffmann in *AG for Belize v Belize Telecom* [2009] 1 WLR 1988 at [17] in the context of implied terms, where Lord Hoffmann held:

> "[17] The question of implication arises when the instrument does not expressly provide for what is to happen when some event occurs. The most usual inference in such a case is that nothing is to happen. If the parties had intended something to happen, the instrument would have said so…."

67. In my judgment, that approach is out of place where a statute imposes a trust, and the question is whether some gap in the trust can be filled by reference to general trust law. This is because, once a trust is declared and attaches to assets, there are a series of default rules and principles which apply irrespective of the intention of the parties setting up the trust or, indeed, the FSA. For instance, there is a fiduciary duty not to make a secret profit and a duty to account to the beneficiary in accordance with the terms of the trust. There are also rules applying in equity to the distribution of a common fund, such as hotchpot and the rule in *Cherry v Boultbee* (1839) 2 Keen 319, which may be applicable. There are also the maxims of equity, such as "equality is equity". This has frequently been applied by the courts to the distribution of assets upon the dissolution of a body or fund (see, for example, *Re Bucks Constabulary Widows' Fund* (No. 2) [1979] 1 WLR 936 (a friendly society)).

68. For the same reason the judge was not, as suggested by Mr Snowden, impermissibly legislating when he relied on rules of trust law. Those rules apply by default whenever there is a trust for which the applicable rules have not been fully articulated. They supplement but do not supplant, or predefine the meaning of, the provisions expressly laid down. In any event, statutory trusts do not always set out detailed rules about all the duties of the trustee: see, for example, section 105 of the Law of Property Act 1925 and section 981(9) of the Companies Act 2006. Put another way, it is simply not an answer to the judge's conclusion that there was a trust on receipt to say that some particular aspect of the trust law was not provided for. If a provision is made, then the default rules of trust law will be displaced or varied. Trust law can be moulded to meet the requirements of the situation.

69. For the same reason, it is not possible to accept without qualification the submission of Mr Milligan that the rules in CASS7 about pooling have to be construed in accordance with the normal rules of statutory interpretation, such as the rule that there is a presumption that Parliament did not intend to take away private property law rights and the presumption that where statute expressly permits one thing (the making of rules providing for the pooling of money in accounts), any further power of pooling is excluded. If the effect of the default rules of trust law is that private law property rights are clearly taken away, or that the pooling must necessarily extend to other property, those default rules displace the normal rules of statutory interpretation.

70. In connection with the role of general law, it is important to make it clear that this court has been asked not to deal with any individual tracing claim. Accordingly there has been no real argument on the rights of a client who pays money to a firm adopting the alternative approach under the general law. When the alternative approach is adopted, CASS7 contemplates that client money should be paid into a running account of the firm. So it is implicit in the structure of CASS7 that the firm will be able to use client monies which it receives, but the implication may go no further than

this so that the authority to do this would only be on the basis that the firm's account contained equivalent substitute assets, and so that the beneficiary obtained a beneficial interest in substitute assets. On this basis, it would be a breach of trust if the house account into which client monies were paid was overdrawn or if it would not have enough monies in it at any time relevant for the client to have a proprietary interest to the full extent of his monies. (Any breach of trust claim would, however, be only an unsecured claim against LBIE conferring no priority over other unsecured creditors such as trade creditors, and we were told that such a claim may raise issues as to double proof). Those issues are left open by this appeal. It should also be borne in mind that a client need not, under CASS7, know that his money is being paid into a house account. He may reasonably be under the impression that prior to segregation it is being paid into a general client account.

71. If and to the extent that (as the judge held) a client has an individual right of tracing, his right will clearly attach to interest and dividends earned on any investment into which he can trace. I leave aside for later consideration the question of manufactured interest and dividends.

72. We have not been asked to consider whether, if any client has a tracing claim in respect of client money paid into a firm's account, it is an individual claim or one belonging to clients in the same position collectively. If the right of clients to trace monies into the firm account were a collective right, then it may be that the right to follow the monies misapplied belongs not to any individual client but to the clients entitled to share in the house account collectively. If, however, the claim is an individual claim, there are, as I have indicated, a number of default rules of trust law, such as hotchpot and the rule in *Cherry v Boultbee*, which are potentially applicable. We have not heard argument on these rules but the principle of hotchpot may offer the means of solving the problem, highlighted by Mr Snowden, of a client seeking to benefit from a share in the pool and not bringing into account the benefit of other claims which he has. On that basis, the client who happens to have an individual claim to follow trust property, because his monies were misapplied, would have to bring that claim into account if he wishes to share in the house account pool.

73. The above analysis may provide the answer to the point made to us that section 139(1) of FSMA does not give the FSA power to require the pooling of other forms of property, such as a yacht, purchased with client monies misappropriated from a client or house account. Such property may have to be brought into account under the default rules of trust law applying to individual claims or they may in any event belong to clients collectively. This is, as the FSA point out in their written submissions, the sensible solution since no single client could ever easily identify that it was his particular monies that were spent on the yacht. Cheques or cash received from a client do not present a like problem because these are clearly "money" as defined for the purposes of CASS7 and they therefore fall within the definition of "client money" even if they have not been paid into the house accounts.

74. Needless to say, if a client were only to have a share in a collective claim as a result of the firm paying money into a house account, that would have provided an argument for the claims of those clients being added to the CMP and those clients being included in those entitled to claim on the CMP.

Role of insolvency law

75. In *Re BA Peters (in Administration)* [2008] EWCA 1604, [2010] BCLC 142 at [21], Lord Neuberger counselled against the court leaning in favour of a trust which might be contrary to commercial expectations and which would certainly give the beneficiaries priority over unsecured creditors. In this case, however, the court must give effect to statutory intention, clearly expressed, even if it is to the disadvantage of unsecured creditors.

76. Giving priority to a creditor offends the basic principle of insolvency law that creditors who rank on the same footing should be entitled to distributions *pari passu* and rateably. Since the principle has been invoked in this appeal and forms part of the conceptual framework of the questions of interpretation we have to decide, I set out the brief description of the origin and significance of the *pari passu* concept which I recently gave in *Re Golden Key Ltd (In receivership)* [2009] EWCA Civ 636:

> "[3] *Pari passu* distribution is derived from the maxim that "equality is equity". Halsbury's Laws, 4th ed, vol 16 par 747 states:
>
> > "The maxim that equality is equity expresses in a general way the object both of law and equity, namely to effect a distribution of property and losses proportionate to the several claims or to the several liabilities of the persons concerned. Equality in this connection does not necessarily mean literal equality, but may mean proportionate equality . . . [I]n the distribution of property, the highest equity is to make an equality between parties standing in the same relation, though this cannot be done contrary to the plain meaning of the deed."
>
> [4] In *Cox v Bankside Members Agency Ltd* [1995] 2 Lloyd's Rep 437, Peter Gibson LJ explained:
>
> > "The fairness of a rateable distribution of limited assets insufficient to meet all the claims on them is what underlies the insolvency legislation and has led the court to adopt that solution in contexts not governed by that legislation where a common misfortune has occurred (see, for example, *Barlow Clowes International v Vaughan* [1992] 4 All ER 22). But the maxim is not of universal applicability. It always yields to a contrary intention, express or inferred, …"
>
> [5] *Pari passu* provisions are commonly found in debentures. A provision for *pari passu* repayment can, however, be implied if it is clear that the debenture holders are to stand on an equal footing (see for example *Murray v Scott* (1884) 9 App Cas 519, 53 LJ Ch 745, 33 WR 173). Accordingly, where a document on its true interpretation provides for the distribution of assets to a group of persons as between whom no distinction is to be drawn, the court will imply a requirement to make distributions proportionately even though the words "equally" or "*pari passu*" are not used. Such an implication is not, however,

possible where the document evinces an intention that the distribution should be on some other basis."

Conclusion

77. In summary, CASS7 is a code for dealing with client money but is not a substitute for, or a codification of, the general law. The default rules of the general law of trust may fill in gaps and provide additional remedies in the protection for investors provided by CASS7. The principle of *pari passu* distribution also forms part of the legal background which the court must keep well in mind.

ISSUE 1: TRUST ON RECEIPT OR TRUST ON SEGREGATION?

78. The main protagonists on this issue are Mr Snowden, who argues that the judge was wrong to hold that CASS7 created a trust on receipt, and Mr Miles who seeks to uphold the judge's judgment. The core issues as argued by the main protagonists revolve around the following questions: (1) What is the relevant requirement of the MiFID Directives? and (2) when does the trust of client money created by CASS7 arise? These questions pass over the point that the authority for CASS7 lies not just in the MiFID Directives but also in FSMA, but no-one sought to suggest that CASS7 was ultra vires section 139 of FSMA until Issue 2, and so I will deal with the question of *ultra vires* there. The court must start with the MiFID Directives to give effect to the primacy of European Union law, but before plunging into the MiFID Directives it is worth noting that the definition of client money in CASS7.2.1R, which forms the subject matter of the statutory trust created by CASS7.7.2R, read literally, supports the judge's conclusion.

(1) What is the relevant requirement of the MiFID Directives?

79. The MiFID Directives contain no express requirement to establish a trust on the receipt of money from or for a client, and so the issue is whether they authorise or require the FSA to make rules that impose such a trust on receipt. If they prohibit a trust on receipt, then CASS7.2.1R would in my judgment have to be construed as meaning that the trust was not imposed until (1) money had been received for a client and (2) it was held for the client in the sense that it was segregated for that client.

80. Mr Snowden's main argument is that the key requirements of the MiFID Directives are organisational: in particular, client monies should not be used for the purposes of the firm. Investor protection is addressed by the segregation and the separate identification of client funds: that is how the MiFID Directives intend that client money should be protected. Article 13(8) of MiFID and Article 16(1)(f) of the MiFID Implementing Directive are fully implemented by CASS7.3.1R and CASS7.3.2R (and those Articles are noted in the notes which follow those provisions). It is not open to the FSA to impose additional requirements on firms since this would offend Article 4 of the MiFID Implementing Directive (set out in Appendix 2 below), which save in limited cases prohibits what has been called in these proceedings the "gold-plating" of the requirements of the MiFID Directives. It is common ground that the United Kingdom has not taken advantage of the provisions in that Article for notification of any relevant additional requirement to the European Commission.

81. Accordingly, on Mr Snowden's submission, nothing in MiFID requires a trust on receipt of money for or from clients. Indeed such a requirement would conflict with other objectives of MiFID, especially avoiding unnecessary regulatory requirements impeding the efficient operation of a firm's MiFID business (see for example recital (71) to MiFID). A firm using the alternative approach has to be able to use client funds in its house accounts to run its MiFID business. A firm cannot in practice be expected to comply with the prudential buffers described by the judge. There could only be estimates as to the amounts required. If the firm created prudential buffers in client accounts for client money in the house accounts, the investor's money would be protected in both places. Moreover the firm will not know at any particular point in time whether its house account will go into debit.

82. Mr Snowden has various textual points. Firstly, the MiFID Directives nowhere refer to a trust. He then suggested that the court should apply the principle enunciated by Lord Neuberger in *Re BA Peters plc (In Administration)* (discussed above), but that would be to apply a domestic law principle of interpretation to a European Union instrument and accordingly I reject that submission. Secondly, Mr Snowden submits that the MiFID Directives do not refer to receipt, but to holding monies, and this supports his submission. Moreover, the domestic laws of many member states of the European Union do not recognise the concept of dual ownership. Mr Jarvis with some force asked us to reject this submission as an oversimplification, and I can attach little weight to it.

83. Mr Snowden submits that it was recognised by Professor L.C.B. Gower in his report, *Review of Investor Protection* (1984) (Cmnd.9125) that the mere segregation of clients' money was not enough to give them proper protection. Therefore a trust has been imposed by CASS7 to reinforce the effectiveness of segregation and in order to prevent the operational requirement of segregation from being precluded by domestic insolvency law.

84. Mr Snowden emphasises that it is important to leave aside the possibility of a private arrangement between the client and the investment adviser for monies to be held on trust. He submits that if there was a trust from receipt it did not attach to any property until segregation, generally by the allocation of funds to the client's client account. The court should not allow the statutory scheme in CASS7 to be distorted because of the existence of a short intra-day risk, as in this case. The intra-day risk occurred between the PLS and the PPE: client money received in that period was not in general segregated.

85. Mr Miles submits that the prohibition on a firm using client money for its own purposes is all that is needed to create a trust (see generally *Ayerst v C & K Construction* [1976] AC 167). The MiFID rules provide that client money must not be used by the firm for its own purposes. This is the essential requirement for a trust (see *Ayerst*). MiFID does not suggest that different consequences should attach to client money before and after segregation. The word "belonging" in Article 13(8) of MiFID and the word "entrusted" in recital (26) to the same Directive reflect ownership antecedent to the placing in a client account. Thus these references are consistent with a client retaining ownership of his money paid to the firm. It is turning things on their head to say that segregation is a precondition for full protection of client assets. "Holding funds" in Article 13(8) must include funds not held in segregated accounts since otherwise a firm could avoid the effect of the MiFID Directive altogether.

86. At one point in his argument Mr Miles' approach was to suggest that the court will find more support for his argument in CASS7 itself than in the MiFID Directives. I do not consider that this is correct. The starting point is Article 13(1) of MiFID, which requires the home Member State to oblige firms to comply with the organisational requirements in (among other provisions) Article 13(8). Article 13(8) provides that a firm holding client money, must make "adequate arrangements to safeguard clients' rights and… prevent the use of client funds for its own account." Nothing is said in the MiFID Directives to suggest that the obligations in Article 13(8) do not apply at all times when a firm holds client money. Indeed, it would in reality undermine the protection intended to be given to investors if it were anything other than a totally immaterial period of time when the obligations in Article 13(8) did not apply.

87. The next relevant provision is Article 16(1)(e) of the MiFID Implementing Directive. This imposes an obligation on Member States to take the necessary steps to ensure the client monies are deposited in accordance with Article 18 in an account which is separate from the firm's house account. Article 18 imposes a further obligation on Member States to require firms "promptly" to place client money in an approved account. The expression "promptly" is not defined, and what is "prompt" may be capable of variation as between different firms. However, Article 16(2) contains a further obligation on Member States to prescribe measures that investment firms must take if an obligation to place client funds in a separate bank account would not afford investors the protections required by Article 13(8) of MiFID.

88. It is part of Mr Snowden's case that on payment into a house account the client is simply an unsecured creditor of the firm for the money he has paid. It follows from this submission that in the event of an insolvency a firm can (unless some effective measure is taken to stop this) use client monies for its own account. Thus the United Kingdom had an obligation to require firms to take further effective measures. That measure is in my judgment to comply with CASS7, in particular CASS7.2.1R. Under this provision it must receive and hold client money as a trustee and this will enable the client to pursue a proprietary claim to his money and to prevent the firm from using the money, so long as it is identifiable, to pay its own creditors in the event of an insolvency.

89. On this analysis, MiFID requires CASS7 to contain a provision constituting a trust of client monies as from the moment of receipt in order to comply with Article 13(8). The requirement cannot therefore constitute an additional requirement contrary to Article 4 of the MiFID Implementing Directive. That Article must exclude conditions of authorisation that are imposed to comply with the MiFID Directives.

90. In my judgment, this interpretation of the MiFID Directives is not inconsistent with the alternative approach. When CASS7.4.16G and CASS7.4.18G (which set out the parameters of the alternative approach) are read with Annex 1 to CASS7, it is clear that the main benefit of the alternative approach is the firm's ability to net out a client's positive and negative balances, where appropriate. There is no indication that the FSA contemplated that a firm would use the alternative approach to fund its MiFID or other business.

91. In any event, I would reject the argument of Mr Snowden that the judge's prudential buffers result in an investor being protected by a fully-funded proprietary interest in a

house account and a reserve raised for his benefit in the client accounts. An investor is obviously adequately protected by either form of protection, and so he is not entitled to require both measures. In fact on my interpretation of the MiFID Directives there was no need for the judge to suggest prudential buffers. They are implicit in the MiFID Directives themselves.

(2) When does the trust of client money created by CASS7 arise?

92. I now turn to the interpretation of CASS7. I have already reached the conclusion, on the basis that the MiFID Directives require the creation of a trust on receipt, that there is no difficulty in reaching the conclusion that CASS7.7.2R achieves compliance with that requirement, since as I have already observed, that is the literal meaning of that provision. But I will turn to consider the question whether CASS7.7.2R in any event on its true interpretation creates a trust of client money as from receipt.

93. Mr Snowden submits that under the general law, when the client pays monies to the firm for investment, the relationship between the client and a firm would be that of debtor and creditor only. He had a number of authorities on this point, which were not examined, but even if the relationship were that of debtor and creditor, which Mr Miles did not seek to challenge, that would not under the general law exclude the possibility of a trust (see *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567). However that may be, our main task is to construe what CASS7 says: it undoubtedly imposes a trust irrespective of whether there is also a debtor and creditor relationship: the only question is when it bites: on receipt of client monies or on segregation? Normally segregation would occur when the firm earmarked the money to be placed in a client account.

94. The most persuasive point made by Mr Snowden, as it seemed to me, was the anomalous effects of what he called “the bifurcated scheme” flowing from the judge’s conclusions. As he submits, the drafter of CASS7 is unlikely to have intended a scheme under which (1) on receipt of client monies there was a statutory trust whose enforcement is governed by the general law and (2) on the occurrence of a PPE the same statutory trust led to the consequences expressly set out in CASS7.9. That led Mr Snowden to the conclusion that the better interpretation of CASS7 was that there was no trust until segregation. This was the point at which Mr Snowden pressed his submission based on the *Belize* case that, if the drafter had not provided for the consequences of the statutory trust from the moment of receipt but only on the occurrence of the PPE, the drafter did not intend a trust to exist as from receipt. I have already rejected this submission but need to mention an extension of it: Mr Snowden further submits that in any event, if the judge was minded to find a trust whose consequences were governed by the general law, he was required to consider all the consequences and it was not open to him to hold, as he did in paragraphs 151 to 156 of his judgment, that the full consequences were not a matter for him. I reject that submission for the same reason.

95. Mr Snowden has a subsidiary argument based on the lack of utility of the alternative approach on the judge’s view. This is important because one of the objectives of interpretation in this case so far as can properly be done is to give CASS7 a sensible and practical construction. On Mr Snowden’s submission, the alternative approach was necessary to enable firms to operate and provide the services required by clients. The purpose of the alternative approach is explained in the first sentence of

CASS7.4.16G, namely that compliance with the normal approach would be unduly burdensome and would not achieve the client protection objective. In his submission, the effect of the judgment was to undermine the utility of the alternative approach and to make it difficult for investment firms to operate the alternative approach.

96. Mr Snowden submits that there are a number of problems if there is a trust before segregation. For instance, does the client's right to claim in the house account revive if the aggregate of segregated accounts falls below the aggregate amount of clients' entitlement to such accounts? That is the type of question which as explained above has not been pursued on this appeal. In my judgment, it would be the tail wagging the dog if an argument of this kind had any impact on the question whether a trust arises on the receipt of client funds. Mr Snowden's example is one which flows from events following segregation. Provisionally it seems to me that it would be surprising if the clock could be turned back in this way.

97. Mr Snowden makes the point, which in my judgment is no more than a forensic point, that there is an inconsistency in the parties arguing for a statutory trust on receipt then arguing in favour of a contributions-based approach in respect of the house account.

98. Mr Miles likewise argues that there should not be a bifurcated trust but his submission on behalf of unsegregated clients is that there are not two regimes but one and that all client monies were from receipt held on trust and all of them share in the pooling. Mr Miles submits that CASS7.7.2R shows that monies received from the client are client money before segregation. He also points out that the obligation to segregate applies to "client money" (CASS7.4.1R). Thus CASS7.2.1R must clearly apply to client money even before segregation.

99. Mr Miles submits that Mr Snowden's interpretation is not even an available interpretation in view of the word "receives" in the definition of client money in CASS7.2.1R.

100. Mr Miles submits that it is clear law that where money is paid into a mixed account, the beneficiary is entitled to treat monies paid out as trust money and follow them into other assets into which they have been converted. He cites the following passage from the judgment of Jessel MR in *Re. Hallett's Estate* (1879) 13 Ch D 696 at page 719, (in which he is quoting a passage from *Frith v Cartland* (1865) 2 H. & M. 417):

> "The guiding principle is, that a trustee cannot assert a title of his own to trust property. If he destroys a trust fund by dissipating it altogether there remains nothing to be the subject of the trust. But so long as the trust property can be traced and followed into other property into which it has been converted that remains subject to the trust. A second principle is, that if a man mixes trust funds with his own, the whole will be treated as the trust property, except so far as he may be able to distinguish what is his own," that is, that the trust property comes first."

101. The judge suggested two options for the use of prudential buffers to avoid any breach of trust by the firm through using for its own purposes money in a house account containing client monies. Mr Miles submits that either of those options would

achieve the objective of client protection. The benefits of segregation for a client with money in a segregated account are enhanced by notification to the bank under CASS7.8, since that notice would prevent the bank from exercising any right to combine that account with other accounts of the firm. However, the absence of a similar requirement for client money in a house account does not mean that the creation of a trust on receipt has no benefit for a client with money in such an account in an insolvency. A client with money in a house account does not have the same level of protection against the bank as it would do if the account was a segregated account but if there is a trust on receipt it still has greater protection than would be available to it simply as an unsecured creditor. Moreover, the requirements of CASS7 relating to record-keeping apply both to segregated and non-segregated accounts, and this shows that client money is to be safeguarded through record-keeping in whichever type of account it is held.

102. Mr Miles points out that in *Re Kayford Ltd* [1975] 1 WLR 279, at page 282 Megarry J held a trust of money can be created even without a stipulation for payment into a separate account :

> "In *Re Nanwa Gold Mines Ltd* the money was sent on the faith of a promise to keep it in a separate account, but there is nothing in that case or in any other authority that I know of to suggest that this is essential. I feel no doubt that here a trust was created."

But in any event, submits Mr Miles, the question here is what the statute requires.

103. Mr Russen's submissions are helpfully directed to analysing closely the nature of the obligations that arise on receipt. He supports Mr Miles's submissions in support of a trust at the moment of receipt and hence the obligation to pay into accounts. He cited *Re Eastern Capital Futures Ltd (in Liquidation)* [1989] BCLC 371, a decision of Morritt J, as he then was, about entitlement under the general law to monies held for clients on trust by a commodity broker. It is unnecessary to refer to that decision as it does not concern CASS7.

104. I now turn to my conclusions. In my judgment the judge dealt comprehensively and correctly with this issue at paragraphs 141 to 156 of his judgment. I have no doubt that CASS7.7.2R can and should be read as creating a trust on receipt and I reach that conclusion irrespective of the stronger interpretive obligations of the court with respect to conforming interpretation if the imposition of a trust from receipt is a requirement of European Union law. As the judge stated, CASS7.2.1R has to refer both to receipt and holding trust monies because the monies may come from the firm itself. The opening line of CASS7.7.2R refers to both receiving and holding not in order to create a trust only on the completion of the second stage but to ensure that the statutory trust applies both to money which has been received and to money which is held by the firm.

105. A further point, which was not made by the judge, is that CASS7.7.1G provides that the statutory trust creates a relationship under which client money is in the legal ownership of the firm "but remains in the beneficial ownership of the client". This wording is also consistent with the client retaining ownership of his monies

throughout, and that result is achieved by the creation of a statutory trust on receipt by the firm of client monies.

106. It is also of note that the provisions for discharge of fiduciary duty in CASS7.2.15R do not provide for the fiduciary duty to be discharged by payment of client money save in two limited situations: (1) where the money is paid in or towards discharge of a sum due to the firm and (2) where the sum paid to the firm as being in excess of the amounts needed on reconciliation of client accounts. It is significant that there is no provision for discharge of the fiduciary duty in relation to client money when it is paid into a house account. This omission in my judgment provides some additional support for the judge's conclusion. Likewise, CASS7.4.23G (dealing with segregation of mixed remittances of firm and client money) (see Appendix 1 below) also provides support for a trust of client money on receipt and not on segregation as it proceeds on the basis that there can be client money in a mixed remittance and before any segregation occurs.

107. Finally, the judge's supplementary judgment demonstrates that in some circumstances the firm may hold money for clients without having allocated it to particular clients. The judge ruled that in this situation the money should be treated as allocated to the clients to whom according to the firm's records at any time the firm intended to distribute this money. This involves inquiring into the intentions of the firm. The conclusion that there was a trust on receipt avoids the necessity of making this inquiry into the firm's intentions in order to know whether those monies were subject to a statutory trust.

ISSUE 2: DOES CASS7 POOL IDENTIFIABLE CLIENT MONEY WHEREVER FOUND OR ONLY SEGREGATED CLIENT MONEY?

108. On this issue, the MiFID Directives give no clear steer. There is no requirement as to what should happen to client money once a firm enters insolvency save that which is implicit in the requirement in Article 16 of the MiFID Implementing Directive to safeguard client funds. In implementing this provision, a Member State would have to act in accordance with the fundamental principles of European Union law. This means that they would have to observe the European Union law principle of equality (Cases 201 and 202/85 *Klensch v Secrétaire d'Etat à L'Agriculture et à la Viniculture* [1986] ECR 3477).

109. This issue turns on the true meaning of CASS7.9.6R and in particular the provision that "(i) If a *primary pooling event* occurs: (1) client money held in each *client money* account of the firm is treated as "pooled"." In the judgment of the judge, the words "*client money* account" referred to the client bank accounts and client transaction accounts, that is, segregated accounts of a client, and not any other account of the firm. Thus, only the funds in those accounts were to be pooled. The expression "*client money* account" is not a defined term. (It may be that the drafter simply added the word "account" to "client money" in endeavouring to bring CASS7.9.6(1) within the powers conferred on the FSA by section 139(1)(b) of FSMA, but that is speculation.) The judge rejected submissions that clients had an interest under a floating trust or by way of a charge over a firm's account to recover money paid to the firm, which remained in the firm's hands and had not been segregated. Those submissions have not been renewed in this court. The judge considered that it would

be difficult for a client to establish a proprietary claim unless his money had been segregated. The judge continued:

> "194. Against that backdrop, it seems to me entirely understandable that CASS7 should deliberately have restricted the CMP to client money held, as at the PPE, in segregated accounts, as appears from the language of CASS7.9.6R(1). To require the CMP to be constituted by an expensive, slow, contentious and probably unrewarding search for identifiable client money elsewhere among the firm's assets would introduce, for no good purpose, a burdensome stage in the pooling and distribution of client money to the clients entitled to it out of all proportion to its likely reward, in the general run of cases.
>
> 195. There is in any event a persuasive symmetry between that part of CASS7 which requires the identification and segregation of client money by a firm while in business, and the distribution rules which, on that interpretation, require the money thus segregated to be promptly distributed to the clients entitled to it upon the firm's failure."

110. The judge accepted that any firm money which happened to be in client accounts (perhaps by mistake) would have to be excluded from the pooling (judgment, paragraph 196).

111. The key issue here is the meaning of "client money account" in CASS7.9.6(1)R. In the absence of a definition, the court has to find the meaning of this expression by deduction from the context in which it appears.

112. The proposition which Mr Miles advances is that a "client money account" is any account of the firm whether segregated or not in which there is identifiable client money to which a client can establish a proprietary right using the general law. The principal points which he relies on in support of that proposition are as follows: (1) CASS7 creates a single trust. If there is a pooling only of monies in segregated accounts, there is no unified trust. Mr Miles submits that the judge has treated segregation like a declaration of a further trust for particular clients. He has therefore created a further trust over and above the statutory trust formed on receipt. On Mr Miles' submission there is a single trust and all clients share in it not according to the intention of the firm but according to the mechanism set out in CASS7.9.6. (2) CASS7.9.2G states that when a pooling occurs, there is a notional pooling of "all client money". (3) Distribution is required to take place in accordance with the client money entitlement of clients. The calculation of a client's client money entitlement has to take place in accordance with Annex 1. This calculation does not draw any distinction between a client's entitlement to assets in segregated accounts and other accounts. (4) CASS7.9.7R provides for mandatory set-off of a client's negative and positive *client balances* and *equity balances* for the purposes of pooling. These terms are defined in Annex 1, from which it is clear again that a client need not have a segregated client account or transaction account to bring these provisions into play. This is a further indication that the expression "each client money account" is wider than "each client bank or transaction account". (5) If the judge's conclusion is right,

CASS7 fails to protect the client who pays money to the firm on its last day of trading so that a PPE occurs before a reconciliation occurs. This is not just a minor deficiency in the scheme resulting from the judge's interpretation. It is endemic in the use of the alternative approach. Thus it would have been obvious to the FSA from the outset that it would occur, and thus the likelihood is that it was contemplated and catered for by the scheme. (6) To treat the clients with segregated accounts separately means that they get the benefit of any payments made in error into their accounts in circumstances where the claim of the client without segregation is defeated. On the judge's approach, the rules have the effect of protecting individual clients rather than clients as a body.

113. Mr Miles criticises the judge's conclusion that CASS7.9.7 and Annex I, paragraph 18 represent no more than a mechanism to reduce claims that were calculated by reference to the firm's historic ledgers. Mr Miles submits that this was incorrect because CASS7.9.6R envisaged a netting off of actual client money entitlements. It was not limited to a historic assessment of entitlements as at the PLS. On the contrary, it is a straightforward provision to give effect to MiFID and the result is that actual client money entitlements need to be assessed for all clients of the firm at the PPE. On this basis, CASS7.9.7R is at odds with the judge's conclusion that clients share in the pool only to the extent of the amount notionally segregated for them in a historic reconciliation actually effected by the firm, together with evidence about the firm's intentions when segregating unapplied credits. Mr Miles submits that the judge's interpretation of the rules was inconsistent with the provisions of CASS7.

114. Mr Zacaroli supports the judge's conclusion on Issue 2. Mr Zacaroli submits that the reason for using the expression "client money account" is to include not only client bank accounts, which were referred to in earlier versions of CASS7, but also client transaction accounts. He submits that there is no basis on which fully segregated clients should have to share the CMP with clients for whom monies were not properly segregated. He calls this the "reckless broker risk" (by which I understand him to refer to the firm that uses the alternative approach but does not maintain the prudential buffers). The creation of a CMP in which even non-segregated clients can share constitutes an interference with the rights of the segregated clients. CASS7 should not be distorted so as to confer a benefit on those who suffered from the intra-day risk or those who suffered from the reckless broker risk. Mr Zacaroli submits that the beneficial interest in money paid into a house account before segregation is that the client retains his beneficial interest in such money provided it is still identifiable. He submits that monies held outside the CMP should be dealt with in accordance with the general law.

115. Mr Zacaroli submits that the expression "client money account" in CASS7.9.6R(1) cannot mean any bank account of the firm because that renders the words "client money" meaningless. Mr Zacaroli also relies on CASS7.9.8G. He submits that there is an important distinction between a "client money account" and a "client bank account", as required in relation to a secondary pooling event. In a secondary pooling, a distinction must be drawn between client bank accounts and designated client bank accounts. If the bank account is a designated client bank account, which the client has specifically chosen, then any shortfall is borne by that client and other clients with designated client bank accounts at that third party, but not other clients with bank accounts with that third party. No such distinction is needed in relation to a

primary pooling event. Thus, submits Mr Zacaroli, the phrase "client money account" is merely shorthand to encompass client bank accounts and client transaction accounts. He relies on the guidance in CASS7.9.3G, which refers to every type of client money account, in support of this submission.

116. Mr Zacaroli draws attention to the different levels of protection afforded to clients with client money which has not been segregated and those with client money which has been segregated. He submits that CASS7 draws important distinctions between the consequences of the statutory trust for segregated funds and the consequences of the statutory trust for funds in house accounts. Thus, for example, CASS7.8 requires notification of the statutory trust to banks only in relation to client bank accounts and client transaction accounts. There is no similar requirement for the firm's house accounts. Likewise, the obligation to select a bank with due care applies only to client bank accounts and not to house accounts. Furthermore, a firm is enabled to use a house account for its own purposes. Thus the funds are mixed and a client cannot point to any specific balance as representing his money. Mr Zacaroli submits that the most that can be said is that the firm becomes a trustee of a mixed fund and thus must not allow the overall balances of the house accounts to fall below the aggregate amount of client money contained in them, but in my judgment this point does not deal with the point that the statutory trust imposed on receipt provides some protection, even if it is less protection than is given to segregated accounts. He also relies on the guidance at CASS7.9.3G.

117. Mr Zacaroli made a short submission to the effect that section 139(1)(b) of FSMA does not permit pooling of house and client accounts. In my judgment, as further explained below, section 139 permits such a pooling.

118. The FSA supports Mr Miles' submission that CASS7.9.6 requires the pooling of both client money in the segregated accounts and identifiable client money in other accounts, and makes a number of additional points including the textual point that CASS7.9 as a whole is not restricted to client money in segregated accounts. CASS7.9.9R excludes from the pooling client money received after the failure of the firm.

119. A number of submissions were addressed to the speed of making a distribution and there was disagreement in relation to the judge's point that a single pooling of all client monies was likely to be slower and more cumbersome than a pooling and distribution of segregated accounts to the clients entitled to those accounts. Mr Zacaroli seeks to support the judge's point: he submits that the distribution of segregated accounts to non-segregated clients will involve cost and delay. If it was intended that the Administrators should have regard to the claims of clients whose assets had not been segregated, CASS7 would have given guidance to the liquidator or administrator as to the steps which they had to take. Mr Miles takes the position that no assumption can be made that any process of distribution is very quick. In any event, he submits that it is far from clear that the judge's solution would be more timely than one in which non-segregated clients share. The judge's interpretation requires the trustee to examine the firm's records with respect to depot breaks and unapplied credits. The records will have to be examined to see to which clients the firm intended to allocate the unapplied credits (see paragraphs 3 and 7 to 10 of the judge's supplemental judgment). This is not a calculation in accordance with CASS7.9.7R, which provides for an objective calculation without reference to the

firm's subjective intentions. Certainly there is no evidence which supports a proposition that a distribution in accordance with the judge's judgment will be more timely than any other. The benefit of including non-segregated accounts on Mr Miles' submission is that the need for individual tracing exercises would be reduced. Neither CASS7.9.6R nor CASS7.9.7R refers to client money entitlements by reference to the accounting records of the firm.

120. Mr Miles submits that the references in the MiFID Directives to speed of distribution or return of client money are exiguous. The desirability of speed of distribution is on his submission subordinate to the aim of investor protection. It is possible to have interim dividends because the liquidator can make a reserve for the costs related to assets which he may receive through tracing, and the difficulties of interim dividends may be overstated.

121. In the debate over speed the Administrators make what looks as if it ought to be an obvious point that the distribution would be easier and quicker if restricted to segregated assets, but Mr Miles makes the point that, even with a pooling limited to segregated monies, there may be open transactions affected by exchange movements. There may be depot breaks and so on. He submits that his route is in fact easier because each client entitlement at the PPE is brought into account. There would be records for that. It is an easier process and is similar to tracing money in a non-client account. In so far as there is money in house accounts, that should go into the pot and there will be more money in the pot. He submits that there is nothing that could be clearly concluded by this timing point. Mr Miles also rejects the Administrators' submission that the identification of contributions depends on the reliability of the firm's records because the accounting records are not conclusive and have to be considered with other evidence.

122. There is also some disagreement about the role of the Administrators. Mr Milligan did not on their behalf evince great enthusiasm for the task of distributing a pool comprising both monies in segregated accounts and identifiable monies found elsewhere. He did not make any point on conflict of interest: such situations would clearly be manageable, as Mr Miles submits. Mr Mabb makes the important point that it is likely to be more efficient if the insolvency officeholder decides whether to pursue other identifiable client money since he will have access to all the accounting records and other information. The Administrators, however, do not accept that it would necessarily be easier for them rather than the clients to identify client money outside the segregated accounts. They submit that, unless they have been put on enquiry that a particular receipt of client money has not been segregated, they will be dependent on claims made by clients being backed by sufficient evidence to justify further enquiry. I consider that Mr Mabb is right on this point. The task for the Administrators may be difficult but not as difficult as that facing clients with individual tracing claims as a whole.

123. The Administrators express anxiety about the possible outcome of this appeal on the amount of work with which they will be faced with a somewhat uphill task of ascertaining the pool and those entitled to it. This is understandable: it has already taken two person years of work to work out the pool and its claimants on the judge's approach. The Administrators submit in relation to pooling that they should be treated as new trustees. If the firm were to continue as trustee, that would in practice be artificial and impose an unrealistic burden on the officeholder. Accordingly, the

Administrators submit that it should not be incumbent on the Administrators to identify client money outside the segregated accounts unless they had been put on enquiry, whether by the firm's records or by a sufficiently supported claim, to the effect that the money was such money. In that event it is submitted that they would be obliged to pursue the enquiry, subject to any question of cost effectiveness. I record this submission but at the hearing of the appeal the court made it clear that it would not give guidance to the Administrators on these matters. That would be a matter for directions to be given by the Companies Court.

Conclusions on this issue

124. I start with the textual points. The crucial expression "client money account" in the pooling provision (CASS7.9.6R) is undefined, but it is noteworthy that the expression is not "client account" or "segregated client account" (although the latter is again not a defined term) but a term which brings in the definition of client money. Client money is not money only to be found in segregated accounts. Accordingly, if the intention of CASS7 is to include all client money in the expression "client money account", the term must be wider than accounts containing segregated monies.

125. There are other textual indications which help to construe the meaning of "client money account". First, the statutory trust created by CASS7.7 is a single trust. It is not a series of individual trusts, one for each client. A single trust would indicate that a single pooling was intended: applying the maxim "equality is equity" discussed in the *Analytical Framework*, it is unlikely that a single trust would treat the beneficiaries in entirely different ways, especially if only one form of treatment is expressed in the terms of the trust, here CASS7. As I see it, the creation of a single trust is an overarching reason for having a single pooling. As Mr Miles submits, it is consistent with the creation of a single trust that, if there is to be a pooling at all, it should be a unitary scheme of pooling. A unitary scheme recognises that clients have met a common misfortune, namely the failure of the firm. Mr Zacaroli submits that this is not a common misfortune shared by all clients since they have different rights according to whether monies are segregated or not. But this is what I will call the "happenstance point" to which I shall refer below.

126. There is also the powerful point made by Mr Miles that CASS7.9.6(2) envisages distribution of the monies in the pool to clients in accordance with their "client money entitlement" which more naturally refers to a contractual right to client money rather than to a proprietary right in the segregated accounts. CASS7.9.7 supports this view as it sensibly stipulates for set off in order to identify the amount of an entitlement for a client where claims go in opposite directions.

127. The opening provision of CASS7.9, CASS7.9.1R, does not indicate that CASS7.9 is in any way limited to client money which is held in segregated accounts. Furthermore, in CASS7.9.3G, the penultimate sentence makes it clear that, if there is a PPE (which is the trigger for pooling under CASS7.9.6R), there will be a pooling of "all the client money, in every type of client money account". That, too, supports a pooling of all client money, in whatever account it is found. CASS7.9.6(1)R speaks of the pooling of client money held in "each client money account". The use of the word "each" here tends towards the idea that "client money accounts" represent the totality of the accounts in which client money is found.

128. Again, the provisions of CASS7.7.2R setting out the order of priority for client money held on the statutory trust, called "the waterfall provision", make it clear that the firm should only be interested in the residue of client money after all valid claims to client money have been met: this too is consistent with a single pooling of all monies representing client money in whatever account found.

129. Mr Zacaroli relies on CASS7.9.8G as setting out the FSA's view that a client had no proprietary claim except in respect of the segregated monies, but this, when read strictly, does not deal with claims by clients for identifiable client money in house accounts. It is therefore incomplete or inaccurate but, as it is only guidance, not much weight can attach to this.

130. The court is entitled to look for guidance as to the meaning of "client money account" by the process of deduction from the substance of CASS7.9. It was unnecessary to have any pooling at all in CASS7. Each client could have been left to his rights under the general law, which as explained in the *Analytical Framework* (above) would have applied by default if no express provision had been made. Pooling was evidently introduced to simplify distribution and thereby to effect distribution more speedily. However, it clearly had to be done fairly. If pooling is restricted to client money in client bank accounts and client transaction accounts, then it will not be possible for any client to follow money which he has paid into a house account into a segregated account into which it has been paid. The rule on pooling will operate as a bar on his exercising his tracing rights under the general law. That consequence is unfair and unlikely to have been intended by the rules. A right to trace in these circumstances may be exceptional but the possibility of such a claim is an indication that it cannot have been intended to restrict pooling in this way to segregated monies.

131. A distribution which pooled money in segregated accounts but not other monies would be unfair for another reason: the happenstance point. In my judgment, Mr Mabb is correct to submit that the fact that the non-segregated clients have come off worse in any particular insolvency than clients for whom assets were actually segregated is sheer happenstance. In this case, non-segregated clients suffered because of the interval of time between the PLS and the PPE in which trading and the movement of client money continued to take place. But on the next occasion, it might be the holders of segregated accounts which suffer. There could be a failure of the bank at which their accounts are held. There could be extreme movements in margin accounts. There could have been a "raid" on segregated accounts by malefactors. In those circumstances it would be clients with identifiable monies in house accounts who might be giving up the more valuable claims. It cannot be said therefore that it will always be the holders of segregated accounts who will be worse off by pooling. Moreover, there will be a disparity between the treatment of clients of a firm which adopts the alternative approach and the clients of the firm which uses the normal approach. In my judgment, particularly bearing in mind that the safeguarding of the rights of clients in general is a principle sought to be achieved by the MiFID Directives, the court should lean against any construction which has that effect.

132. It would be an objection to a pooling of monies that it interferes with the course of distribution of monies mandated by the Insolvency Act 1986. However, pooling of this sort is only of identifiable client money. On this basis there will be a client with a proprietary interest in such money which takes it outside insolvency law so that no infringement occurs.

133. It is not an objection to Mr Miles' submission that he seeks only the pooling of identifiable client money. CASS7.9.6R refers to "client money" without distinction but it cannot mean or include client money which has ceased to be identifiable, for example because it has been spent or lost.

134. Mr Zacaroli makes the attractive point that his clients have an unqualified right to the credit on their segregated accounts. The court should not of course interfere with property rights. However, I do not consider that such interference is caused by pooling in accordance with CASS7, since the dealings between the firm and its clients take place on the basis of CASS7, and thus pooling is implicit in their dealings. That segregated monies are always subject to defeasance can be seen from CASS7.9.3G. This states that there is a pooling even without a PPE, for instance in general client bank accounts.

135. Mr Zacaroli correctly makes the point that CASS7 does not put client monies in a house account on the same footing as client monies in segregated accounts. There is for instance no obligation under CASS7 on the firm to give a bank notice that a house account contains client money. In consequence, a bank may be able to exercise a right of combination of accounts against the firm even in respect of the house accounts containing client monies in which clients have proprietary interests. This could not happen with segregated accounts. But that does not mean that the protection is not to converge at any point in time and so that consideration, though important, does not exclude the possibility of a single pool containing the segregated accounts and identifiable money from house accounts.

136. Mr Zacaroli placed a certain amount of reliance on the secondary pooling provisions of CASS7.9. In relation to a secondary pooling event there is specific reference to client bank accounts and designated client bank accounts, but this point does not assist Mr Zacaroli as this suggests that the expression "client money account" in CASS7.9.6 was deliberately chosen and must be wider than client accounts, whether the bank accounts or transaction accounts.

137. Once it is concluded that the CMP includes all client money, not simply client money in segregated accounts, it becomes difficult logically to justify restricting the CMP to any class of clients, such as the clients to the extent of their segregated accounts. The judge's symmetry between the obligation to segregate while a going concern and the obligation to distribute on the failure (segregated assets for segregated clients) is as I see it a distraction from what CASS7 envisages, which is that all client monies are held on the terms of a single trust with ultimately a single pooling of all then identifiable client monies.

138. As to the speed of distribution point, there is no evidential basis for holding that a distribution on the basis of the judge's interpretation of CASS7.9.6R will be more timely. That will depend on the facts. One can, however, deduce that when the FSA made a policy decision that client money should be pooled it must have taken the view that overall this was in the best interests of clients who benefited from the pool. While it is likely to be the case in many situations that the pooling only of segregated accounts will be quicker than a pooling of such accounts and all identifiable client monies in the hands of the firm, this cannot be a universal rule for the reasons I have given. In any event it is capable of leading to unfairness. For those reasons, I think there is limited value in the speed of distribution point.

139. For the reasons given above I consider that the balance on this difficult point comes down against the judge's interpretation. Despite the lack of definition of "client money account" for the purposes of CASS7.9.6, in my judgment CASS7 as a whole demonstrates that what was intended and indeed (unless the next issue disproves it) achieved by CASS7.9.6 was a pooling of all client money in segregated accounts and house accounts. I do not need to go further than that for the purposes of this issue.

140. There was a certain amount of discussion as to whether CASS7 required a firm to carry out a further final reconciliation as at the PPE, always observing priorities. Mr Miles submits that a final reconciliation was required and that by continuing to comply with its obligations under CASS7 the firm will identify client money in unsegregated accounts as at the PPE and place it in segregated accounts so that they can be pooled. Mr Miles submits that contributions are determined as at the PPE, not by reference to the PLS. Contrary to the view of the judge at paragraph 387 of his judgment, there cannot be a restitutionary claim for monies wrongly paid out between the PLS and the PPE if CASS7.9.6R requires the sum to be pooled. Mr Miles submits that, as a matter of general trust law, the obligation to segregate did not stop at the PLS. The FSA accepts that there has to be a final reconciliation. Mr Russen also agrees that there should be a reconciliation after the PLS. He referred to CASS7.6.13R which deals with the rectification of discrepancies. In his submission, it does not matter that the obligation for a final reconciliation does not appear in client money distribution rules as the judge (at paragraph 213 of his judgment) suggested.

141. Mr Zacaroli, on the other hand, submits that the clock effectively stops at the PLS, save only that client transaction accounts movements continue to occur to reflect changes in underlying transactions. CASS7.9.9R requires money received after the PPE to be dealt with outside the CMP.

142. In the light of the conclusions that I have reached on pooling I consider that Mr Miles' submission as to the need for a final reconciliation is correct. CASS7.9.6R does not limit pooling to client money accounts at any particular point in time prior to the PPE. At that point in time, applying to a trust the general principle of valuation applying to claims in the winding up of a company (and no doubt alluding to *Ecclesiastes*), the tree is taken to lie where it falls (see the decision o this court in *Re Lines Brothers Ltd (in liquidation)* [1983] Ch 1).

ISSUE 3: DO CLIENTS PARTICIPATE IN THE POOL IF THEY HAVE CLAIMS TO CLIENT MONEY OR ONLY IF THEY HAVE CONTRIBUTED TO THE POOL?

143. This is a contest between the claims basis of distribution and the contributions basis of distribution, which the judge decided, principally on his interpretation of CASS7.7.2(2)R and CASS7.9.6R, in favour of the fully segregated clients. On the view which the judge had taken on what I have called Issue 2, his conclusion on this issue was understandable.

144. The MiFID Directives do not directly confront the issue of whether if a firm fails client monies are to be pooled. In my judgment it is implicit in safeguarding the assets of clients that the clients should all share in the remaining assets, but the basis is not specified.

145. Mr Miles launched a strong attack on the judge's answer to this question, and, while he sought to advance submissions to that effect even if the judge was right on Issue 2, I intend only to deal with the arguments which proceed on the basis of the answer given to Issue 2.

146. Mr Miles' argument focuses on CASS7.9.6(2)R:

> "If a *primary pooling event* occurs:
>
> …
>
> (2) the *firm* must distribute that *client money* in accordance with CASS7.7.2 R, so that each *client* receives a sum which is rateable to the *client money* entitlement calculated in accordance with CASS7.9.7 R."

147. CASS7.9.7R requires the set off of individual client balances and client equity balances. These terms are described in Annex 1 to CASS7. This sets out a standard method of reconciliation which a firm can use to carry out the requisite internal and external reconciliations of its accounts and records. On that basis, a firm using the alternative approach should on each business day ensure that the average balance on its client bank accounts at the close of business on that day is at least equal to the client money requirement at the close of business on the previous business day. A client money requirement is calculated in accordance with paragraph 6 of Annex 1. A firm has to aggregate all clients' individual client balances in accordance with paragraph 7 and the total margined transactions. Paragraph 7 requires the aggregation of cash held for the client, sale proceeds, the cost of purchases made but not delivered less money owed by the client to the firm and proceeds remitted to the client in respect of sales transactions where the client has not yet delivered the investments to be sold. The equity balances of clients are also excluded. These are the balances which firms hold with intermediaries for a particular client (see paragraph 13). Paragraph 18 of Annex 1 confers a reduced client money requirement option, but it is superseded by CASS7.9.7R once a PPE occurs.

148. Mr Miles submits that the client money entitlement is not ascertained by reference to the money in fact held for a client but by reference to what ought to be held for him, namely contractual entitlement.

149. The judge was influenced in his rejection of this analysis by the fact that as he saw it the expression "client money entitlement" was used inconsistently in CASS7 having regard to CASS7.9.21R. This point was also made by Mr Zacaroli, and I deal with it below in the context of his submissions. In addition, the judge concluded that the drafter had assumed the rules would be complied with (judgment, paragraph 246). I have already expressed my conclusion that the latter view was not correct.

150. As respects the judge's concerns, Mr Miles submits that the expression "client money entitlement" embodies a single concept. CASS7.9.7R makes mandatory the offset which is only optional under Annex 1. As to compliance with CASS7, Mr Miles appears to accept that this assumption was made but submits that it cannot bear much weight as the intention of CASS7 was merely to protect investors in accordance with MiFID and it is this intention which should be kept in mind.

151. Mr Zacaroli submits that the judge was right for the reasons that he gave to exclude the claims basis. Even if there is a trust on receipt, the non-segregated clients cannot claim a beneficial interest in any of the segregated funds immediately prior to the PPE. He submits that "pooling" suggests no more than that separate items of property are treated as one pool and that the claims of the beneficiaries to those separate items of property are now to be treated as claims against one pool. No new claims are created as against the pool. On that basis the persons who merely had claims to recover client money could not share with those who had contributed to the pool. If the CMP were limited to monies in segregated accounts, only clients for whom monies had been segregated could make claims on the CMP. Mr Zacaroli submits that the expression "each client" in CASS7.9.6(2)R must mean each client "for whom that money is held; according to their respective interests in it" under CASS7.7.2(2)R. Mr Zacaroli also relies on the argument that the court should not interpret CASS7 in a way that interferes with the property rights of the clients with segregated accounts but I have already addressed this point under Issue 2 above.

152. Mr Zacaroli submits that CASS7.9.7R and Annex 1 are inappropriate following the failure of the firm and do not provide the means for the firm to calculate "entitlement". CASS7.9.6(2)R refers only to CASS7.9.7R and not to Annex 1. Annex 1 provides the means of calculating the client money requirement while the firm is a going concern. Therefore Annex 1 does not envisage calculations of actual client money entitlements as at the PPE. CASS7.9.7R does not provide a basis for calculation. It merely makes offsetting mandatory in certain circumstances. Annex 1 contains a large number of discretionary elements e.g. paragraphs 6, 9 and 11.

153. As regards the question of the client money entitlement having different meanings in different provisions, the judge had regard to the fact that under CASS7.9.21R, on a secondary pooling, entitlement was assessed by reference to amounts segregated to client accounts with the intermediary which had failed. However, in my judgment, this did not provide a clear guide to the judge since it was inevitable that on a secondary pooling distribution had to be according to segregation since it was concerned with the distribution of funds held with a particular intermediary. In the context of CASS7 apart from secondary pooling, entitlement was clearly used in the sense of contractual entitlement: see for example CASS7.4.16G. The judge also referred to CASS7.4.27G and 28G, which use a different expression, "client entitlement", and accordingly I do not consider that these instances provide a basis for his conclusion that the expression "client money entitlement" was used inconsistently in CASS7.

154. I turn to my conclusions. In my judgment, all clients whose monies are pooled must share in the CMP. The more difficult question is whether those who have only a contractual right but no proprietary right should also share. In my judgment, Mr Miles' approach is to be preferred. The underlying concept of "client money entitlement", the term used in CASS7.9.6R(2), is that of contractual entitlement. The effect of this interpretation is that some clients will benefit from a distribution even if they have no proprietary claim to client money. However, it was open to the FSA to determine that the failure of the firm should be treated as a common misfortune in which those who had claims to the recovery of client money should share without distinction. There are a number of further points arising out of the wording of CASS7.9.6R and CASS7.9.7R with which I must deal.

155. CASS7.9.6(2)R states that each client should on the distribution receive "a sum which is rateable to the client money entitlement calculated in accordance with CASS7.9.7R". However, that does not in my judgment mean that it is inappropriate to refer to Annex 1. It is necessary to do so to ascertain the meaning of individual client balances and equity balances. Even if that were not so, as I have explained above, the word "entitlement" clearly signals a contractual entitlement. If the drafter intended that the distribution should be in accordance with the monies actually contributed by clients to the CMP, he would in my judgment have more naturally used words in the final clause as follows "so that each client receives a sum which is rateable to the share of the CMP represented by the monies which he has contributed to the pool." There is no need to say anything about the date at which such contributions are calculated as that is dealt with fully in CASS7.9.9R (see Appendix 1 below). In that connection, it is worthy of note that this provision also uses the expression "client money entitlement". There is a presumption that words used in a statute are used consistently unless the context otherwise requires. It would be very odd if, in the context of post-PPE receipts, "client money entitlement" there meant only the client money entitlement as shown by the last reconciliation. That point provides some support for the conclusion I have reached on this issue. The judge's approach inevitably means that in interpreting the expression "client money entitlement" he has to depart from contractual entitlement, and to relate the term to the client monies held for a client in a separate account as at the PLS. There has to be a means of identifying what was so held and the judge identifies the last reconciliation as the appropriate way of achieving this, but as I explain below that is somewhat artificial and unstable as it is likely to need adjustment of a significant nature.

156. As the judge accepted, there will on his approach be a wide range of situations in which there have to be adjustments. Perhaps the most obvious would be where the PPE occurred after the last reconciliation but before the firm was able to perform a physical segregation. Other examples can be found in the judge's judgment, for example a client might have been repaid his client money after the last reconciliation and before the PPE. All these adjustments could be substantial. It is remarkable that CASS7 makes no provision for any of these adjustments. It may be possible to achieve these adjustments without express provision. Nonetheless, the absence of any express provision for adjustments of this kind not only undermines the contributions basis of distribution but also reinforces the claims basis of distribution since it is wholly unnecessary on the claims basis.

157. The judge referred to the lack of an appropriate rule for adjustments as a "glitch" (judgment paragraph 265). In my judgment, this term understates the problem and accordingly I would not agree with the judge's conclusion at paragraph 273 of his judgment that:

> "As a blemish on an otherwise rational interpretation of the client money and distribution rules as a whole, they come nowhere near the difficulties, in particular of delay, expense, inefficiency and potential for litigation which would arise from an adoption of the claims theory. Furthermore, the general law is, as I shall endeavour to explain below, adequate to remedy

> such injustices as the application of the contributions theory to such events would otherwise cause."

158. I also consider that the judge has there clearly understated the difficulties that could arise in relation to a pool consisting only of segregated monies. Where there has been a misappropriation of funds from segregated accounts there would not be a timely distribution of the CMP to clients. As I see it, the way in which CASS7 achieves timely return, as referred to in CASS7.9.2G, is by pooling: if the fund is pooled, and there is a single trustee, it is likely to be a more efficient and speedier distribution.

159. The final sentence of that quotation from paragraph 273 of the judge's judgment refers to the individual tracing claims which non-segregated clients might have. Often these would be of no value because the right to trace had been lost, for example because the money had been used to pay a bona fide creditor of the firm. Accordingly this point should not have received the weight given to it in the judge's judgment.

160. CASS7.7.2R also has an important bearing on CASS7.9.6R because it sets out the terms of the statutory trust. CASS7.7.2R states that the firm holds client money as statutory trustee "for the clients … for whom that money is held, according to their respective interests in it". While the firm is a going concern those interests are the several interests of the clients but on a PPE a pooling occurs so that on any view those interests are varied. Accordingly as from the happening of a PPE, the expression "their respective interests" must mean their respective interests under CASS7.9.6R. The judge also held that it was no part of the purpose of CASS7.9 to confer on clients whose money was not segregated a beneficial interest in the fund which did not exist immediately prior to the PPE. He held that this was implicit in the opening words of CASS7.9.6R which require the firm to distribute "that client money" in accordance with CASS7.7.2R, and in the words of CASS7.7.2R that "for the clients … for whom that money is held according to their respective interests in it". My answer to this point is the same as that last given.

161. The judge was influenced by the desirability of achieving symmetry between those who contributed to the pool and those who could share in it. That would as he pointed out often be the case where distribution of a mixed fund is made under the general law. But CASS7.9.6R is a statutory rule and the normal provision might therefore be displaced by a different rule. The judge placed some reliance on the point that the drafter has assumed compliance with the obligation to segregate client monies under CASS7, particularly when CASS7.9.6(2)R refers to "that client money". However, in my judgment, that expression must mean client money or (as the case may be) whatever represents client money at the point in time of distribution. This means that CASS7.9.6(2)R does not provide symmetry between client money in segregated accounts and clients with such accounts. I have dealt with the question whether CASS7 makes an assumption about compliance more generally under *Analytical Framework* above.

162. Mr Milligan threw doubt on the power of the FSA to make a rule which would have the effect of pooling segregated accounts with identifiable client money in house accounts. Section 139(1)(b) of FSMA refers to the pooling of two or more accounts for specified purposes, and, while this would clearly cover separate client accounts, there was no provision enabling identifiable client money to be brought in from the house accounts. But there is a power in section 139(1)(a) to create a trust, and by

implication a single trust, and accordingly in my judgment such monies could be brought into the pool. In view of the width of section 139(1)(a), I do not consider that this power is excluded by implication by section 139(1)(b) under the rule of construction: *expressio unius exclusio alterius*.

163. Accordingly, in my judgment, clients should share in the CMP on a claims basis and the appeal on this issue should be allowed. CASS7 achieves as it were a mini-liquidation of monies now representing all client money in which all claimants in respect of client money of the firm share.

164. There is nothing in the submissions raised under this issue which causes me to revisit the conclusions come to under Issue 2.

ISSUE 4: WHEN DOES MONEY WHICH THE FIRM OWES TO A CLIENT BECOME "CLIENT MONEY"?

165. This issue relates to self-generated indebtedness of the firm and what it comes down to is this: in relation to such indebtedness, when does the firm "hold" monies for a client for the purposes of the definition of "client money" in CASS7.2.1R (Appendix 1, below). The judge held that client monies could be those received by a client, or those received by a third party for a client, or funds of the firm appropriated to the client, but not monies which the firm simply owes to the client. For example, the firm may become liable to the client in respect of "manufactured" dividends as a result of a stock lending transaction. A stock lending transaction occurs when a client makes an outright transfer of securities to a third party against a promise by that third party to retransfer equivalent securities or their market value in cash. The third party will often be liable to pay a "manufactured" dividend if the transaction crosses a distribution date. LBIE borrowed stock from its clients, and became liable to pay manufactured dividends to those clients. The judge's judgment means that the amounts needed to satisfy manufactured dividends due and payable by LBIE but not yet paid into client bank accounts are not "client money" for the purposes of CASS7.2.1R. Accordingly, if my Lords agree with the conclusions to which I have come on Issues 1, 2 and 3 above, those amounts will not be pooled.

166. Mr Jarvis submits that the judge was in error on this point and that the money became client money within the meaning of CASS7.2.1R from the moment that the money became due and payable to the firm and the firm became obliged to segregate money for the client in accordance with CASS7.4. He seeks to establish that, at least when the firm records an entry in its accounting records to reflect the accrual of the right to a manufactured dividend, that money is held for the client. His contentions are based on (1) general principles of trust law as to the creation of a trust, and (2) specific provisions of CASS7 which he seeks to call in aid by analogy. He has to overcome the fact that there has been no transfer of any money to an account for the client.

167. No transfer of money to a client account is, on Mr Jarvis' submission, necessary for the creation of a trust. In *Hunter v Moss* [1994] 1 WLR 452, a settlor was held to have made an effective declaration of trust over 5% of his shareholding. It was not an objection that the particular shares had not been identified or transferred into a separate account. Moreover, there was no "transfer" of property rights on an electronic funds transfer: *R v Preddy* [1996] AC 815. Applying these principles, a client of LBIE had an undivided share in the firm's bank balances once a

manufactured dividend has become due and payable to it and thus a beneficial interest in such balances. Accordingly the firm "held" money for the client within CASS7.2.1R.

168. If the client has no beneficial interest under a trust by virtue of the general law, Mr Jarvis submits that CASS7.2.1R creates a statutory trust which confers such an interest on him. Statute can create a trust without imposing all the conditions which have to be satisfied in order to constitute a trust under the general law: *Re Ahmed & Co.* [2006] EWHC 480 (Ch) at [111] to [113]. Mr Jarvis submits that since no receipt of money is involved it is not artificial to treat the firm as holding the relevant amount for the client. To find that client money is in this situation required to be segregated furthers the purpose of MiFID, which is to ensure that clients' money is not put at risk. Clients in this situation should be protected by the buffers referred to by the judge in his judgment. All of LBIE's bank accounts were subject to a liquidity management process, described in the statement of facts, under which cash requirements of LBIE would be met by LBHI, and its cash surpluses removed, on a daily basis. Mr Jarvis further submits that, where client money has been credited to a house account, the firm should have the onus of showing that no part of the money held by it represents trust property (*Foskett v McKeown* [2001] 1 AC 102 at 132E to 133E, per Lord Millett). The judge was correct to hold that this might be a case where credits to house accounts should be treated as intended to be available for clients ahead of the firm.

169. Mr Peacock seeks to rebut what Mr Jarvis's submissions. On his submission, what Mr Jarvis seeks to establish what is effectively a trust of money without segregation. Mr Peacock submits that the result for which Mr Jarvis contends offends the basic principle of insolvency law that unsecured creditors in an insolvency should rank *pari passu* and rateably. Mr Peacock submits that no trust was created by the creation of an entry in LBIE's accounting records. Therefore the clients entitled to unpaid manufactured dividends were no more than unsecured creditors and CASS7.2.1R should not be construed so as to include them because nothing in FSMA gives the FSA the power to give such persons preferential status in an insolvency.

170. Mr Jarvis answers this point by reliance on two specific provisions of CASS7. First he relies on CASS7.2.13G (see Appendix 1, below), which counsels firms to treat commission rebates as client monies when they become due and payable, not at some later date or when the commission rebates are actually credited to the client's bank account. He points out that the judge considered that CASS7.2.13G meant that the firm came under an obligation to appropriate and segregate as client money the required sum of its own money on account of the commission rebate to meet its obligation under this provision, unless the obligation was discharged by immediate payment to the client. Secondly Mr Jarvis relies on CASS7.2.9R (see Appendix 1, below) which shows that money due and payable to the firm is not client money. On his submission, the situation where a firm owes money to a client is the obverse of this case and so such money should be client money. He submits that his approach is supported by CASS7.4.29G (see Appendix 1, below). He submits that this provision makes it clear that, where under the normal approach a firm becomes liable to pay money to the client, it should do so promptly and pay the money into the client bank account if not paid to the client direct, and that this suggests that money which is due and payable to the client is "client money".

171. Cogently as Mr Jarvis' arguments in support of this issue were put, I fundamentally disagree with them. As I indicated under *Analytical Framework* above, trust law can in general be moulded by the terms of the trust, and of course it is open to Parliament to enact any provision that it thinks fit (though this proposition may have to be modified in relation to European Union law). However, because of the impact on unsecured creditors, the court has in my judgment to start from the position that a trust is not intended to be created by a statutory rule if the trust is not one which could be created under the general law. In my judgment, a trust cannot be created without property to which it can attach. Where there is no property which is sufficiently identified to form the subject matter of a trust, no trust is created. In *Hunter v Moss*, the shareholding was in existence; the shares were fungible and thus the trust property could be identified. The same would be true if LBIE had an account called "manufactured dividends" into which it paid whatever was found to be due at each reconciliation on account of such dividends, and held for the benefit of clients entitled to manufactured dividends. But it does not suffice under the general law that LBIE had sufficient funds in some other account which could have been dedicated for this purpose but which was not so used. Turning to CASS7, there is no indication in CASS7.2.1R that the definition of "client money" is intended to create a trust in circumstances where the relationship under the general law could never be anything more than that of debtor and creditor. On the contrary, in my judgment, the choice of the word "holds" in CASS7 supports the conclusion that CASS7.2.1R requires that money should (if not received for the client) have been set aside for the client, and means more than simply "becomes indebted".

172. I do not consider that *Preddy* assists Mr Jarvis since it turned on the distinction between (1) transferring to, and (2) extinguishing and then creating a new chose of action in the hands of, the person to whom money was credited by electronic transfer. Whatever the legal mechanics, "money" (as defined in the Glossary) is received by LBIE. As to CASS7.2.13G, this would I accept have been a powerful point if it had been shown that commission rebates were rebates of commission which LBIE charged and then rebated without receipt of a rebate from a third party. There is no definition of "commission rebate", but the hearing proceeded on the basis that it was a sum payable by another party, and not the firm, so that commission rebates are received by the firm, and that is what one would expect. Commission rebates are therefore capable of separate identification. They stand on a different footing from manufactured dividends because they constitute monies received from third parties.

173. As to Mr Jarvis's submission on CASS7.2.9R, it is necessary to read such the provision to like effect to deal with the case where the firm owes money to the client. Mr Jarvis sought to do this by reference to CASS7.4.29G but in my judgment this undermines rather than supports his submission. This provision deals only with firms operating the normal approach, and it neither states nor proceeds on the basis that money payable to a client is "client money" prior to segregation to a client account.

174. The definition of "client money" in CASS7.2.1R, as one would expect, in part tracks the opening words of section 139(1) of FSMA. However, it is not necessary for me to rule on Mr Peacock's submission as to the meaning of this power. It may be affected by the question whether in any particular case it is sought to be used to implement the MiFID Directives.

175. This is not affected by the MiFID Directives because, as explained under *Analytical Framework*, the MiFID Directives do not prescribe the content of a right conferred by national law.

176. Accordingly I would dismiss the appeal against the judge's judgment on this issue.

Disposition of the appeal

177. I would allow the appeal to the extent indicated above. On Issue 1, I would dismiss the appeal and hold that the statutory trust arose on the receipt of funds. On Issues 2 and 3, I would allow the appeal and hold that the pool arising under CASS7.9.6R on the PPE includes not only segregated monies in segregated accounts but also all identifiable client money in the firm's house accounts, and that such pool should be distributed on a claims basis and not a contributions basis. On Issue 4, I would dismiss the appeal and hold that client money does not include sums due and payable by the firm to its clients but not yet appropriated for that purpose.

Appendix 1 to judgment of Arden LJ

Client money: MiFID business

CASS7.1 **Application and Purpose**

Application

7.1.1 R This chapter (the *client money rules*) applies to :

(1) a *MiFID investment firm*:

(a) that holds *client money*; or

(b) that opts to comply with this chapter in accordance with *CASS7.1.3 R (1)* (Opt-in to the MiFID client money rules); and

(2) a *third country investment firm* that opts to comply with this chapter in accordance with *CASS7.1.3 R (2)* (Opt-in to the MiFID client money rules);

unless otherwise specified in this section.

7.1.2 G *CASS7.2* (Definition of client money) sets out the circumstances in which *money* is considered *client money* for the purposes of this chapter.

…

7.1.9 G If a credit institution that holds *money* as a deposit with itself is subject to the *requirement to disclose information before providing services*, it should, in compliance with that obligation, notify the *client* that:

(1) *money* held for that *client* in an account with the *credit institution* will be held by the *firm* as banker and not as trustee (or in Scotland as agent); and

(2) as a result, the *money* will not be held in accordance with the *client money rules*.

7.1.10 G Pursuant to *Principle* 10 (Clients' assets), a *credit institution* that holds *money* as a deposit with itself should be able to account to all of its *clients* for amounts held on their behalf at all times. A bank account opened with the *firm* that is in the name of the *client* would generally be sufficient. When *money* from *clients* deposited with the *firm* is held in a pooled account, this account should be clearly identified as an account for *clients*. The *firm* should also be able to demonstrate that an amount owed to a specific *client* that is held within the pool can be reconciled with a record showing that individual's *client* balance and is, therefore, identifiable at any time. Similarly, where that *money* is reflected only in a *firm's* bank account with other banks (nostro accounts), the *firm* should be able to reconcile amounts owed to that *client* within a reasonable period of time.

7.1.11 G A *credit institution* is reminded that the exemption for deposits is not an absolute exemption from the *client money rules*.

Affiliated companies

7.1.12 G A *firm* that holds *money* on behalf of, or receives *money* from, an *affiliated company* in respect of *MiFID business* must treat the *affiliated company* as any other *client* of the *firm* for the purposes of this chapter.

7.1.13 G A *firm* that holds *client money* on behalf of, or receives *money* from, an *affiliated company* in respect of its *non-MiFID business* and opts under *CASS7.1.3 R (1)* to comply with this chapter in with respect of that *non-MiFID business*, should refer to the *non-directive client money chapter* (see *CASS 4.1.18 R* (Affiliated companies)) to determine whether that money falls within the scope of the non-directive client money chapter and therefore within the scope of the opt-in.

…

General purpose

7.1.16 G

(1) *Principle* 10 (Clients' assets) requires a *firm* to arrange adequate protection for *clients'* assets when the *firm* is responsible for them. An essential part of that protection is the proper accounting and treatment of *client money*. The *client money rules* provide requirements for *firms* that receive or hold *client money*, in whatever form.

(2) The *client money rules* also, implement the provisions of *MiFID* which regulate the obligations of a *firm* when it holds *client money*.

CASS7.2 **Definition of client money**

7.2.1 R For the purposes of this chapter and the *MiFID custody chapter*, *client money* means any *money* that a *firm* receives from or holds for, or on behalf of, a *client* in the course of, or in connection with, its *MiFID business* unless otherwise specified in this section.

Business in the name of the firm

7.2.2 R *Money* is not *client money* where the *firm* carries on business in its own name on behalf of the *client* where that is required by the very nature of the transaction and the *client* is in agreement. [**Note:** recital 26 to *MiFID*]

Title transfer collateral arrangements

7.2.3 R Where a *client* transfers full ownership of *money* to a *firm* for the purpose of securing or otherwise covering present or future, actual or contingent or prospective obligations, such *money* should no longer be regarded as *client money*.
[**Note:** recital 27 to *MiFID*]

7.2.4 G A title transfer financial collateral arrangement under the *Financial Collateral Directive* is an example of a type of transfer of *money* to cover obligations where that *money* will not be regarded as *client money*.

7.2.5 G Where a *firm* has received full title or full ownership to *money* under a collateral arrangement, the fact that it has also taken a security interest over its obligation to repay that *money* to the *client* would not result in the *money* being *client money*. This can be compared to a situation in which a *firm* takes a charge or other security interest over *money* held in a *client bank account*, where that *money* would still be *client money* as there would be no absolute transfer of title to the *firm*. However, if that security interest includes a "right to use arrangement", under which the *client* agrees to transfer all of its rights to *money* in that account to the *firm* upon the exercise of the right to use, the

money may cease to be *client money*, but only once the right to use is exercised and the *money* is transferred out of the account to the *firm*.

7.2.6 G *Firms* are reminded of the *client's best interest rule*, which requires a *firm* to act honestly, fairly and professionally in accordance with the best interests of its *clients* when structuring its business particularly in respect of the effect of that structure on *firms'* obligations under the *client money rules*.

7.2.7 G Pursuant to the *client's best interests rule*, a *firm* should ensure that where a *retail client* transfers full ownership of *money* to a *firm*:

(1) the *client* is notified that full ownership of the *money* has been transferred to the *firm* and, as such, the *client* no longer has a proprietary claim over this *money* and the *firm* can deal with it on its own right;

(2) the transfer is for the purposes of securing or covering the *client's* obligations;

(3) an equivalent transfer is made back to the *client* if the provision of collateral by the *client* is no longer necessary; and

(4) there is a reasonable link between the timing and the amount of the collateral transfer and the obligation that the *client* owes, or is likely to owe, to the *firm*.

Money in connection with a "delivery versus payment" transaction

7.2.8 R *Money* need not be treated as *client money* in respect of a delivery versus payment transaction through a commercial settlement system if it is intended that either:

(1) in respect of a *client's* purchase, *money* from a *client* will be due to the *firm* within one *business day* upon the fulfilment of a delivery obligation; or

(2) in respect of a *client's* sale, *money* is due to the *client* within one *business day* following the *client's* fulfilment of a delivery obligation;

unless the delivery or payment by the *firm* does not occur by the close of business on the third *business day* following the date of payment or delivery of the *investments* by the *client*.

Money due and payable to the firm

7.2.9 R

(1) *Money* is not *client money* when it becomes properly due and payable to the *firm* for its own account.

(2) For these purposes, if a *firm* makes a payment to, or on the instructions of, a *client*, from an account other than a *client bank account*, until that payment has cleared, no equivalent sum from a client bank account for reimbursement will become due and payable to the *firm*.

7.2.10 G *Money* held as *client money* becomes due and payable to the *firm* or for the *firm's* own account, for example, because the *firm* acted as *principal* in the contract or the *firm*, acting as agent, has itself paid for *securities* in advance of receiving the purchase *money* from its *client*. The circumstances in which it is due and payable will depend on the contractual arrangement between the *firm* and the *client*.

7.2.11 G When a *client's* obligation or liability, that is secured by that *client's* asset, crystallises, and the *firm* realises the asset in accordance with an agreement entered into between the *client* and the *firm*, the part of the proceeds of the asset to cover such liability that is due and payable to the *firm* is not *client* money. However, any proceeds of sale in excess of the amount owed by the

client to the *firm* should be paid over to the *client* immediately or be held in accordance with the *client money rules*.

Commission rebate

7.2.12 G When a *firm* has entered into an arrangement under which *commission* is rebated to a *client*, those rebates need not be treated as *client money* until they become due and payable to the *client* in accordance with the terms of the contractual arrangements between the parties.

7.2.13 G When *commission* rebate becomes due and payable to the *client*, the *firm* should:

(1) treat it as *client money*; or

(2) pay it out in accordance with the *rule* regarding the discharge of a *firm's* fiduciary duty to the *client* (see *CASS7.2.15 R*);

unless the *firm* and the *client* have entered into an arrangement under which the *client* has agreed to transfer full ownership of this *money* to the *firm* as collateral against payment of future professional fees (see *CASS7.2.3 R* (Title transfer collateral arrangements)).

Interest

7.2.14 R Unless a *firm* notifies a *retail client* in writing whether or not interest is to be paid on *client money* and, if so, on what terms and at what frequency, it must pay that *client* all interest earned on that *client money*. Any interest due to a *client* will be *client money*.

Discharge of fiduciary duty

7.2.15 R *Money* ceases to be *client money* if it is paid:

(1) to the *client*, or a duly authorised representative of the *client*; or

(2) to a third party on the instruction of the *client*, unless it is transferred to a third party in the course of effecting a transaction, in accordance with *CASS7.5.2 R* (Transfer of client money to a third party); or

(3) into a bank account of the *client* (not being an account which is also in the name of the *firm*); or

(4) to the *firm* itself, when it is due and payable to the *firm* (see *CASS7.2.9 R* (Money due and payable to the firm)); or

(5) to the *firm* itself, when it is an excess in the *client bank account* (see *CASS7.6.13 R (2)* (Reconciliation discrepancies)).

7.2.16 G When a *firm* wishes to transfer *client money* balances to a third party in the course of transferring its business to another *firm*, it should do so in a way which it discharges its fiduciary duty to the *client* under this section.

7.2.17 R When a *firm* draws a cheque or other payable order to discharge its fiduciary duty to the *client*, it must continue to treat the sum concerned as *client money* until the cheque or order is presented and paid by the bank.

Allocated but unclaimed client money

7.2.18 G The purpose of the *rule* on allocated but unclaimed *client money* is to allow a *firm*, in the normal course of its business, to cease to treat as *client money* any balances, allocated to an individual *client*, when those balances remain unclaimed.

7.2.19 R A *firm* may cease to treat as *client money* any unclaimed *client money* balance if it can demonstrate that it has taken reasonable steps to trace the *client* concerned and to return the balance.

7.2.20 E

(1) Reasonable steps should include:

(a) entering into a written agreement, in which the *client* consents to

the *firm* releasing, after the period of time specified in (b), any *client money* balances, for or on behalf of that *client*, from *client bank accounts*;

(b) determining that there has been no movement on the *client's* balance for a period of at least six years (notwithstanding any payments or receipts of charges, interest or similar items);

(c) writing to the *client* at the last known address informing the *client* of the *firm's* intention of no longer treating that balance as *client money*, giving the *client* 28 days to make a claim;

(d) making and retaining records of all balances released from *client bank accounts*; and

(e) undertaking to make good any valid claim against any released balances.

(2) Compliance with (1) may be relied on as tending to establish compliance with *CASS7.2.19 R*.

(3) Contravention of (1) may be relied on as tending to establish contravention of *CASS7.2.19 R*.

7.2.21 G When a *firm* gives an undertaking to make good any valid claim against released balances, it should make arrangements authorised by the *firm's* relevant *controllers* that are legally enforceable by any *person* with a valid claim to such *money*.

CASS7.3 **Organisational requirements: client money**

Requirement to protect client money

7.3.1 R A *firm* must, when holding *client money*, make adequate arrangements to safeguard the *client's* rights and prevent the use of *client money* for its own account.

[**Note:** article 13(8) of *MiFID*]

Requirement to have adequate organisational arrangements

7.3.2 R A *firm* must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of *client money*, or of rights in connection with *client money*, as a result of misuse of *client money*, fraud, poor administration, inadequate record-keeping or negligence. [**Note:** article 16(1)(f) of the *MiFID implementing Directive*]

CASS7.4 **Segregation of client money**

Depositing client money

7.4.1 R A *firm*, on receiving any *client money*, must promptly place this *money* into one or more accounts opened with any of the following:

(1) a central bank;

(2) a *BCD credit institution*;

(3) a bank authorised in a third country;

(4) a *qualifying money market fund*.

[**Note:** article 18(1) of the *MiFID implementing Directive*]

7.4.2 G An account with a central bank, a *BCD credit institution* or a bank authorised in a third country in which *client money* is placed is a *client bank account*.

…

A firm’s selection of a credit institution, bank or money market fun

7.4.7 R A *firm* that does not deposit *client money* with a central bank must exercise all due skill, care and diligence in the selection, appointment and periodic review of the *credit institution*, bank or *qualifying money market fund* where the *money* is deposited and the arrangements for the holding of this *money*. [**Note:** article 18(3) of the *MiFID implementing Directive*]

…

7.4.10 R A *firm* must make a record of the grounds upon which it satisfies itself as to the appropriateness of its selection of a *credit institution*, a bank or a *qualifying money market fund*. The *firm* must make the record on the date it makes the selection and must keep it from the date of such selection until five years after the *firm* ceases to use the third party to hold *client money*.

Client bank accounts

7.4.11 R A *firm* must take the necessary steps to ensure that *client money* deposited, in accordance with *CASS7.4.1 R*, in a central bank, a *credit institution*, a bank authorised in a third country or a *qualifying money market fund* is held in an account or accounts identified separately from any accounts used to hold *money* belonging to the *firm*. [**Note:** article 16(1)(e) of the *MiFID implementing Directive*]

7.4.12 G A *firm* may open one or more *client bank accounts* in the form of a *general client bank account*, a *designated client bank account* or a *designated client fund account* (see *CASS7.9.3 G*).

7.4.13 G A *designated client fund account* may be used for a *client* only where that *client* has consented to the use of that account and all other *designated client fund accounts* which may be pooled with it. For example, a *client* who consents to the use of bank A and bank B should have his *money* held in a different *designated client fund account* at bank B from a *client* who has consented to the use of banks B and C.

Payment of client money into a client bank account

7.4.14 G Two approaches that a *firm* can adopt in discharging its obligations under the *MiFID client money segregation requirements* are:

(1) the 'normal approach'; or

(2) the 'alternative approach'.

7.4.15 R A *firm* that does not adopt the normal approach must first send a written confirmation to the *FSA* from the *firm's* auditor that the *firm* has in place systems and controls which are adequate to enable it to operate another approach effectively.

7.4.16 G The alternative approach would be appropriate for a *firm* that operates in a multi-product, multi-currency environment for which adopting the normal approach would be unduly burdensome and would not achieve the *client* protection objective. Under the alternative approach, *client money* is received into and paid out of a *firm's* own bank accounts; consequently the *firm* should have systems and controls that are capable of monitoring the *client money* flows so that the *firm* can comply with its obligations to perform reconciliations of records and accounts (see *CASS7.6.2 R*). A *firm* that adopts the alternative approach will segregate *client money* into a *client bank account* on a daily basis, after having performed a reconciliation of records and accounts of the entitlement of each *client* for whom the *firm* holds *client money* with the records and accounts of the *client money* the *firm* holds in

client bank accounts and *client transaction accounts* to determine what the *client money* requirement was at the close of the previous *business day*.

7.4.17 G Under the normal approach, a *firm* that receives *client money* should either:

(1) pay it promptly, and in any event no later than the next *business day* after receipt, into a *client bank account*; or

(2) pay it out in accordance with the *rule* regarding the discharge of a *firm's* fiduciary duty to the *client* (see *CASS7.2.15 R*).

7.4.18 G Under the alternative approach, a *firm* that receives *client money* should:

(1)

(a) pay any *money* to or on behalf of *clients* out of its own account; and

(b) perform a reconciliation of records and accounts required under *CASS7.6.2 R* (Records and accounts), *SYSC 4.1.1 R* and *SYSC 6.1.1 R*, adjust the balance held in its *client bank accounts* and then segregate the *money* in the *client bank account* until the calculation is re-performed on the next *business day*; or

(2) pay it out in accordance with the *rule* regarding the discharge of a *firm's* fiduciary duty to the *client* (see *CASS7.2.15 R*).

7.4.19 G A *firm* that adopts the alternative approach may:

(1) receive all *client money* into its own bank account;

(2) choose to operate the alternative approach for some types of business (for example, overseas equities transactions) and operate the normal approach for other types of business (for example, *contingent liability investments*) if the *firm* can demonstrate that its systems and controls are adequate (see *CASS7.4.15 R*); and

(3) use an historic average to account for uncleared cheques (see paragraph 4 of *CASS7 Annex 1 G*).

7.4.20 G Pursuant to the *MiFID client money segregation requirements*, a *firm* should ensure that any *money* other than *client money* deposited in a *client bank account* is promptly paid out of that account unless it is a minimum sum required to open the account, or to keep it open.

7.4.21 R If it is prudent to do so to ensure that *client money* is protected, a *firm* may pay into a *client bank account money* of its own, and that *money* will then become *client money* for the purposes of this chapter.

Automated transfers

7.4.22 G Pursuant to the *MiFID client money segregation requirements*, a *firm* operating the normal approach that receives *client money* in the form of an automated transfer should take reasonable steps to ensure that:

(1) the *money* is received directly into a *client bank account*; and

(2) if *money* is received directly into the *firm's* own account, the *money* is transferred into a *client bank account* promptly, and in any event, no later than the next *business day* after receipt.

Mixed remittance

7.4.23 G Pursuant to the *MiFID client money segregation requirements*, a *firm* operating the normal approach that receives a *mixed remittance* (that is part *client money* and part other *money*) should:

(1) pay the full sum into a *client bank account* promptly, and in any event, no later than the next *business day* after receipt; and

(2) pay the *money* that is not *client money* out of the *client bank account* promptly, and in any event, no later than one *business day* of the day

on which the *firm* would normally expect the remittance to be cleared.

…

Client entitlements

7.4.27 G Pursuant to the *MiFID client money segregation requirements*, a *firm* operating the normal approach that receives outside the *United Kingdom* a *client* entitlement on behalf of a *client* should pay any part of it which is *client money*:

(1) to, or in accordance with, the instructions of the *client* concerned; or

(2) into a *client bank account* promptly, and in any event, no later than five *business days* after the *firm* is notified of its receipt.

7.4.28 G Pursuant to the *MiFID client money segregation requirements*, a *firm* operating the normal approach should allocate a *client* entitlement that is *client money* to the individual *client* promptly and, in any case, no later than ten *business days* after notification of receipt.

Money due to a client from a firm

7.4.29 G Pursuant to the *MiFID client money segregation requirements*, a *firm* operating the normal approach that is liable to pay *money* to a *client* should promptly, and in any event no later than one *business day* after the *money* is due and payable, pay the *money*:

(1) to, or to the order of, the *client*; or

(2) into a *client bank account*.

Segregation in different currency

7.4.30 R A *firm* may segregate *client money* in a different currency from that of receipt. If it does so, the *firm* must ensure that the amount held is adjusted each *day* to an amount at least equal to the original currency amount (or the currency in which the *firm* has its liability to its *clients*, if different), translated at the previous day's closing spot exchange rate.

7.4.31 G The *rule* on segregation of *client money* in a different currency (*CASS7.4.30 R*) does not apply where the *client* has instructed the *firm* to convert the *money* into and hold it in a different currency.

CASS7.5 **Transfer of client money to a third party**

7.5.1 G This section sets out the requirements a *firm* must comply with when it transfers *client money* to another *person* without discharging its fiduciary duty owed to that *client*. Such circumstances arise when, for example, a *firm* passes *client money* to a *clearing house* in the form of margin for the *firm's* obligations to the *clearing house* that are referable to transactions undertaken by the *firm* for the relevant clients. They may also arise when a *firm* passes *client money* to an *intermediate broker* for *contingent liability investments* in the form of initial or variation margin on behalf of a *client*. In these circumstances, the *firm* remains responsible for that *client's equity balance* held at the *intermediate broker* until the contract is terminated and all of that *client's* positions at that *broker* closed. If a *firm* wishes to discharge itself from its fiduciary duty, it should do so in accordance with the *rule* regarding the discharge of a *firm's* fiduciary duty to the *client* (*CASS7.2.15 R*).

7.5.2 R A *firm* may allow another *person*, such as an exchange, a *clearing house* or an *intermediate broker*, to hold or control *client money*, but only if:

(1) the *firm* transfers the *client money*:
(a) for the purpose of a transaction for a *client* through or with that *person*; or
(b) to meet a *client's* obligation to provide collateral for a transaction (for example, an *initial margin* requirement for a *contingent liability investment*); and
(2) in the case of a *retail client*, that *client* has been notified that the *client money* may be transferred to the other *person*.

7.5.3 G A *firm* should not hold excess *client money* in its *client transaction accounts* with *intermediate brokers*, *settlement agents* and *OTC* counterparties; it should be held in a *client bank account*.

CASS7.6 **Records, accounts and reconciliations**

Records and accounts

7.6.1 R A *firm* must keep such records and accounts as are necessary to enable it, at any time and without delay, to distinguish *client money* held for one *client* from *client money* held for any other *client*, and from its own *money*. [**Note:** article 16(1)(a) of the *MiFID implementing Directive*]…

Internal reconciliations of client money balances

7.6.6 G
(1) *SYSC 4.1* .1 R requires *firms* to have robust governance arrangements, such as internal control mechanisms, including sound administrative and accounting procedures and effective control and safeguard arrangements for information processing systems. In addition, *SYSC 6.1.1 R* requires *firms* to establish, implement and maintain adequate policies and procedures sufficient to ensure the *firm's* compliance with its obligations under the *regulatory system*. Carrying out internal reconciliations of records and accounts of the entitlement of each *client* for whom the *firm* holds *client money* with the records and accounts of the *client money* the *firm* holds in *client bank accounts* and *client transaction accounts* should be one of the steps a *firm* takes to satisfy its obligations under *CASS7.6.2 R*, *SYSC 4.1.1 R* and *SYSC 6.1.1 R*.
(2) A *firm* should perform such internal reconciliations:
(a) as often as is necessary; and
(b) as soon as reasonably practicable after the date to which the reconciliation relates;to ensure the accuracy of the *firm's* records and accounts.
(3) The *standard method of internal client money reconciliation* sets out a method of reconciliation of client money balances that the *FSA* believes should be one of the steps that a *firm* takes when carrying out internal reconciliations of *client money*.

…

7.6.8 R A *firm* that does not use the *standard method of internal client money reconciliation* must first send a written confirmation to the *FSA* from the *firm's* auditor that the *firm* has in place systems and controls which are adequate to enable it to use another method effectively.

Reconciliations with external records

7.6.9 R A *firm* must conduct, on a regular basis, reconciliations between its internal accounts and records and those of any third parties by whom *client money* is held.
[**Note:** article 16(1)(c) of the *MiFID implementing Directive*]

…

Reconciliation discrepancies

7.6.13 R When any discrepancy arises as a result of a *firm's* internal reconciliations, the *firm* must identify the reason for the discrepancy and ensure that:

(1) any *shortfall* is paid into a *client bank account* by the close of business on the day that the reconciliation is performed; or

(2) any excess is withdrawn within the same time period (but see *CASS7.4.20 G* and *CASS7.4.21 R*).

7.6.14 R When any discrepancy arises as a result of the reconciliation between a *firm's* internal records and those of third parties that hold *client money*, the *firm* must identify the reason for the discrepancy and correct it as soon as possible, unless the discrepancy arises solely as a result of timing differences between the accounting systems of the party providing the statement or confirmation and that of the *firm*.

7.6.15 R While a *firm* is unable to resolve a difference arising from a reconciliation between a *firm's* internal records and those of third parties that hold *client money*, and one record or a set of records examined by the *firm* during its reconciliation indicates that there is a need to have a greater amount of *client money* or *approved collateral* than is in fact the case, the *firm* must assume, until the matter is finally resolved, that the record or set of records is accurate and pay its own *money* into a relevant account.

…

CASS7.7 **Statutory trust**

7.7.1 G Section 139(1) of the Act (Miscellaneous ancillary matters) provides that *rules* may make provision which result in *client money* being held by a *firm* on trust (England and Wales and Northern Ireland) or as agent (Scotland only). This section creates a fiduciary relationship between the *firm* and its *client* under which *client money* is in the legal ownership of the *firm* but remains in the beneficial ownership of the *client*. In the event of *failure* of the *firm*, costs relating to the distribution of *client money* may have to be borne by the trust.

Requirement

7.7.2 R A *firm* receives and holds *client money* as trustee (or in Scotland as agent) on the following terms:

(1) for the purposes of and on the terms of the *client money rules* and the *client money (MiFID business) distribution rules*;

(2) subject to (3), for the *clients* (other than *clients* which are *insurance undertakings* when acting as such with respect of *client money* received in the course of *insurance mediation activity* and that was opted in to this chapter) for whom that *money* is held, according to their respective interests in it;

(3) after all valid claims in (2) have been met, for *clients* which are *insurance undertakings* with respect of *client money* received in the course of *insurance mediation activity* according to their respective interests in it;

(4) on *failure* of the *firm*, for the payment of the costs properly attributable to the distribution of the *client money* in accordance with (2); and

(5) after all valid claims and costs under (2) to (4) have been met, for the *firm* itself.

CASS7.8 **Notification and acknowledgement of trust**

Banks

7.8.1 R

(1) When a *firm* opens a *client bank account*, the *firm* must give or have given written notice to the bank requesting the bank to acknowledge to it in writing that:

(a) all *money* standing to the credit of the account is held by the *firm* as trustee (or if relevant, as agent) and that the bank is not entitled to combine the account with any other account or to exercise any right of set-off or counterclaim against *money* in that account in respect of any sum owed to it on any other account of the *firm*; and

(b) the title of the account sufficiently distinguishes that account from any account containing *money* that belongs to the *firm*, and is in the form requested by the *firm*.

…

Exchange, clearing house, intermediatebroker or OTC counterparty

7.8.2 R

(1) A *firm* which undertakes any *contingent liability investment* for *clients* through an exchange, *clearing house*, *intermediate broker* or *OTC* counterparty must, before the *client transaction account* is opened with the exchange, *clearing house*, *intermediate broker* or *OTC* counterparty:

(a) notify the *person* with whom the account is to be opened that the *firm* is under an obligation to keep *client money* separate from the *firm's* own *money*, placing *client money* in a *client bank account*;

(b) instruct the *person* with whom the account is to be opened that any *money* paid to it in respect of that transaction is to be credited to the *firm's client transaction account*; and

(c) require the person with whom the account is to be opened to acknowledge in writing that the *firm's client transaction account* is not to be combined with any other account, nor is any right of set-off to be exercised by that *person* against *money* credited to the *client transaction account* in respect of any sum owed to that person on any other account.

…

CASS7.9 **Client money distribution**

Application

7.9.1 R This section (the *client money (MiFID business) distribution rules*) applies to a *firm* that holds *client money* which is subject to the *client money rules* when a *primary pooling event* or a *secondary pooling event* occurs.

Purpose

7.9.2 G The *client money (MiFID business) distribution rules* seek to facilitate the timely return of *client money* to a *client* in the event of the *failure* of a *firm* or third party at which the *firm* holds *client money*.

Failure of the authorised firm: primary pooling event

7.9.3 G A *firm* can hold *client money* in either a *general client bank account*, a *designated client bank account* or a *designated client fund account*. A *firm* holds all *client money* in *general client bank accounts* for its *clients* as part of a common pool of *money* so those particular *clients* do not have a claim against a specific sum in a specific account; they only have a claim to the *client money* in general. A *firm* holds *client money* in *designated client bank accounts* or *designated client fund accounts* for those *clients* that requested their *client money* be part of a specific pool of *money*, so those particular *clients* do have a claim against a specific sum in a specific account; they do not have a claim to the *client money* in general unless a *primary pooling event* occurs. A *primary pooling event* triggers a notional pooling of all the *client money*, in every type of *client money* account, and the obligation to distribute it. If the *firm* becomes insolvent, and there is (for whatever reason) a *shortfall* in *money* held for a *client* compared with that *client's* entitlements, the available funds will be distributed in accordance with the *client money (MiFID business) distribution rules*.

7.9.4 R A *primary pooling event* occurs:

(1) on the *failure* of the *firm*;

(2) on the vesting of assets in a *trustee* in accordance with an 'assets *requirement*' imposed under section 48(1)(b) of the *Act*;

(3) on the coming into force of a *requirement* for all *client money* held by the *firm*; or

(4) when the *firm* notifies, or is in breach of its duty to notify, the *FSA*, in accordance with *CASS7.6.16 R* (Notification requirements), that it is unable correctly to identify and allocate in its records all valid claims arising as a result of a *secondary pooling event*.

7.9.5 R *CASS7.9.4 R (4)* does not apply so long as:

(1) the *firm* is taking steps, in consultation with the *FSA*, to establish those records; and

(2) there are reasonable grounds to conclude that the records will be capable of rectification within a reasonable period.

Pooling and distribution

7.9.6 R If a *primary pooling event* occurs:

(1) *client money* held in each *client money* account of the *firm* is treated as pooled; and

(2) the *firm* must distribute that *client money* in accordance with *CASS7.7.2 R*, so that each *client* receives a sum which is rateable to the

client money entitlement calculated in accordance with *CASS7.9.7 R*.

7.9.7 R

(1) When, in respect of a *client*, there is a positive individual *client* balance and a negative *client equity balance*, the credit must be offset against the debit reducing the individual *client* balance for that *client*.

(2) When, in respect of a *client*, there is a negative individual *client* balance and a positive *client equity balance*, the credit must be offset against the debit reducing *client equity balance* for that *client*.

7.9.8 G A *client's* main claim is for the return of *client money* held in a *client bank account*. A *client* may be able to claim for any *shortfall* against *money* held in a *firm's* own account. For that claim, the *client* will be an unsecured creditor of the *firm*.

Client money received after the failure of the firm

7.9.9 R *Client money* received by the *firm* after a *primary pooling event* must not be pooled with *client money* held in any *client money* account operated by the *firm* at the time of the *primary pooling event*. It must be placed in a *client bank account* that has been opened after that event and must be handled in accordance with the *client money rules*, and returned to the relevant *client* without delay, except to the extent that:

(1) it is *client money* relating to a transaction that has not settled at the time of the *primary pooling event*; or

(2) it is *client money* relating to a *client*, for whom the *client money* entitlement, calculated in accordance with *CASS7.9.7 R* , shows that *money* is due from the *client* to the *firm* at the time of the *primary pooling event*.

7.9.10 G *Client money* received after the *primary pooling event* relating to an unsettled transaction should be used to settle that transaction. Examples of such transactions include:

(1) an equity transaction with a trade date before the date of the *primary pooling event* and a settlement date after the date of the *primary pooling event*; or

(2) a *contingent liability investment* that is 'open' at the time of the *primary pooling event* and is due to settle after the *primary pooling event*.

7.9.11 R If a *firm* receives a *mixed remittance* after a *primary pooling event*, it must:

(1) pay the full sum into the separate *client bank account* opened in accordance with *CASS7.9.9 R*; and

(2) pay the *money* that is not *client money* out of that *client bank account* into a *firm's* own bank account within one *business day* of the *day* on which the *firm* would normally expect the remittance to be cleared.

7.9.12 G Whenever possible the *firm* should seek to split a *mixed remittance* before the relevant accounts are credited.

Failure of a bank, intermediate broker, settlement agent or OTC counterparty: secondary pooling events

7.9.13 R If both a *primary pooling event* and a *secondary pooling event* occur, the provisions of this section relating to a *primary pooling event* apply.

7.9.14 R A *secondary pooling event* occurs on the *failure* of a third party to which *client money* held by the *firm* has been transferred under *CASS7.4.1 R (1)* to *CASS7.4.1 R (3)* (Depositing client money) or *CASS7.5.2 R* (Transfer of client money to a third party).

7.9.15 R *CASS7.9.19 R* to *CASS7.9.31 R* do not apply if, on the *failure* of the third

party, the *firm* repays to its *clients* or pays into a *client bank account*, at an unaffected bank, an amount equal to the amount of *client money* which would have been held if a *shortfall* had not occurred at that third party.

7.9.16 G When *client money* is transferred to a third party, a *firm* continues to owe fiduciary duties to the *client*. Whether a *firm* is liable for a *shortfall* in *client money* caused by a third party failure will depend on whether it has complied with its duty of care as agent or trustee.

Failure of a bank

7.9.17 G When a bank *fails* and the *firm* decides not to make good the *shortfall* in the amount of *client money* held at that bank, a *secondary pooling event* will occur in accordance with *CASS7.9.19 R*. The *firm* would be expected to reflect the *shortfall* that arises at the *failed* bank in its records of the entitlement of *clients* and of *money* held with third parties.

7.9.18 G The *client money (MiFID business) distribution rules* seek to ensure that *clients* who have previously specified that they are not willing to accept the risk of the bank that has *failed*, and who therefore requested that their *client money* be placed in a *designated client bank account* at a different bank, should not suffer the loss of the bank that has *failed*.

Failure of a bank: pooling

7.9.19 R If a *secondary pooling event* occurs as a result of the *failure* of a bank where one or more *general client bank accounts* are held, then:

(1) in relation to every *general client bank account* of the *firm*, the provisions of *CASS7.9.21 R*, *CASS7.9.26 R* and *CASS7.9.27 R* will apply;

(2) in relation to every *designated client bank account* held by the *firm* with the *failed* bank, the provisions of *CASS7.9.23 R*, *CASS7.9.26 R* and *CASS7.9.27 R* will apply;

(3) in relation to each *designated client fund account* held by the *firm* with the *failed* bank, the provisions of *CASS7.9.24 R*, *CASS7.9.26 R* and *CASS7.9.27 R* will apply;

(4) any *money* held at a bank, other than the bank that has *failed*, in *designated client bank accounts*, is not pooled with any other *client money*; and

(5) any *money* held in a *designated client fund account*, no part of which is held by the bank that has *failed*, is not pooled with any other *client money*.

7.9.20 R If a *secondary pooling event* occurs as a result of the *failure* of a bank where one or more *designated client bank accounts* or *designated client fund accounts* are held, then:

(1) in relation to every *designated client bank account* held by the *firm* with the *failed* bank, the provisions of *CASS7.9.23 R*, *CASS7.9.26 R* and *CASS7.9.27 R* will apply; and

(2) in relation to each *designated client fund account* held by the *firm* with the *failed* bank, the provisions of *CASS7.9.24 R*, *CASS7.9.26 R* and *CASS7.9.27 R* will apply.

7.9.21 R *Money* held in each *general client bank account* and *client transaction account* of the *firm* must be treated as pooled and:

(1) any *shortfall* in *client money* held, or which should have been held, in *general client bank accounts* and *client transaction accounts*, that has arisen as a result of the *failure* of the bank, must be borne by all the

clients whose *client money* is held in either a *general client bank account* or *client transaction account* of the *firm*, rateably in accordance with their entitlements;

...

CASS7 Annex 1

Annex 1

G As explained in *CASS7.6.6 G*, in complying with its obligations under *CASS7.6.2 R* (Records and accounts), *SYSC 4.1.1 R* (General organisational requirements) and *SYSC 6.1.1 R* (Compliance), a *firm* should carry out internal reconciliations of records and accounts of *client money* the *firm* holds in *client bank accounts* and *client transaction accounts*. This Annex sets out a method of reconciliation that the *FSA* believes is appropriate for these purposes (the *standard method of internal client money reconciliation*).

1. Each *business day*, a *firm* that adopts the normal approach (see *CASS7.4.17 G*) should check whether its *client money* resource, being the aggregate balance on the *firm's client bank accounts*, as at the close of business on the previous *business day*, was at least equal to the *client money* requirement, as defined in paragraph 6 below, as at the close of business on that day.

2. Each *business day*, a *firm* that adopts the alternative approach (see *CASS7.4.18 G*) should ensure that its *client money* resource, being the aggregate balance on the *firm's client bank accounts*, as at the close of business on that *business day* is at least equal to the *client money* requirement, as defined in paragraph 6 below, as at the close of business on the previous *business day*.

3. No excess or *shortfall* should arise when adopting the alternative approach.

4. If a *firm* is operating the alternative approach and draws a cheque on its own bank account, it will be expected to account for those cheques that have not yet cleared when performing its reconciliations of records and accounts under paragraph 2. An historic average estimate of uncleared cheques may be used to satisfy this obligation (see *CASS7.4.19 G (3)*).

5. For the purposes of performing its reconciliations of records and accounts under paragraphs 1 or 2, a *firm* should use the values contained in its accounting records, for example its cash book, rather than values contained in statements received from its banks and other third parties.

Client money requirement

6. The *client money* requirement is either:

(1) (subject to paragraph 18) the sum of, for all *clients*:

(a) the individual *client* balances calculated in accordance with paragraph 7, excluding:

(i) individual *client* balances which are negative (that is, debtors); and

(ii) *clients' equity balances*; and

(b) the total *margined transaction* requirement calculated in accordance with paragraph 14; or

(2) the sum of:

(a) for each *client bank account*:

(i) the amount which the *firm's* records show as held on that account; and

(ii) an amount that offsets each negative net amount which the *firm's* records show attributed to that account for an individual *client*; and

(b) the total *margined transaction* requirement calculated in accordance with paragraph 14.

General transactions

7. The individual *client* balance for each *client* should be calculated in accordance with this table:

Individual client balance calculation			
Free *money* (no trades) and			A
sale proceeds due to the *client*:			
(a)	in respect of *principal deals* when the *client* has delivered the *designated investments*; and		B
(b)	in respect of agency *deals*, when either:		
	(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)	in respect of *principal deals*, paid for by the *client* but the *firm* has not delivered the *designated investments* to the client; and		D
(d)	in respect of agency *deals*, paid for by the *client* when either:		
	(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* in respect of 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* in respect of 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

8. A *firm* should calculate the individual *client* balance using the

contract value of any *client* purchases or sales.

9. A *firm* may choose to segregate *designated investments* instead of the value identified in paragraph 7 (except E1) if it ensures that the *designated investments* are held in such a manner that the *firm* cannot use them for its own purposes.

10. Segregation in the context of paragraph 9 can take many forms, including the holding of a *safe custody investment* in a nominee name and the safekeeping of certificates evidencing title in a fire resistant safe. It is not the intention that all the *custody rules* in the *MiFID custody chapter* should be applied to *designated investments* held in the course of settlement.

11. In determining the *client money* requirement under paragraph 6, a *firm* need not include *money* held in accordance with *CASS7.2.8 R* (Delivery versus payment transaction).

12. In determining the *client money* requirement under paragraph 6, a *firm*:

(1) should include dividends received and interest earned and allocated;

(2) may deduct outstanding *fees*, calls, rights and interest charges and other amounts owed by the *client* which are due and payable to the *firm* (see *CASS7.2.9 R*);

(3) need not include *client money* in the form of *client* entitlements which are not required to be segregated (see *CASS7.4.27 G*) nor include *client money* forwarded to the *firm* by its appointed representatives, *tied agents*, field representatives and other agents, but not received (see *CASS7.4.24 G*);

(4) should take into account any *client money* arising from *CASS7.6.13 R* (Reconciliation discrepancies); and

(5) should include any unallocated *client money*.

Equity balance

13. A *firm's* equity balance, whether with an exchange, *intermediate broker* or *OTC* counterparty, is the amount which the *firm* would be liable to pay to the exchange, *intermediate broker* or *OTC* counterparty (or vice-versa) in respect of the *firm's margined transactions* if each of the open positions of the *firm's clients* was liquidated at the closing or settlement prices published by the relevant exchange or other appropriate pricing source and the *firm's* account with the exchange, *intermediate broker* or *OTC* counterparty is closed.

Margined transaction requirement

14. The total *margined transaction* requirement is:

(1) the sum of each of the *client's equity balances* which are positive;Less

(2) the proportion of any individual negative *client equity balance* which is secured by *approved collateral*; and

(3) the net aggregate of the *firm's* equity balance (negative balances being deducted from positive balances) on transaction accounts for *customers* with exchanges, *clearing houses*, *intermediate brokers* and *OTC* counterparties.

15. To meet a shortfall that has arisen in respect of the requirement in paragraph 6(1)(b) or 6(2)(b), a *firm* may utilise its own *approved*

collateral provided it is held on terms specifying when it is to be realised for the benefit of *clients*, it is clearly identifiable from the *firm's* own property and the relevant terms are evidenced in writing by the *firm*. In addition, the proceeds of the sale of that *collateral* should be paid into a *client bank account*.

16. If a *firm's* total *margined transaction* requirement is negative, the *firm* should treat it as zero for the purposes of calculating its *client money* requirement.

17. The terms '*client equity balance*' and '*firm's* equity balance' in paragraph 13 refer to cash values and do not include non-cash *collateral* or other *designated investments* held in respect of a *margined transaction*.

17A. A *firm* with a *Part 30 exemption order* which also operates an LME bond arrangement for the benefit of US-resident investors, should exclude the *client equity balance*s for transactions undertaken on the London Metal Exchange on behalf of those US-resident investors from the calculation of the *margined transaction* requirement.

Reduced client money requirement option

18.

(1) When, in respect of a *client*, there is a positive individual *client* balance and a negative *client equity balance*, a *firm* may offset the credit against the debit and hence have a reduced individual *client* balance in paragraph 7 for that *client*.

(2) When, in respect of a *client*, there is a negative individual *client* balance and a positive *client equity balance*, a firm may offset the credit against the debit and hence have a reduced *client equity balance* in paragraph 14 for that *client*.

19. The effect of paragraph 18 is to allow a *firm* to offset, on a *client* by *client* basis, a negative amount with a positive amount arising out of the calculations in paragraphs 7 and 14, and, by so doing, reduce the amount the *firm* is required to segregate.

[Definitions taken from the Glossary to the FSA Handbook]

Client bank account

(2) (in CASS7 and CASS7A)

(a) an account at a bank which:

(i) holds the money of one or more *clients*;

(ii) is in the name of the *firm*; and

(iii) is a current or a deposit account; or

(b) a money market deposit account of *client money* which is identified as being *client money*.

Client money rules

(3) (in... CASS7...) CASS7.1 to 7.8.

Client money segregation requirements
CASS7.4.1 R and CASS7.4.11 R.

Client transaction account
(in relation to a *firm* and an exchange, *clearing house* or *intermediate broker*) an account maintained by the exchange, *clearing house*

Designated client bank account

A *client bank account* with the following characteristics:

(a) the account holds the money of one or more *clients*;
(b) the account includes in its title the word "designated";
(c) the *clients* whose *money* is in the account have each consented in writing to the use of the bank with which the *client money* is to be held; and
(d) in the event of the *failure* of that bank, the account is not pooled with any other type of account unless a *primary pooling event* occurs

Margined transaction

(1) (except in CASS4 and CASS7) a transaction *executed* by a *firm* with or for a *client* relating to a *future*, *option* or *contract for differences* (or any right to or any interest in such an *investment*) under the terms of which the *client* will or may be liable to provide cash or *collateral* to secure performance of obligations which he may have to perform when the transaction falls to be completed or upon the earlier *closing out* of his position.
(2) (in CASS4 and CASS7):

(a) a transaction within (1); or
(b) an *option* purchased by a *client*, the terms of which provide that the maximum liability of the *client* in respect of the transaction will be limited to the amount payable as premium.

MiFID client money segregation requirements

CASS7.4.1R and CASS7.4.11R

Money

Any form of money, including cheques and other payable orders.

Shortfall

(1) …

(2) (in relation to *client money*) the amount by which the *client money* in a *client bank account* is insufficient to satisfy the claims of *clients* in respect of that *money*, or not immediately available to satisfy such claims.

[Extracts from *The Readers' Guide* published by the FSA]

INTERPRETING THE HANDBOOK

Purposive interpretation
2.2.1 R

Every provision in the Handbook must be interpreted in the light of its purpose.
2.2.2 G

The purpose of any provision in the Handbook is to be gathered first and foremost from the text of the provision in question and its context among other relevant provisions. The guidance given on the purpose of a provision is intended as an explanation to assist readers of the Handbook. As such, guidance may assist the reader in assessing the purpose of the provision, but it should not be taken as a complete or definitive explanation of a provision's purpose.

Appendix 2

DIRECTIVE 2004/39/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
of 21 April 2004
on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC

Whereas:

(1) Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field([5]) sought to establish the conditions under which authorised investment firms and banks could provide specified services or establish branches in other Member States on the basis of home country authorisation and supervision. To this end, that Directive aimed to harmonise the initial authorisation and operating requirements for investment firms including conduct of business rules. It also provided for the harmonisation of some conditions governing the operation of regulated markets.

(2) In recent years more investors have become active in the financial markets and are offered an even more complex wide-ranging set of services and instruments. In view of these developments the legal framework of the Community should encompass the full range of investor-oriented activities. To this end, it is necessary to provide for the degree of harmonisation needed to offer investors a high level of protection and to allow investment firms to provide services throughout the Community, being a Single Market, on the basis of home country supervision. In view of the preceding, Directive 93/22/EEC should be replaced by a new Directive.

…

(17) Persons who provide the investment services and/or perform investment activities covered by this Directive should be subject to authorisation by their home Member States in order to protect investors and the stability of the financial system.

…

(26) In order to protect an investor's ownership and other similar rights in respect of securities and his rights in respect of funds entrusted to a firm those rights should in particular be kept distinct from those of the firm. This principle should not, however, prevent a firm from doing business in its name but on behalf of the investor, where that is required by the very nature of the transaction and the investor is in agreement, for example stock lending.

(27) Where a client, in line with Community legislation and in particular Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements, transfers full ownership of financial instruments or funds to an investment firm for the purpose of securing or otherwise covering present or future, actual or contingent or prospective obligations, such financial instruments or funds should likewise no longer be regarded as belonging to the client.

…

(31) One of the objectives of this Directive is to protect investors. Measures to protect investors should be adapted to the particularities of each category of investors (retail, professional and counterparties).

…

(44) With the two-fold aim of protecting investors and ensuring the smooth operation of securities markets, it is necessary to ensure that transparency of transactions is achieved and that the rules laid down for that purpose apply to investment firms when they operate on the markets. In order to enable investors or market participants to assess at any time the terms of a transaction in shares that they are considering and to verify afterwards the conditions in which it was carried out, common rules should be established for the publication of details of completed transactions in shares and for the disclosure of details of current opportunities to trade in shares. These rules are needed to ensure the effective integration of Member State equity markets, to promote the efficiency of the overall price formation process for equity instruments, and to assist the effective operation of "best execution" obligations. These considerations require a comprehensive transparency regime applicable to all transactions in shares irrespective of their execution by an investment firm on a bilateral basis or through regulated markets or MTFs. The obligations for investment firms under this Directive to quote a bid and offer price and to execute an order at the quoted price do not relieve investment firms of the obligation to route an order to another execution venue when such internalisation could prevent the firm from complying with "best execution" obligations.

…

(71) The objective of creating an integrated financial market, in which investors are effectively protected and the efficiency and integrity of the overall market are safeguarded, requires the establishment of common regulatory requirements relating to investment firms wherever they are authorised in the Community and governing the functioning of regulated markets and other trading systems so as to prevent opacity or disruption on one market from undermining the efficient operation of the European financial system as a whole. Since this objective may be better achieved at Community level, the Community may adopt measures in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve this objective,
HAVE ADOPTED THIS DIRECTIVE:

TITLE I

DEFINITIONS AND SCOPE
ARTICLE 1 SCOPE
1. This Directive shall apply to investment firms and regulated markets….

ARTICLE 4 DEFINITIONS

For the purposes of this Directive, the following definitions shall apply:

1) "Investment firm" means any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis;

Member States may include in the definition of investment firms undertakings which are not legal persons, provided that:

(a) their legal status ensures a level of protection for third parties' interests equivalent to that afforded by legal persons, and

(b) they are subject to equivalent prudential supervision appropriate to their legal form.

However, where a natural person provides services involving the holding of third parties' funds or transferable securities, he may be considered as an investment firm for the purposes of this Directive only if, without prejudice to the other requirements imposed in this Directive and in Directive 93/6/EEC, he complies with the following conditions:

(a) the ownership rights of third parties in instruments and funds must be safeguarded, especially in the event of the insolvency of the firm or of its proprietors, seizure, set-off or any other action by creditors of the firm or of its proprietors;

…

TITLE II

AUTHORISATION AND OPERATING CONDITIONS FOR INVESTMENT FIRMS
ARTICLE 13 ORGANISATIONAL REQUIREMENTS

1. The home Member State shall require that investment firms comply with the organisational requirements set out in paragraphs 2 to 8.
2. An investment firm shall establish adequate policies and procedures sufficient to ensure compliance of the firm including its managers, employees and tied agents with its obligations under the provisions of this Directive as well as appropriate rules governing personal transactions by such persons.
3. An investment firm shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest as defined in Article 18 from adversely affecting the interests of its clients.
4. An investment firm shall take reasonable steps to ensure continuity and regularity in the performance of investment services and activities. To this end the investment firm shall employ appropriate and proportionate systems, resources and procedures.
5. An investment firm shall ensure, when relying on a third party for the performance of operational functions which are critical for the provision of continuous and satisfactory service to clients and the performance of investment activities on a continuous and satisfactory basis, that it takes reasonable steps to avoid undue additional operational risk. Outsourcing of important operational functions may not be undertaken in such a way as to impair materially the quality of its internal control and the ability of the supervisor to monitor the firm's compliance with all obligations.

An investment firm shall have sound administrative and accounting procedures, internal control mechanisms, effective procedures for risk assessment, and effective control and safeguard arrangements for information processing systems.

6. An investment firm shall arrange for records to be kept of all services and transactions undertaken by it which shall be sufficient to enable the competent authority to monitor compliance with the requirements under this Directive, and in particular to ascertain that the investment firm has complied with all obligations with respect to clients or potential clients.

7. An investment firm shall, when holding financial instruments belonging to clients, make adequate arrangements so as to safeguard clients' ownership rights, especially in the event of the investment firm's insolvency, and to prevent the use of a client's instruments on own account except with the client's express consent.

8. An investment firm shall, when holding funds belonging to clients, make adequate arrangements to safeguard the clients' rights and, except in the case of credit institutions, prevent the use of client funds for its own account…

ARTICLE 16 REGULAR REVIEW OF CONDITIONS FOR INITIAL AUTHORISATION

1. Member States shall require that an investment firm authorised in their territory comply at all times with the conditions for initial authorisation established in Chapter I of this Title.

2. Member States shall require competent authorities to establish the appropriate methods to monitor that investment firms comply with their obligation under paragraph 1. They shall require investment firms to notify the competent authorities of any material changes to the conditions for initial authorisation.

3. In the case of investment firms which provide only investment advice, Member States may allow the competent authority to delegate administrative, preparatory or ancillary tasks related to the review of the conditions for initial authorisation, in accordance with the conditions laid down in Article 48(2).

COMMISSION DIRECTIVE OF 10 AUGUST 2006 IMPLEMENTING DIRECTIVE 2004/39/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL AS REGARDS ORGANISATIONAL REQUIREMENTS AND OPERATING CONDITIONS FOR INVESTMENT FIRMS AND DEFINED TERMS FOR THE PURPOSES OF THAT DIRECTIVE
(2006/73/EC)

Whereas:

(1) Directive 2004/39/EC establishes the framework for a regulatory regime for financial markets in the Community, governing, among other matters, operating conditions relating to the performance by investment firms of investment services and, where appropriate, ancillary services and investment activities; organisational requirements for investment firms performing such services and activities, and for regulated markets; reporting requirements in respect of transactions in financial instruments; and transparency requirements in respect of transactions in shares admitted to trading on a regulated market.

(2) The rules for the implementation of the regime governing organisational requirements for investment firms performing investment services and, where appropriate, ancillary services and investment activities on a professional basis, and for regulated markets, should be consistent with the aim of Directive 2004/39/EC. They should be designed to ensure a

high level of integrity, competence and soundness among investment firms and entities that operate regulated markets or MTFs, and to be applied in a uniform manner.
(3) It is necessary to specify concrete organisational requirements and procedures for investment firms performing such services or activities. In particular, rigorous procedures should be provided for with regard to matters such as compliance, risk management, complaints handling, personal transactions, outsourcing and the identification, management and disclosure of conflicts of interest.
(4) The organisational requirements and conditions for authorisation for investment firms should be set out in the form of a set of rules that ensures the uniform application of the relevant provisions of Directive 2004/39/EC. This is necessary in order to ensure that investment firms have equal access on equivalent terms to all markets in the Community and to eliminate obstacles, linked to authorisation procedures, to cross-border activities in the field of investment services.
(5) The rules for the implementation of the regime governing operating conditions for the performance of investment and ancillary services and investment activities should reflect the aim underlying that regime. That is to say, they should be designed to ensure a high level of investor protection to be applied in a uniform manner through the introduction of clear standards and requirements governing the relationship between an investment firm and its client. On the other hand, as regards investor protection, and in particular the provision of investors with information or the seeking of information from investors, the retail or professional nature of the client or potential client concerned should be taken into account.
…
(67) For the purposes of ensuring that an investment firm obtains the best possible result for the client when executing a retail client order in the absence of specific client instructions, the firm should take into consideration all factors that will allow it to deliver the best possible result in terms of the total consideration, representing the price of the financial instrument and the costs related to execution. Speed, likelihood of execution and settlement, the size and nature of the order, market impact and any other implicit transaction costs may be given precedence over the immediate price and cost consideration only insofar as they are instrumental in delivering the best possible result in terms of the total consideration to the retail client.
…
(80) This Directive respects the fundamental rights and observes the principles recognised in particular by the Charter of Fundamental Rights of the European Union and in particular by Article 11 thereof and Article 10 of the European Convention on Human Rights. In this regard, this Directive does not in any way prevent Member States from applying their constitutional rules relating to freedom of the press and freedom of expression in the media.
…
Article 4
Additional requirements on investment firms in certain cases
1. Member States may retain or impose requirements additional to those in this Directive only in those exceptional cases where such requirements are objectively justified and proportionate so as to address specific risks to investor protection or to market integrity that are not adequately addressed by this Directive, and provided that one of the following conditions is met:

(a) the specific risks addressed by the requirements are of particular importance in the circumstances of the market structure of that Member State;

(b) the requirement addresses risks or issues that emerge or become evident after the date of application of this Directive and that are not otherwise regulated by or under Community measures.
2. Any requirements imposed under paragraph 1 shall not restrict or otherwise affect the rights of investment firms under Articles 31 and 32 of Directive 2004/39/EC.
3. Member States shall notify to the Commission:

(a) any requirement which it intends to retain in accordance with paragraph 1 before the date of transposition of this Directive; and

(b) any requirement which it intends to impose in accordance with paragraph 1 at least one month before the date appointed for that requirement to come into force.
In each case, the notification shall include a justification for that requirement.
The Commission shall communicate to Member States and make public on its website the notifications it receives in accordance with this paragraph.

4. By 31 December 2009 the Commission shall report to the European Parliament and the Council on the application of this Article….

CHAPTER II

ORGANISATIONAL REQUIREMENTS
SECTION 1
ORGANISATION
…
Article 16
Safeguarding of client financial instruments and funds
(*Article 13(7) and (8) of Directive 2004/39/EC*)
1. Member States shall require that, for the purposes of safeguarding clients' rights in relation to financial instruments and funds belonging to them, investment firms comply with the following requirements:

(a) they must keep such records and accounts as are necessary to enable them at any time and without delay to distinguish assets held for one client from assets held for any other client, and from their own assets;

(b) they must maintain their records and accounts in a way that ensures their accuracy, and in particular their correspondence to the financial instruments and funds held for clients;

(c) they must conduct, on a regular basis, reconciliations between their internal accounts and records and those of any third parties by whom those assets are held;

(d) they must take the necessary steps to ensure that any client financial instruments deposited with a third party, in accordance with Article 17, are identifiable separately from the financial instruments belonging to the investment firm and from financial instruments belonging to that third party, by means of differently titled accounts on the books of the third party or other equivalent measures that achieve the same level of protection;

(e) they must take the necessary steps to ensure that client funds deposited, in accordance with Article 18, in a central bank, a credit institution or a bank authorised in a third country or

a qualifying money market fund are held in an account or accounts identified separately from any accounts used to hold funds belonging to the investment firm;

(f) they must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client assets, or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence.
2. If, for reasons of the applicable law, including in particular the law relating to property or insolvency, the arrangements made by investment firms in compliance with paragraph 1 to safeguard clients' rights are not sufficient to satisfy the requirements of Article 13(7) and (8) of Directive 2004/39/EC, Member States shall prescribe the measures that investment firms must take in order to comply with those obligations.
3. If the applicable law of the jurisdiction in which the client funds or financial instruments are held prevents investment firms from complying with points (d) or (e) of paragraph 1, Member States shall prescribe requirements which have an equivalent effect in terms of safeguarding clients' rights.
…
Article 18
Depositing client funds
(*Article 13(8) of Directive 2004/39/EC*)
1. Member States shall require investment firms, on receiving any client funds, promptly to place those funds into one or more accounts opened with any of the following:

(a) a central bank;

(b) a credit institution authorised in accordance with Directive 2000/12/EC;

(c) a bank authorised in a third country;

(d) a qualifying money market fund.
The first subparagraph shall not apply to a credit institution authorised under Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast)[1] in relation to deposits within the meaning of that Directive held by that institution.
2. For the purposes of point (d) of paragraph 1, and of Article 16(1)(e), a "qualifying money market fund" means a collective investment undertaking authorised under Directive 85/611/EEC, or which is subject to supervision and, if applicable, authorised by an authority under the national law of a Member State, and which satisfies the following conditions:

(a) its primary investment objective must be to maintain the net asset value of the undertaking either constant at par (net of earnings), or at the value of the investors' initial capital plus earnings;

(b) it must, with a view to achieving that primary investment objective, invest exclusively in high quality money market instruments with a maturity or residual maturity of no more than 397 days, or regular yield adjustments consistent with such a maturity, and with a weighted average maturity of 60 days. It may also achieve this objective by investing on an ancillary basis in deposits with credit institutions;
(c) it must provide liquidity through same day or next day settlement.
For the purposes of point (b), a money market instrument shall be considered to be of high quality if it has been awarded the highest available credit rating by each competent rating

agency which has rated that instrument. An instrument that is not rated by any competent rating agency shall not be considered to be of high quality.
For the purposes of the second subparagraph, a rating agency shall be considered to be competent if it issues credit ratings in respect of money market funds regularly and on a professional basis and is an eligible ECAI within the meaning of Article 81(1) of Directive 2006/48/EC.
3. Member States shall require that, where investment firms do not deposit client funds with a central bank, they exercise all due skill, care and diligence in the selection, appointment and periodic review of the credit institution, bank or money market fund where the funds are placed and the arrangements for the holding of those funds.
Member States shall ensure, in particular, that investment firms take into account the expertise and market reputation of such institutions or money market funds with a view to ensuring the protection of clients' rights, as well as any legal or regulatory requirements or market practices related to the holding of client funds that could adversely affect clients' rights.
Member States shall ensure that clients have the right to oppose the placement of their funds in a qualifying money market fund.

…

Lord Neuberger MR:

178. These appeals raise a number of issues as to the interpretation of Chapter 7 of the Client Assets Sourcebook ("CASS7"), and the consequent effect on the rights of various clients of Lehman Brothers International (Europe) ("LBIE") in relation to monies held in various accounts at the date that it entered administration. CASS7 was issued by the Financial Services Authority ("the FSA"), pursuant to section 139 of the Financial Services and Markets Act 2000, and was fashioned so as to comply with the United Kingdom's obligations under the provisions of EU Directive 2004/39/EC ("MiFID") and EU Directive 2006/73/EC ("the Implementing Directive"), in relation to client money held by investment firms.

Introductory

179. Arden LJ has appended the provisions of CASS7 (together with relevant extracts from the FSA Handbook Glossary) as Appendix 1, and the relevant provisions of MiFID and the Implementing Directive (together "the Directives") as Appendix 2, to her judgment. She has also summarised the factual background in paragraphs 2, 8, 9 and 10, the assumed facts being more fully set out by Briggs J in his promptly produced judgment, at [2009] EWHC 3228 (Ch), paragraphs 46-49. His conclusions are summarised by Arden LJ in paragraphs 39-55, and she has set out the arguments which Counsel put forward in paragraph 6.

180. There are four principal issues which we need to determine, but, before turning to those issues, I should like to make one or two points about the general approach to be adopted when considering them. The resolution of each of the issues depends, at least in the main, on the interpretation of CASS7. The origin, structure, and summary of the effect of CASS7 are helpfully set out by Arden LJ in paragraphs 11 to 35 of her judgment, and a fuller guide to its provisions may be found in the judgment of Briggs J – [2009] EWHC 3228 (Ch), paragraphs 81-136.

181. At the risk of appearing anodyne, it appears to me that when considering how to interpret CASS7, the following factors are relevant. First, CASS7 must be construed in the light of its overall purpose, namely to protect the "client money" held by a firm. Secondly, CASS7 must be construed on the basis that it is intended to produce a practical and commercially sensible result. Thirdly, CASS7 must be interpreted bearing well in mind the fact that it is intended to implement, and to comply with, the Directives. Fourthly, if at all possible, different provisions of CASS7 should be interpreted coherently, and different points at issue should be resolved mutually consistently. Fifthly, while such general points are of cardinal importance, the actual wording of CASS7 must ultimately govern any decision as to its effect. With those brief general observations, I turn to the issues.

182. They appear to me to be as follows:

   i. Is client money held on the statutory trust imposed by CASS7.7 from the moment of receipt by the firm or only when it is paid into segregated accounts? (This is the Judge's issue 1).

   ii. Do the primary pooling and distribution provisions in CASS7.9.6R extend to client money not in segregated accounts – i.e. in house accounts? (This is the Judge's issue 3).

   iii. Is the basis for sharing in the pool the amount which ought to have been segregated for each client, or the amount which was in fact segregated for each client? (This is the Judge's issue 6).

   iv. When does money which the firm owes to the client become "client money"? (This is part of the Judge's issue 1).

183. While the issues must inevitably be considered separately, they must also be considered together, as they all involve interpreting CASS7, in the light of the Directives. This is because CASS7 has to be construed as a whole, and, more particularly as the Judge said, the issues (or at least the first three) interrelate. Thus, the first and second issues enjoy a degree of mutual symmetry, and that is even truer of the second and third issues. Accordingly, before turning to the specific issues, I propose to consider the wider picture, whose impact I will then address after considering the specific issues.

The general thrust of the legislation

184. CASS7 is concerned with implementing the Directives whose basic purpose can be encapsulated in the aim of "provid[ing] for the degree of harmonisation needed to offer investors a high level of protection and to allow investment firms to provide services throughout the Community, being a Single Market, on the basis of home country supervision" to quote from recital (2) of MiFID. Because it is easy to become bogged down in detail, it is useful to identify the centrally relevant provisions of the Directives, and CASS7.

185. For present purposes, Article 13, headed "Organisational requirements", is the centrally relevant provision of MiFID. Article 13(7) requires investment firms to "make adequate arrangements so as to safeguard clients' ownership rights, especially

in the event of the investment firm's insolvency, and to prevent the use of a client's instruments on [its] own account". Article 13(8) provides that where "an investment firm [holds] funds belonging to clients" it must make "adequate arrangements to safeguard the clients' rights and ... prevent use of client funds for its own account".

186. The Implementing Directive contains more detailed provisions which have to be complied with, and Article 4 permits a Member State to impose additional requirements "only in [specified] exceptional cases". Articles 16 and 18 of the Implementing Directive, "Safeguarding of client assets" and "Depositing client funds", are the principally relevant provisions. Article 16(1)(e) requires client funds to be placed "in an account or accounts identified separately from any accounts used to hold funds belonging to the investment firm", and Article 18 refers to those funds being placed in such an account or accounts "promptly". Article 16(2) states that if "for reasons of the applicable law, including in particular the law relating to property or insolvency, the arrangements [set out in Article 16(1)] are not sufficient to satisfy the requirements of Article 13(7) and (8) of [MiFID], Member States shall prescribe the measures that investment firms must take in order to comply with those obligations".

187. CASS7 imposes "client money rules" (CASS7.1.1R) which are self-evidently intended to implement the Directives. Client money is defined in CASS7.2.1R as "money that a firm receives from or holds for, or on behalf of, a client ... in connection with its MiFID business". CASS7.4 is concerned with "segregation of client money", which must be paid by a firm into "a client bank account". Two different methods may be adopted. The "normal approach" involves direct payment into a client bank account "promptly, and in any event no later than the next *business day* after receipt" – CASS7.4.17G. The "alternative approach" can only be adopted by a firm which "has in place systems and controls which are accurate" (CASS7.4.15R), and entitles a firm to pay client money into a house account, on the basis that it "will segregate *client money* into a *client bank account* on a daily basis, after having performed a reconciliation of records and accounts" – CASS7.4.16G.

188. CASS7.6 is concerned with "Records, accounts and reconciliations", and its provisions include reference to "*the standard method of internal client money reconciliation*" which is contained in Annex 1 to CASS7 ("Annex 1"). CASS7.7.2R states that "[a] *firm* receives and holds *client money* as trustee on the following terms: (1) for the purposes of and on the terms of the *client money rules* and the *client money (MiFID business) distribution rules* ...". CASS7.8 requires notification to be given to the bank at which a client bank account is held that "all *money*" in the account "is held by the *firm* as trustee...".

189. CASS7.9 is concerned with "Client Money Distribution", and contains the "*client money (MiFID business) distribution rules*" – CASS7.9.1R. CASS7.9.2G states that these distribution rules "seek to facilitate the timely return of *client money* to a *client* in the event of the *failure* of a *firm* or third party at which the *firm* holds *client money*." CASS7.9.6R provides that on a "primary pooling event" (which includes "the *failure* of the *firm*" – CASS7.9.4(1)R), (1) "*client money* held in each *client money* account of the *firm* is treated as pooled; and (2) the *firm* must distribute that *client money* in accordance with CASS7.7.2R, so that each *client* receives a sum which is rateable to the *client money* entitlement calculated in accordance with CASS7.9.7R". CASS7.9.7 contains provisions for set-off. There are also provisions

as to what happens on a secondary pooling event, which is the failure of a bank at which client money is held – CASS7.9.14R. CASS7.9.8G, having stated that "a *client's* main claim is for the return of *client money* held in a *client bank account*", adds that he "may" be able to claim for any *shortfall* against *money* held in a *firm's* own account" for which "the *client* will be an unsecured creditor of the *firm*".

190. Having identified what appear to me to be the centrally relevant provisions of MiFID, the Implementing Directive, and CASS7, I turn to consider, in turn, the four issues which require to be resolved in these appeals.

(i) When does the statutory trust arise?

191. It is common ground, in the light of the provisions of CASS7.7, that client money in a segregated account, as provided for in CASS7.4, is held on the statutory trust whose terms are governed by CASS7.7. The first issue is whether this statutory trust:

- takes effect immediately upon receipt of client money by a firm – i.e. the moment the money is placed into an account, whether or not it is a segregated account, or
- takes effect only upon segregation of that money – i.e. when the money is deposited in a segregated account in accordance with CASS7.4.

192. CASS7.7.2R states that "A *firm* receives and holds *client money* as trustee on the following terms ….". It is very hard to resist the proposition that the effect of the word "receives" naturally means that client money is held on trust from the moment that it is accepted by a firm, and this meaning is reinforced by the fact that it is hard to see what other function the word has in the light of the following words "and holds". The words "and holds" refer to what happens to the money after it is received and they refer to money which is not received as client money (e.g. received from a client for other purposes or received by the firm as its own money) but which subsequently becomes client money.

193. The use of these two verbs "receives" and "holds" is reflected in CASS7.2.1R, which defines "client money" as "any *money* that a *firm* receives from, or holds for, or on behalf of, a *client* ….". That provision seems to me to make it clear that, when money is actually received from a client for MiFID business, it is immediately, i.e. on receipt, client money, and in a case where it was already held for another purpose or it was the firm's money (and therefore already received), but then becomes held for a client for MiFID business, it thereupon immediately becomes client money. Also, in CASS7.2.1R, the word "receives" must be a reference to the moment of receipt, and it is unlikely that the word has a different meaning in CASS7.7.2R.

194. Three points are made against this argument, each of which is said to demonstrate that the statutory trust arises only when client money is segregated. The first is that if CASS7.7.2R has this meaning, then, on the assumption that CASS7.9.6R only applies to client money held in segregated accounts, there is a lacuna in the distribution rules in CASS7.9 as those rules do not deal with client money held on trust and not in segregated accounts.

195. This point assumes that CASS7.9.6(1) only applies to client money in segregated accounts, which is one of the issues to be resolved on this appeal, namely, the next

issue I propose to consider. If, as the Judge held, CASS7.7.2R only applies to client money in segregated accounts, then that would, as he acknowledged, be "a point of substance against the interpretation of CASS7 as imposing a statutory trust from the point of receipt of client money" - [2009] EWHC 3228 (Ch), paragraph 160. On the other hand, albeit perhaps rather less forcefully, if CASS7.7.2R applies to client money in house accounts as well as segregated accounts, that would tend to support the notion that the trust arises on receipt, irrespective of whether it is received into a segregated or house account.

196. Secondly, it is argued that the creation of a trust before segregation would represent an improvement on the protection required to be afforded by MiFID, which would be ruled out by Article 4(1) of the Implementing Directive, which states that a Member State "may retain or impose requirements additional to those in this Directive only in [specified] exceptional cases".

197. In my view, that is not a good point. It is true that Article 16(1)(e) of the Implementing Directive requires client money to be held in accounts separate from those containing the firm's money and says nothing about trusts. However, Article 16(2) states that if compliance with Article 16(1) would not be "sufficient to satisfy the requirements of Article 13(7) and (8) of [MiFID], Member States shall prescribe the measures that … firms must take in order to comply with those obligations". Article 13(7) of MiFID requires Member States to make "adequate arrangements so as to safeguard clients' ownership rights, especially in the event of the … firm's insolvency, and to prevent the use of a client's instruments on own account …". It is also relevant on the issue of timing to mention that Article 18(1) of the Implementing Directive requires funds received from clients to be "promptly" placed into an appropriate account.

198. Until client money is segregated, it therefore seems to me to be positively in accordance with the two Directives to provide that it is subject to the statutory trust, as Briggs J said – [2009] EWHC 3228 (Ch), paragraph 148. Indeed, segregation of client money on its own does not protect it in English law in the event of a firm's insolvency, as Professor Gower pointed out in his *Review of Investor Protection* (Part 1) Cmnd 9125 (January 1984), so the imposition of a trust is appropriate in any event. Accordingly, without the imposition of a trust the segregation required by Article 16(1) of the Implementing Directive would not achieve the protection required by Article 13(7) and (8) of MiFID; so the imposition of a trust seems to me to be positively required by Article 16(2) of the Implementing Directive.

199. It is true that the Directives nowhere refer to the creation of a trust, but that seems to me to be irrelevant. The Directives are intended to apply across the EU to all member states, and the concept of a trust is not familiar even in Scotland, let alone in other civil law jurisdictions. Indeed, the different legal systems explain why the Implementing Directive includes Article 16(2). Quite apart from this, as Mr Miles QC and Mr Russen QC pointed out, the prohibition on a firm using client money for its own purposes is enough to create a trust in English law, so Article 13(8) of MiFID, rather like M. Jourdain speaking prose without realising it, appears to ensure the creation of a trust without appreciating it. It is also not irrelevant to mention in this context that in recital (26) to MiFID there is reference to "securities and … funds entrusted to a firm" by a client.

200. Thirdly, it was argued by Mr Snowden QC that, if client money is held on the statutory trust from the moment it is received, then it renders "the alternative approach" described in CASS7.4.16G of nugatory value to a firm, as the steps which would have to be taken to ensure that the trust protection accorded to client money in a house account was not infringed would render the alternative approach unworkable, or at least of no more benefit in practice to a firm than "the normal approach" described in CASS7.4.17G.

201. If, when a firm pays client money into a house account, that money is subject to the statutory trust, then it would follow that clients' rights in relation to such money would have to be respected, so that the money was not put at risk or used for the firm's own purposes. Accordingly, I accept that, if client money is subject to the statutory trust on receipt, it would render the alternative approach less attractive to a firm than if the money is only subject to the trust on segregation. However, I do not accept that it would render the alternative approach either unworkable or no more beneficial than the normal approach. As an elementary point, the alternative approach releases a firm from having to pay client money immediately into a segregated account, and enables it allows a firm to mix house money and client money, at least initially. That itself is a convenience over the normal approach, although I accept that, on its own, it may be pretty limited.

202. More broadly, though, a firm operating the alternative approach and wanting to use a house account as freely as possible would have to ensure that the balance in the account did not fall below the value of the aggregate client monies which had been paid in to the account. Such client monies should only have been paid in over the past day or so, as segregation should occur by the end of the business day next after client money is paid into a house account (see CASS7.4.16G as explained in more detail by CASS7.4.18(1)(b)G). That is said to require unreasonably detailed record keeping. But it is clear that the alternative approach can only be adopted if the firm "has in place systems and controls which are adequate to enable it to operate [the] approach effectively" – CASS7.4.15R – involving "reconciliation of records" and accounts of the entitlement of each *client*" – CASS7.4.16G. A firm adopting the alternative approach not only has to keep detailed records: it should also be able to rely on its previous experience to maintain a prudent buffer in any such account. Further, the firm can rely on the principle that any payment made out of house account with client money (other than for a trust purpose) is always presumed to be from the trustee's money.

203. Accordingly, while it may be necessary to revisit this point once I have considered the other issues, and in particular, whether CASS7.7.2R applies to client money which has not been segregated, in agreement both with Arden LJ and Briggs J, I am provisionally of the view that client money becomes subject to the statutory trust imposed by that provision on receipt of client money.

(ii) Do the primary pooling arrangements apply to client money in house accounts?

204. The centrally relevant provision in this connection is CASS7.9.6(1)R, which provides that, on the happening of a primary pooling event, "*client money* held in each *client money* account of the *firm* is treated as pooled". The issue between the parties is

- whether "*client money* account" extends to any account of the firm into which client money has been paid ("the wider meaning"), or
- whether it is limited to segregated client money accounts, i.e. client bank accounts and client transaction accounts ("the narrower meaning").

205. The amount of textual assistance one can get on this issue from searching through CASS7 is limited. As a matter of language, the expression "client money account" is capable of having either meaning – either any account which contains client money, or an account exclusively, or almost exclusively, containing client money. There could, on the narrower meaning, be money in a segregated account which is not client money (although it would be unusual in the light of CASS7.4.20G, which requires any of the firm's money in a client bank account to be "promptly paid out of that account unless it is a minimum sum required to open the account, or to keep it open"); equally, on the wider meaning, a firm could obviously have accounts which contain no client money.

206. There is force in the point that the words "client money" in the expression "*client money* account" in CASS7.9.6(1)R are redundant if the wider meaning is correct, as it would be quite sufficient to refer to each "account" of the firm, or even to limit CASS7.9.6(1)R to the words "*client money* is treated as pooled". Further, although the expression must be construed in its documentary and commercial context, it is fair to say that (possibly for the reason identified in the preceding sentence) the narrower meaning is the one that the expression initially conveyed to me, after getting to grips with the issue.

207. However, the drafter of CASS7 was well aware that the various types of segregated account had been defined in CASS7 or the Glossary, namely client bank accounts and client transaction accounts, and they had been referred to in terms in CASS7. He could have been expected to use such defined terms if he had wanted to limit the types of account he had in mind in CASS7.9.6(1)R to those which were defined, but he did not do so. The fact that he used the undefined expression "*client money* account" can fairly be said to suggest that he may well have intended CASS7.9.6(1)R to apply to any account where client money was held.

208. It also appears to me relevant that CASS7.9.1R, the first, and governing, provision of CASS7.9, the "Client money distribution" section of CASS7, provides that the section "applies to a *firm* that holds *client money* which is subject to the *client money rules* [i.e. CASS7] when a *primary pooling event* … occurs". That suggests that the provisions of the section are intended to apply to all client money held by the firm, irrespective of the account in which it is held, which tends to support the wider meaning.

209. The reference to "*client money* entitlement" in CASS7.9.6(2)R is said to be rather more consistent with the wider meaning. Given that the expression is not a defined term (although the first two words are), I think there is a little force in the point. If money initially paid into a house account is client money, then the natural meaning of the expression is an entitlement to all the client money, and not just the client money in segregated accounts. However, the point seems to me to be of pretty slight weight.

210. The fact that the mandatory set-off provisions in CASS7.9.6R, as expanded in Annex 1, work perfectly well if the wider meaning is correct does not, at least in my view,

assist in establishing that that meaning is correct, as they also work perfectly well on the narrower meaning. It is true that these provisions have a more far reaching effect on the wider meaning, but it is by no means clear to me why this means that the wider meaning is more likely to be correct.

211. The narrower meaning is said to be supported by provisions such as CASS7.8.1R, which requires a firm to give written notice to the bank, when opening a client bank account, of the fact that "all *money* standing to the credit of the account is held by the *firm* as trustee…" (and CASS7.8.2R has a similar provision for client transaction accounts). I accept that client money in client bank accounts and client transaction accounts is accorded more protection as against third parties under CASS7, but I am unpersuaded that this assists the argument that CASS7.9.6(1)R should similarly only apply to client bank accounts, and client transaction accounts. As a matter of simple practicality, CASS7.8 could not apply to house accounts into which client money is paid, so the absence of such accounts from the ambit of the provision is unremarkable. The fact that it would not have been possible to give client money in house accounts the same protection against third parties is scarcely of assistance in deciding whether such client money is to be subject to pooling arrangements, together with client money in segregated accounts, on the happening of a primary pooling event.

212. It is of some interest to note that the drafter was prepared to treat all money in client bank accounts as being client money for the purpose of CASS7.8.1R. Given that it would only be in rare circumstances that the firm's money would be in such accounts, that is not surprising, but it can be said slightly to undermine the point made in favour of the narrower meaning in paragraph [206] above, that "*client money* held in each *client money* account" in CASS7.9.6(1)R has no redundant words on the narrower meaning, unlike in the case of the wider meaning.

213. It is also said that CASS7.9.3G provides support for the narrower meaning, in that, although it refers to the types of account whose contents would be pooled, they are limited to segregated client accounts. In my view, it is of little assistance. First, it omits any reference to client transaction accounts, which on any view should have been included if it was to contain a complete list, and it is therefore incomplete. That point alone indicates the danger of relying too heavily on an approach to the interpretation of CASS7 involving "detailed semantic analysis". Secondly, and subject to the first point, it can be said that the list of segregated accounts in CASS7.9.3G demonstrates that, where the drafter wished to limit his reference to segregated accounts, he said so. Thirdly, CASS7.9.3G is guidance which does not appear to be intended to be exclusive in its ambit. Finally, its penultimate sentence refers to "every type of *client money* account" which brings one back to the point at issue.

214. CASS7.9.8G is, at least at first sight, of some assistance to the narrower meaning, as Mr Zacaroli QC said in the course of his argument. But, on closer analysis, I do not consider that it is of much relevance. It is a very summary provision: for instance, there is no suggestion that the pooling may result in the client referred to only getting part of "his" money. Subject to that, given that client money should be paid into a segregated account under the normal approach, and if paid into house accounts under the alternative approach, it should be transferred into a segregated account by the end of the next business day, the thrust of the brief provision will normally be right, even where the firm concerned operates the alternative approach. Further, although

CASS7.9.8G does not say that a client may have a right to seek a return of client money from a house account, it does not say that he cannot have such a right. Further, it refers to "client bank account", which again is in marked contrast with the reference to "client money account" in CASS7.9.6(1)R.

215. Mr Zacaroli also suggested that the secondary pooling provisions in CASS7.9.19R assisted his case, in that it appears fairly clear that they do not extend to client money in house accounts, as opposed to client bank accounts. I do not think that those provisions assist: they are concerned with a different issue. If anything, the fact that the secondary pooling provisions are drafted so as to make it clear that they do not extend to client money in house accounts could be said to support the wider meaning of CASS7.9.6(1)R, which, concerned as it is with pooling arrangements, could presumably have been similarly so drafted if it was meant to have that, narrower, effect. In any event, as CASS7.9.13R recognises (by saying that the primary pooling event regime should prevail), the provisions regulating what should happen on primary and secondary pooling events are different.

216. Turning from textual factors to policy and commercial considerations, it seems to me that it is unlikely that client money which had yet to be segregated under the alternative approach was intended to be treated differently from client money which had been segregated either under the normal approach or under the alternative approach. It seems to me that it is unlikely that the FSA would have intended a client who made a payment to a firm which adopted the alternative approach should, albeit for a couple of days at most, be at risk in a way in which a client who made a similar payment to a firm which adopted the normal approach would not be. After all, as Arden LJ said in argument, a client would have no knowledge which approach a particular firm was adopting. Similarly, it seems unlikely that the FSA intended that there should be two categories of client when it came to the clients of a firm which adopted the alternative approach. That approach was simply introduced to give large firms a degree of administrative flexibility and it seems somewhat unlikely that it was intended to affect clients' substantive rights.

217. Against this, there is some initial attraction in the notion that the wider meaning would render the clients with money in the segregated accounts worse off, and it cannot have been intended that they should be prejudiced in this way. On analysis, it seems to me that this attack on the wider meaning fails, and may well rebound. The thrust of CASS7.7.2R and CASS7.9.6R is that, at least on a primary pooling event, the clients of a firm are "in it together", and client money is pooled and paid out to all clients on a *pro rata* basis. So it should not be surprising if the pooling extends to client money in house accounts. In any event, unless the firm infringes CASS7, there should be no great disadvantage: client money should only be in house accounts for two working days at most, and, even then, it should be protected and should not be used for the firm's business (if my provisional view on the first issue is correct).

218. This point goes a little further than that. As on the facts of this case, no doubt in most cases where a primary pooling event occurs, if the narrower meaning is correct, clients whose money is in segregated accounts will be better off than those whose money is in house accounts. However, not even that is clear: those clients with money in house accounts would have tracing or following rights which could conceivably mean that they are better off than their counterparts whose money is in segregated accounts. In other cases, where CASS7.9.6R applies, it may be that, on the narrower

meaning, clients with money in house accounts are better off than those with money in segregated accounts. As Mr Mabb QC said, it seems fairer, and thus more likely, that the two groups of clients were intended to be treated similarly, rather than facing this degree of randomness.

219. Some reliance was placed on the increased practical difficulties and likely delays so far as distribution is concerned, if the wider meaning was correct. I accept that the CASS7.9.6 pooling and distribution exercise is likely to be a slower and more complicated process if the wider meaning is correct. There would not only be more clients, more claims, more accounts and more money to collect, but tracing and similar exercises would add to the delays. Although, as CASS7.9.2G makes clear, speed of recovery is important, particularly in the context of recovery of client money in relation to MiFID business, I am not very impressed with this point. The disadvantage identified would be shared by all clients, rather than merely those clients with money in house accounts, and those clients would benefit from their *pro rata* share of the money in the segregated accounts. Further, the extent of any extra delay may well be relatively slight, and there could be some cases where it is positively advantageous for clients with client money to get access, through the pooling arrangements, to client money in house accounts.

220. The wider meaning also seems more consistent with the notion that client money is subject to the statutory trust on receipt, just as the Judge rightly accepted that the narrow construction is more consistent with the notion that the statutory trust only arises when client money is paid into a segregated account. Accordingly, my provisional conclusion on the first point tends to support the wider meaning.

221. Further, as Mr Miles pointed out, CASS7 seems to create a single trust, and if the trust extends to client money in house accounts, one would expect those clients to have the same rights as those with money in segregated accounts.

222. It also appears to me that the wider meaning is more consistent with the thrust of the Directives. On the narrower meaning, the effect of the alternative approach would be that clients with money in house accounts would (at least normally) enjoy less protection than that enjoyed by clients with money in segregated accounts. Yet all clients who deposit money with firms for MiFID business are intended to receive protection which complies with the Directives, and, as I see it, a single and consistent level of protection.

223. This second issue is not easy to resolve, at least on its own. None of the arguments in support of either meaning is outstandingly persuasive, but I have reached the conclusion, in agreement with Arden LJ, that the wider meaning is to be preferred, subject to reconsideration after discussing the third and fourth points. The arguments based on textual analysis, whether of CASS7.9.6R itself or of the other provisions of CASS7, and assessing what light those other provisions cast on CASS7.9.6(1)R, appear to me to be fairly limited in their value and pretty finely balanced in their relative strengths, and, overall, I do not consider that they favour either approach. The arguments based on the policy of the Directives and CASS7 are also by no means overwhelming or all one way, but they do appear to me to point in favour of the wider meaning.

224. Briggs J reached a different conclusion. In the light of the difficulty of the issue, that is scarcely surprising; in addition, the argument before him was rather, possibly very, different in nature and extent from the argument before us.

(iii) Is participation in the pool dependent on actual segregation?

225. Arden LJ has expressed this question slightly differently: is participation in the pool limited to clients who have client money in the pool, or can any client with a claim to client money participate? This issue is linked to the dispute as to whether the pool is shared out *pro rata* to clients' segregated client money or by reference to the amount of client money which should have been segregated. The Judge described the two alternatives as the contribution basis and the claims basis, and so shall I.

226. There is, of course, a degree of correlation between this issue and the second issue. Just as the Judge below thought the contribution basis was supported by his conclusion that the narrower meaning should be attributed to CASS7.9.6(1)R, so can it be said that my present conclusion that the wider meaning is appropriate tends to support the conclusion that the claims basis is correct. Accordingly, in a sense, I approach this third issue from a slightly different perspective from that of the Judge. Further, if the wider meaning of CASS7.9.6(1)R is correct, then the argument that the contribution basis would result in a quicker and easier distribution is largely by-passed. I also disagree with the Judge's view that the Directives tend to support the contribution basis. So, too, I consider that it could be dangerous to look at the normal rules relating to trusts: CASS7 is intended to be a code, and while it will have some "gaps" which will have to be filled in by the general law, it is dangerous to assume that the general law is intended to be followed by specific provisions.

227. It seems to me that Mr Miles, who supported the claims basis, was right to concentrate on CASS7.9.6(2)R, when considering this third issue. After all, it is this provision which primarily governs the distribution of client money following a primary pooling event. Once one accepts that client money includes such money when paid into a mixed money house account, then the concept of "client money entitlement", which is, of course, not defined, carries with it the notion of all money, a point reinforced by the opening provision of the chapter, CASS7.9.1R, all of which tends to suggest that the claims basis is correct.

228. If the contribution basis were correct, there is a difficulty which the Judge identified very clearly at [2009] EWHC 3228 (Ch), paragraph 242, in these terms:

> "i) CASS7.9.6R(2) requires the firm to distribute *client money* 'in accordance with CASS7.7.2R, so that each *client* receives a sum which is rateable to the *client money* entitlement calculated in accordance with CASS7.9.7R' ...;
>
> ii) CASS7.9.7R requires, on a client by client basis, a netting process to be carried out between each client's 'individual *client* balance' and that client's '*client equity balance*';
>
> iii) CASS7.9.9R(2) makes it clear (albeit for a different purpose) that the '*client money* entitlement' for each client will be calculated in accordance with CASS7.9.7R as at the time of the [primary pooling event];

iv) The phrase '*client equity balance*' is defined in the Glossary by reference to the amount which a firm would be liable to pay to a client in respect of that client's margined transactions if each of his open positions was liquidated at the prices published by the relevant exchange and his account closed. It is a form of entitlement having nothing to do with the amount contributed by the client to the firm's segregated accounts;

v) The phrase 'individual *client* balance' is not a term defined in the Glossary, but it is fully explained in paragraph 7 of Annex 1, again in terms which are based upon the contractual position between the client and the firm, rather than the amount actually contributed by the client to the firm's segregated accounts;

vi) Thus it necessarily follows that the phrase '*client money* entitlement', where used both in CASS7.9.6R(2) and 7.9.9R(2) is a reference to the client's contractual entitlement to have money segregated for it, rather than to the client's proprietary interest in the [client money pool], derived from having had its money actually segregated, i.e. paid into the segregated accounts from which the [pool] is constituted. …."

229. In the following paragraph of his judgment, this analysis was described by the Judge as "a formidable textual argument", but he did not accept it because "CASS7 uses the partially defined phrase '*client money* entitlement' as meaning different things in different places", for instance in CASS7.9.9R, and because the drafter would have expected firms to comply with their obligations under CASS7.

230. I do not consider that either of those are good reasons for rejecting the formidable textual argument. If the claims basis is correct, and if every client who has a claim for client money can participate in the pool, then "*client money* entitlement" has a consistent meaning, namely a contractual entitlement, as identified in the Judge's step (vi) above. If the contribution basis is correct, then "*client money* entitlement" does not have a consistent meaning in CASS7. Also, even if one should construe CASS7 on the basis that the drafter anticipated strict compliance with its terms, there would still be clients whose client money was in a house account where a primary pooling event occurs in any case where a firm operated the alternative approach.

231. I have gone into this point in a little detail, as it is necessary in order to explain it. It is a textual or analytical point in favour of the claims basis. However, it is a slightly esoteric point, and it would be wrong to make too much of it.

232. Another problem with the contribution basis is that it is inevitable that there will be "a short period ... between the [date of] the last internal reconciliation accounts ... and the [primary pooling event], during which events may occur which would increase or reduce the amount which the firm would ordinarily segregate for a client, if it carried out a further segregation as at the [primary pooling event]" – [2009] EWHC 3228 (Ch), paragraph 265. As the Judge went on to say in the next two paragraphs, there could be events which might increase or reduce a client's entitlement to share in the pool, for which "CASS7 makes no express provision" and "[t]he claims basis for sharing in the [pool] naturally accommodates these events, because they all adjust the

relevant client's contractual entitlement to have client money segregated for him[, but] the contributions basis for sharing offers no such ready solution ...".

233. The Judge said that these difficulties were outweighed by the extra complications and delays which would be caused if the claims basis (coupled with the wider approach) was correct. I am unpersuaded of that. The extent to which the claims basis coupled with the wider approach would lead to greater delays and difficulties than the contribution basis coupled with the narrower approach is a matter of speculation, even of debate, and will vary from case to case. On the other hand, it is significant that the contribution basis leads to lacunae and "glitches", to quote the Judge, which do not arise if the claims basis is correct. I should add that it may well be, as Arden LJ says, that the problems which could arise in this connection if the contribution basis is correct, may well be more than "glitches".

234. For these reasons, I have come to the conclusion, in agreement with Arden LJ, that the claims basis, rather than the contribution basis, is correct, and that the basis for sharing in the pool is the amount which ought to have been segregated for each client, rather than the amount which was in fact segregated for each client.

(iv) When does money owed by a firm to a client become "client money"?

235. The point involved in this issue is described by Arden LJ in paragraph [165] above, and she goes on to explain why she rejects the argument raised by Mr Jarvis QC, and opposed by Mr Peacock QC. For the reasons she gives in paragraphs [171]-[175], and in agreement with Briggs J, I too would reject that argument.

The wider picture on issues (i), (ii), and (iii)

236. The first three issues are connected, and my conclusions on those issues are, I believe, mutually consistent in commercial and policy terms. On the happening of a primary pooling event, the treatment of client monies, and the basis of assessing a client's rights arising from paying client money to a firm, are the same whether the money has been paid into a segregated account or into a house account. If, as the Judge held, and it is hard to challenge, monies paid to a firm by a client are client money and subject to the statutory trust from the moment the firm receives the money, irrespective of the type of account into which it is paid, then it would seem to follow that it is probable that all such client monies are intended to be treated in the same way under the primary pooling provisions. Similarly, if all such client monies are to be treated in the same way under the primary pooling provisions, then it would seem to follow that the claims basis rather than the contribution basis is more appropriate, and, indeed, if the claims basis, rather than the contribution basis is correct, it would seem more likely that the wider meaning, rather than the narrow meaning, of CASS7.9.6(1) is correct.

237. It is also worth bearing in mind that, if LBIE had operated as CASS7 required, there would only have been two days (at the most) worth of client money in house, non-segregated accounts. It is only because LBIE operated the alternative approach without (on the assumed facts) faithfully ensuring that client money paid into house accounts was promptly paid into segregated accounts that so much is at stake in the present case. It does not seem likely that it can have been intended that a client whose money was in a house account for up to two days for the firm's administrative convenience would be treated completely differently from a client whose money had

been paid into a segregated account, and then wrongly paid out. The notion of all clients who had entrusted client money with the firm being treated equally when it comes to a primary pooling event seems to accord with the general thrust of CASS7.

238. The notion also seems to fit in better with the general thrust of MiFID, whose purpose is to maximise client protection, and to ensure that client money is protected as soon as it is paid into an account by the firm. The alternative approach was intended to assist firms by providing a more convenient system than the normal approach. Given that a firm which operates the alternative approach no doubt could operate the normal approach, it seems unlikely that CASS7 intended clients to be prejudiced in any way (unless it was inevitable) by the fact that the alternative approach was adopted by a firm, particularly as the Implementing Directive envisages client money being protected and being "promptly" paid into a segregated account. If a firm is granted an indulgence for reasons of practicality, it seems more likely that it would not have been intended that the indulgence would have any more disadvantages for the client than were inevitable.

Conclusion

239. I would therefore allow the appeals on the second and third issues, and dismiss the appeals on the first and fourth issues, referred to in paragraph [182] above.

240. It would be remiss to end this judgment without expressing my gratitude to the Judge for having prepared such a full and careful judgment, and to all legal representatives for their impressive written submissions, and their impressive and relatively concise oral submissions.

Sir Mark Waller:

241. The very impressive judgment of Briggs J reached, to my mind, an unsatisfactory conclusion under which client money was held on trust from receipt (issue 1), but (i) only that which had been placed in segregated accounts was subject to pooling (issue 2) and (ii) the division of the pool was to be by reference to contribution and not entitlement (issue 3).

242. It seemed to me that his conclusion as to trust on receipt was likely to be right but that, if that were so, only if driven to it should his conclusions as to pooling and contribution be upheld. If his conclusions as to pooling and contribution were correct, then symmetry would, to my mind, demand revisiting his conclusion on trust on receipt.

243. The very powerful submissions of those representing the different interests have not made reaching a conclusion easy. For the reasons given in the judgments of Arden LJ and the Master of the Rolls it seems to me that the judge was right as to trust on receipt and that he was wrong as to pooling. I have nothing to add to their judgments on issue 4 and I agree that the appeal should be disposed of as concluded by them.