Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets

Final Report

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Contents

Chapter 1 Introduction

In 1996, IOSCO published a report on *Client Asset Protection* (the 1996 Report).[1] The 1996 Report emphasized, among other things, that regulators should "ensure that investors are adequately informed about the arrangements for" protections afforded to Client Assets[2] under their Regimes.[3]

On September 15, 2008, Lehman Brothers Holdings Inc. (Lehman) declared bankruptcy. Simultaneously or shortly thereafter, certain Lehman subsidiaries also declared bankruptcy, including a number of Investment Firms. In the aftermath of such declarations, one thing became evident: clients of the Lehman subsidiaries, as well as applicable regulators, had no means to easily ascertain the manner and extent to which different Regimes, in foreign jurisdictions, protect Client Assets. Thus, the bankruptcies of Lehman and its subsidiaries demonstrated that the goal of investor awareness advocated in the 1996 Report had not been achieved.

This report, including Appendices A and B described below, aims to increase access to information concerning the protections that participating SC3 Regimes offer to Client Assets. Regulators, considering cross-border financial activity, need to understand the methods for, and scope of, protection afforded Client Assets in other jurisdictions, both to fulfil their own responsibilities and to achieve the effective cross-border coordination mechanisms called for in international efforts such as the recent recommendations made by the Financial Stability Board.[4] Market participants, in considering where to do business, need similar information.

Therefore:

- Chapter 2 of this report describes differences in the treatment of Client Assets in various Regimes, based on two issues:
    - (1) distinctions between (i) Securities for which a client has fully paid, and which are free from further pledges and encumbrances (Fully-Paid Securities), and (ii) Securities purchased, in part, with money a customer has borrowed from the Investment Firm (sometimes referred to as "margin securities"); and
    - (2) distinctions between Client Assets securing debts of a client to the Investment Firm (e.g., Securities purchased on margin) and Client Assets serving as a performance bond against the possibility of potential future debts of the client to

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1 *Client Asset Protection*, August 1996, available at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD57.pdf.

2 Capitalized terms are defined in the attached Glossary.

3 For example, the 1996 Report stated in Recommendation 3 that "[r]egulatory authorities should seek to ensure that investors are adequately informed about the arrangements for client asset protection within their jurisdictions." Similarly, the 1996 Report stated in Recommendation 18 that "[r]egulatory authorities should ensure that there is clarity as to the arrangements for protecting client positions held as a result of transactions entered into in their jurisdictions."

4 See, e.g., Reducing The Moral Hazard Posed By Systemically Important Financial Institutions (FSB October 20, 2010).

the investment firm (e.g., initial margin for derivatives Positions.) As discussed below, there are related differences in the regulatory treatment of such Client Assets. For analytical purposes, Chapter 2 also divides Regimes into three separate categories – custodian, trust and agency regimes, based on differences in their characterization of the legal relationship between an Investment Firm and its client with respect to Client Assets;

- Chapters 3 and 4 of this report broadly describe the protections that the Regimes afford to Client Assets, both before and after the bankruptcy of an Investment Firm. Such sections differentiate between the categories of Regimes as necessary;

- Appendix A of this report sets out a more detailed chart summarizing such protections;

- Appendix B of this report contains the actual Survey responses from each Regime; and

- Appendix C of this report sets out two related case studies.

A quick perusal of Appendices A and B reveals that each Regime is unique in the methods by which it protects Client Assets, because such protections depend on the particulars of each jurisdiction's insolvency law and laws defining underlying property rights.

As the 1996 Report notes, "effective client asset protection can be achieved in a number of ways, often through a combination of methods."[5] Also, as the 1996 Report observes, each Regime may define "effective" differently and may have different priorities.[6] For example, there is tension between precision (e.g., tying losses to customers who hold particular a particular stock in which there is a shortfall) and speed in distributing to customers (or transferring to another intermediary) Client Assets held at an insolvent firm. Different Regimes may weigh these goals differently.

Nonetheless, as the bankruptcies of Lehman and its subsidiaries demonstrated, whether a Regime can effectuate the expeditious transfer or distribution of Client Assets has significant implications for both individual clients and the global financial markets.[7] Consequently, in addition to describing the protections that Regimes generally provide to Client Assets, Chapters 3 and 4 of this report discuss the strengths and weaknesses of particular protections in facilitating efficient transfer or distribution of Client Assets.

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5 The 1996 Report, p. 8.

6 Ibid. According to the 1996 Report, "[o]ne aspect of public policy which may differ between jurisdictions is whether the concern within financial markets is to protect the investor or to protect the integrity and efficiency of markets by ensuring the smooth operation of settlement and payment systems."

7 Chapter 2 of this report describes such implications in greater detail.

Chapter 2 General Observations

A. Differences in the Securities and Derivatives Markets

The Survey defines Client Assets as encompassing (i) Securities, (ii) Positions, and (iii) Client Money. These three components of Client Assets serve slightly different functions in the securities markets and the derivatives markets. These differences are reflected in the manner in which such Client Assets are treated and protected in each Regime.

A.1 Conceptual Issues Concerning Client Assets in Securities Markets

Typically, in the securities market, Client Assets consist of: (i) Fully-Paid Securities; (ii) margin securities; and (iii) Client Money.

For margin securities, a balance must be struck between the client's interest in the securities it has purchased, and the Investment Firm's ability to finance the loans it makes to facilitate such purchases. Therefore, the concept of Client Assets with respect to margin securities can often be complex.

Regimes may sometimes treat and protect such Client Assets in different ways. For example, Regimes may require an Investment Firm to segregate[8] Fully-Paid Securities, but not all margin securities. Firms that have margin securities may be permitted to rehypothecate some portion of those securities to finance the loan amount. Where a portion of margin securities may be rehypothecated, some Regimes may require that they be segregated in the Investment Firm's dealings with the lender, while others may not.

If an Investment Firm becomes insolvent, Regimes may (or may not) be able to promptly transfer (to one or more solvent firms) or distribute client Securities, and Client Money. However, there may also be the necessity to procure such margin securities if they are not in the possession or control of the insolvent firm.

A.2 Conceptual Issues Concerning Client Assets in Derivatives Markets

In derivatives markets, clients enter into Positions, which are essentially contractual obligations to make specific payments, rights to receive specific payments, or rights and obligations to take specific actions (e.g. make or receive delivery) in the future. To guarantee performance of such obligations, clients frequently are required to deposit Client Money and Securities (referred to as "performance bond" or "initial margin") and make incremental settlements, which are referred to in the industry as "variation margin" payments. Once a party's Position is no longer outstanding – either due to final settlement, or earlier, because the Position is offset by an opposite Position – the party is entitled to a return of its initial deposit of Client Money and Securities. There is generally no use of Client Money and Securities to finance client Positions. In the derivatives markets, Client Assets are: (i) outstanding Positions; (ii) Client Money resulting from incremental settlements; and (iii) Client Money and Securities initially deposited to guarantee performance of outstanding Positions.

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[8] This report uses the term "segregation" (and variations thereof) to refer to the practice of an Investment Firm in maintaining Client Assets separately from proprietary assets.

Because clients have rights in the Client Assets described in (i), (ii), and (iii) in the same degree, Regimes may offer similar protections to such Client Assets. For example, Regimes may focus on simultaneously transferring or liquidating the Client Assets described in (i), (ii), and (iii).

B. A General Taxonomy of Participating Regimes

As the 1996 Report states, the methods of protecting Client Assets "may vary considerably from jurisdiction to jurisdiction, reflecting different market traditions, political influences and legal and regulatory systems."[9] Although, as mentioned above, each Regime offers unique protections for Client Assets, a review of Appendices A and B show that most Regimes may be organized into three general categories. The philosophical differences between such categories, together with the differences between securities and derivatives markets described above, explain much of the variance between Regimes with respect to protections of Client Assets.

- **Custodial Regimes**. Certain Regimes characterize the relationship between an Investment Firm and its client with respect to Client Assets as primarily a custody arrangement under civil law (the Custodial Regimes).

    - Custodial Regimes have developed in jurisdictions where Investment Firms are either permitted or required to be banking entities.

    - Custodial Regimes generally do not require an Investment Firm that is a bank to segregate Client Money.[10] Rather, Custodial Regimes treat Client Money as a general obligation of such an Investment Firm.

    - In contrast, Custodial Regimes do require the segregation of client Securities.

    - Custodial Regimes tend to give maximum effect to the choice of the client to grant full title (or limited incidents of ownership) in client Securities to a solvent Investment Firm. As discussed further below, such grant may lead to shortfalls in client Securities that are not Fully Paid.

    - Custodial Regimes focus on the prompt distribution of Client Assets from an insolvent Investment Firm. For example, Custodial Regimes permit the "preferential" distribution of client Securities (i.e., on terms that are more protective of clients than of other creditors).[11] If there is a shortfall, such Regimes tend to distribute available client Securities *pro rata*, while relying on

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9 The 1996 Report, p. 8.

10 While most transactions in Custodial Regimes are intermediated by investment firms which are banks, there are also investment frims which are not banks. Such non-bank Investment Firms are required to segregate Client Money.

11 While insolvency laws frequently permit an insolvency officer (*e.g.*, a trustee or administrator) to "claw back" assets from creditors who receive "preferential" transfers in the time period immediately before an insolvency (that is, a recovery of more than they would under the insolvency law), many Regimes exempt Client Assets from such claw-back.

compensation schemes to cover limited amounts of shortfalls in client Securities and Client Money.

- By contrast, most Custodial Regimes do not have an overarching arrangement to facilitate the transfer of Client Assets from an insolvent Investment Firm to a solvent Investment Firm. Indeed, certain Custodial Regimes do not permit such transfer.

- Custodial Regimes include: (i) France; (ii) Germany; (iii) Italy; (iv) Japan; (v) Spain; and (vi) Switzerland.

- **Trust Regimes**. Certain Regimes base the relationship between an Investment Firm and its client with respect to Client Assets in equitable principles and the common law of trusts (the Trust Regimes).

  - In general, Investment Firms in Trust Regimes are not banking entities. Therefore, Trust Regimes require Investment Firms to segregate both Client Money and client Securities.

  - Trust Regimes tend to give maximum effect to the choice of the client in permitting a solvent Investment Firm to use (or to *rehypothecate*) Client Assets for example, to aid firms in financing loans made to customers. As discussed further below, such use may lead to shortfalls in Client Assets, for example, where the value of the re-hypothecated assets exceeds the value segregated to replace them.

  - Trust Regimes focus on the prompt distribution of Client Assets from an insolvent Investment Firm. For example, Trust Regimes permit the preferential distribution of Client Money and client Securities. However, Trust Regimes tend to limit such distribution to only those Client Assets that could be definitively traced back to the trust between the Investment Firm and the client.

  - Most Trust Regimes do not have an overarching arrangement to facilitate the transfer of Client Assets. However, such Regimes will permit and encourage such transfer on a case-by-case basis.

  - If there is a shortfall, Trust Regimes tend to distribute available Client Money on a *pro rata* basis, (although the amount available for distribution may also be subject to tracing remedies in some common law jurisdictions such as the UK). Distributions of client Securities may depend on tracing or may be on a *pro rata* basis by, e.g., stock line. Trust Regimes then permit retail clients to claim a limited amount of the shortfall against a compensation scheme. Any shortfall that the compensation scheme does not cover becomes an unsecured obligation of the insolvent Investment Firm.

  - Trust Regimes include: (i) Australia; (ii) Hong Kong; (iii) Singapore; and (iv) the United Kingdom.[12]

[12] Except for Scotland.

- **Agency Regimes**. Certain Regimes base the relationship between an Investment Firm and its client with respect to Client Assets in a definition of agency that is statutorily created and developed (the Agency Regimes).

    - In general, Investment Firms in Agency Regimes are not banking entities. Therefore, Agency Regimes may require Investment Firms to segregate both Client Money and client Securities.[13]

    - Agency Regimes tend to prohibit solvent Investment Firms from using Client Assets in certain ways, regardless of client directions. Therefore, Agency Regimes tend to prohibit certain practices that may lead to shortfalls in Client Assets.

    - Agency Regimes tend to encourage the bulk transfer of Client Assets. Such Regimes have statutory and regulatory frameworks that support such transfer.

    - Additionally, Agency Regimes permit the preferential distribution of Client Assets from an insolvent Investment Firm. They tend to provide Administrative Officers with specific guidance regarding such distribution.

    - If there is a shortfall, Agency Regimes tend to distribute available Client Assets on a *pro rata* basis. Certain Agency Regimes then permit customers to claim a limited amount of the shortfall against a compensation scheme. Any shortfall that the compensation scheme does not cover becomes an unsecured obligation of the insolvent Investment Firm.

    - Agency Regimes include Canada and the United States (with respect to both the commodity futures and the securities markets).

C. The Importance of Expeditious Transfer or Distribution

Financial markets are complex and volatile. Clients transacting in such markets, when confronted with the insolvency of their Investment Firm, want to minimize disruptions to their trading strategies and to their control of Client Assets as much as possible. Therefore, some jurisdictions value the expeditious transfer or distribution of Client Assets. If such transfer or distribution is delayed, clients may face unanticipated exposures[14] of unpredictable magnitude.[15] Such exposures may lead to the client facing significant liquidity pressure. On the other hand, some jurisdictions value certainty, whilst endeavouring to return money and securities as soon as possible. For example, in the UK an Insolvency Practitioner (IP) acts

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[13] Canada requires segregation of client Securities, but only requires segregation of Client Money in excess of a threshold, which is a multiple of capital. Client Money up to the threshold is not required to be segregated.

[14] For example, a client in the securities markets may not be able to acquire a Security it needs to settle a repo transaction. A client in the derivatives markets may not be able to liquidate an unprofitable Position.

[15] In both the securities and derivatives markets, the magnitude of such exposures would depend on the volatility of the relevant instrument.

with personal responsibility. As a result, the IP needs to be satisfied before the distribution is made that the distribution is accurate.

From a systemic perspective, the expeditious transfer or distribution of Client Assets is important, because such transfer or distribution minimizes the risk that the insolvency of an Investment Firm would result in the insolvency of one or more clients thereof. Also, expeditious transfer or distribution of Client Assets minimizes the liquidity pressures on a client, which is advantageous in an environment where liquidity may be increasingly constrained.

D. The Effect of a Shortfall on Transfer or Distribution

In general, the existence of a shortfall complicates – and consequently delays – the transfer or distribution of Client Assets. For example, with respect to both the securities and derivatives markets, most Regimes require the Administrative Officer to (i) locate the source of the shortfall, (ii) identify the clients that would share in such shortfall, and (iii) calculate the *pro rata* share of each client in the shortfall. Such Regimes would authorize the Administrative Officer to distribute Client Assets only after the completion of (i), (ii), and (iii). This dynamic may be somewhat altered for regimes with a compensation scheme.

Also, with respect to the derivatives markets, the existence of a shortfall creates specific impediments to the transfer of client Positions. No participating Regime reported that it had the power to force a solvent Investment Firm to accept the transfer of client Positions from an insolvent Investment Firm. Therefore, for such a transfer to occur, a solvent Investment Firm has to agree to accept such transfer. In general, a solvent Investment Firm would most likely accept such transfer if the default risk associated with client Positions were minimal. Specifically, a solvent Investment Firm would consider (i) whether the Client Money and Securities supporting client Positions would be simultaneously transferred, (ii) whether a significant shortfall existed in Client Money and Securities, (iii) whether clients would have the ability to advance other assets to cover such shortfall, and (iv) whether there is any governmental assistance that might be provided to cover such shortfall.

Chapters 3 and 4 of this report further describe the strengths and weaknesses of various approaches that Regimes take in treating Client Assets with respect to, *inter alia*, the goal of avoiding shortfalls in Client Assets.

Chapter 3 Observations on Pre-Insolvency Protections for Client Assets

Set forth below are certain observations on (i) the approaches by which participating Regimes treat Client Assets prior to the insolvency of an Investment Firm and (ii) positive and negative aspects of such approaches in facilitating efficient transfer or distribution of Client Assets after the insolvency of an Investment Firm.

- **Required Segregation**

    - **Client Securities**. The majority of Regimes require an Investment Firm to segregate at least some client Securities (e.g., Fully Paid Securities).

    - **Client Money**. In general, Custodial Regimes, especially those Regimes that require an Investment Firm to be a banking entity (or where the majority of such firms are banking entities), do not mandate that an Investment Firm that is a bank segregate Client Money. Rather, Custodial Regimes treat Client Money as a general obligation of an Investment Firm.

    - **Positive aspects**. In order for a Regime to effectuate a prompt transfer of Client Assets after an Investment Firm declares insolvency, the Regime must have a framework for facilitating the identification of Client Assets. Segregation of Client Assets provides an effective framework for such identification. Segregation, particularly when coupled with reconciliation, also discourages fraud or misuse of Client Assets.

    - **Negative aspects of a failure to segregate**

        - As mentioned above, Custodial Regimes generally do not require a solvent Investment Firm that is a bank to segregate Client Money. Therefore, if an Investment Firm becomes insolvent, a client may be treated like an ordinary depositor, with a claim primarily against the compensation scheme. In that case, a client may not recover all of its Client Money.

        - Treating Client Securities differently than Client Money may lead to unintended consequences. For example, in the derivatives markets, if clients deposit Client Money to support Positions, then it may be challenging for a Regime to promptly transfer client Positions, because (i) Client Money in excess of compensation scheme limits would not be available and (ii) Client Money within such limits would be available on a delayed basis. Clients may choose to deposit Securities to support Positions.

- **Omnibus Account**

    - **Client Securities**. Most Regimes permit an Investment Firm to deposit client Securities in an Omnibus Account, although such Regimes require the Investment Firm to maintain books and records that identify the Securities belonging to each client.

- **Client Money**. Most Trust Regimes and Agency Regimes permit an Investment Firm to deposit Client Money in an Omnibus Account, although such Regimes require the Investment Firm to maintain books and records that identify the amount of Client Money belonging to each client. As mentioned above, Custodial Regimes generally do not require that Investment Firms segregate Client Money.

- **Positive aspects**. The use of an Omnibus Account may have certain administrative efficiencies. Also, if there is no shortfall, it may be faster and more efficient to transfer Client Assets in an Omnibus Account than to transfer Client Assets in individual accounts.

- **Negative aspects**. However, depending on the Regime, the use of an Omnibus Account may expose one client to the default risk of another client, particularly when an Investment Firm declares insolvency due to the losses of a specific client. Such losses would likely create a shortfall in Client Assets, which decreases the likelihood of efficient transfer or distribution of Client Assets, as described above. Again, this risk may differ to the extent client losses may be covered by a compensation scheme.

- **Reconciliation**. All Regimes require an Investment Firm to reconcile its books and records to its segregation requirement periodically, although Regimes differ on the frequency of such reconciliation.

  - Approximately half of the Regimes require an Investment Firm (i) to calculate its segregation requirement daily and (ii) to reconcile its books and records with such requirement daily, although such Regimes differ on the deadlines for such calculation and reconciliation (e.g., by noon on the next business day or by the end of the next business day).

  - **Positive aspects**. Frequent calculation of the segregation requirement and frequent reconciliation of books and records with such requirement enables a solvent Investment Firm (i) to detect and resolve shortfalls in Client Assets earlier and (ii) to thereby arrest the accumulation of such shortfalls. The requirement of frequent reconciliation may also serve as a discipline on an Investment Firm, encouraging the continuous application of strong internal controls. Also, as Regimes often require an Investment Firm to report a shortfall in Client Assets, frequent reconciliation may permit a regulator to detect problems with an Investment Firm earlier, including deficiencies in internal controls, fraudulent activity, or financial difficulty.

  - **Negative aspects**. It may be costly to implement frequent calculations of the segregation requirement and frequent reconciliation.

- **Permission/Prohibition of Temporary Deficits and Buffers**. Most Regimes require an Investment Firm to hold exactly the amount of Client Assets specified in the segregation requirement. Such Regimes consider either a deficit or surplus in Client Assets to be a reportable irregularity. Some regimes such as the UK and the US explicitly allow an Investment Firm to hold a surplus in Client Assets, commonly referred to as a buffer, because they view it as prudent to do so in the interest of customer protection.

- As mentioned above, Regimes differ on the frequency with which an Investment Firm must perform reconciliation. In general, the more frequently an Investment Firm performs reconciliation, the more successful it would be at discovering and resolving deficits or surpluses in Client Assets.

- In general, Custodial Regimes and certain Trust Regimes do not permit the Investment Firm to maintain a *buffer* of proprietary assets in an Omnibus Account. As discussed below, Custodial Regimes and certain Trust Regimes tend to emphasize returning to a client the specific Securities due. Inclusion of a *buffer* would attenuate the link between such Securities and the client, and possibly complicate the treatment of client Securities if an Investment Firm becomes insolvent.

- **Positive aspects of prohibiting buffers and temporary deficits**

    - By prohibiting deficits – that is, prohibiting an Investment Firm from holding, even temporarily, less Client Assets than the amount specified in the segregation requirement – a Regime is less likely to encounter a shortfall in Client Assets, which in turn increases the possibility that Client Assets would be promptly transferred or distributed if an Investment Firm becomes insolvent.

    - As mentioned above, Regimes often require an Investment Firm to report a shortfall in Client Assets. Therefore, if a Regime does not permit an Investment Firm to maintain a *buffer*, then the Investment Firm would notify the regulator every time it discovers a shortfall. Such notifications may permit a regulator to detect problems with an Investment Firm, including deficiencies in internal controls, fraudulent activity, or financial difficulty. Thus, the prohibition of a buffer can enhance firm internal controls and prevent the misuse of *error* and similar accounts that played a critical role in the failure of Barings in 1996.

    - In general, under Custodial Regimes and certain Trust Regimes, if the Investment Firm does not maintain a *buffer*, clients may receive client Securities more promptly. Otherwise, an Administrative Officer may freeze the pool of assets until it is able to distinguish between (i) client Securities (which would be distributed to clients) and (ii) the *buffer* (which would be distributed to the general creditors).

- **Positive aspects of permitting buffers or temporary deficits.**

    - If an Investment Firm is not permitted to maintain either a temporary deficit or a *buffer* in Client Assets, then the Investment Firm must perform frequent, precise reconciliations to ensure that it is complying with the segregation requirement. Such reconciliation may be costly.

    - In many instances, an Investment Firm may discover shortfalls in Client Assets resulting from simple clerical errors. It may be cumbersome for (i) the Investment Firm to notify the regulator and (ii) the regulator to review

the notification. If an Investment Firm is permitted to either maintain a temporary deficiency or a *buffer*, then it could avoid making such notifications, as such clerical errors would not result in a shortfall. (To be sure, an alternative viewpoint is that such "simple clerical errors" represent control weaknesses).

- Under certain Agency Regimes and certain Trust Regimes, permitting an Investment Firm to maintain a *buffer* may not complicate the treatment of Client Assets if an Investment Firm becomes insolvent. Such a *buffer* may decrease the likelihood that an Investment Firm would have a shortfall in Client Assets (as client losses guaranteed by the Investment Firm convert the *buffer* to required assets), and would increase the possibility that Client Assets would be promptly transferred or distributed if an Investment Firm becomes insolvent.

- **Treatment of Debit Balances**. With respect to Client Assets held in Omnibus Accounts, most Regimes prohibit an Investment Firm from offsetting credit and debit balances across different clients.

  - **Benefits of prohibiting the use of debit balances to offset credit balances**. An Investment Firm is prohibited from using the Client Assets of one client to finance the transactions of another client, thereby decreasing the risk that the latter poses to the former in an Omnibus Account. Such prohibition decreases the likelihood that an Investment Firm would have a shortfall in Client Assets, and increases the possibility that Client Assets would be promptly transferred or distributed if an Investment Firm becomes insolvent.

  - **Benefits of permitting debit balances to offset credit balances**. Offsetting credit and debit balances across different clients may have administrative and capital efficiencies, depending on available financing transactions in a Regime.

- **Fungibility**

  - **Across Asset Classes**. Most Regimes prohibit an Investment Firm from treating Client Money and client Securities as fungible for purposes of Client Asset protection. In general, if an Investment Firm becomes insolvent, such Regimes may accord less protection to Client Money than client Securities.

    - For example, as mentioned above, Custodial Regimes generally do not require Investment Firms to segregate Client Money. Also, under the Trust Regimes, if an Investment Firm becomes insolvent and transfer proves impracticable, Client Money that the Investment Firm improperly excluded from segregation (whether due to fraud or negligence) may not qualify for preferential distribution.

  - **Within Asset Classes**. Most Regimes prohibit an Investment Firm from treating one client Security as fungible with another client Security unless both Securities have the same terms and conditions, i.e., the same CUSIP or ISIN.

        - In some cases, clients owning different securities may be treated differently. For example, under Custodial Regimes and Trust Regimes, if an Investment Firm becomes insolvent, transfer proves impracticable, and there is no shortfall with respect to client Securities with one CUSIP or ISIN whereas there is a large shortfall of client Securities with a different CUSIP or ISIN, then clients due the former would be satisfied in full while clients due the latter might receive a *pro rata* distribution and limited remuneration from the compensation scheme.

    - With respect to securities, one alternative to Transfer is *distribution in kind*, which may be favored if Securities of the right CUSIP or ISIN are available to be distributed (whether from within the existing Client Assets, or available for purchase at a price that does not exceed the available value to be distributed).

    - If an Investment Firm becomes insolvent and both transfer and distribution in kind prove impracticable, then client Securities would be liquidated. The proceeds from such liquidation may be aggregated with Client Money, and such aggregated amount may be distributed to clients on a *pro rata* basis.

    - *Positive aspects of prohibiting the treatment of different securities as fungible.* The prohibition against fungibility increases the likelihood that a client would recover its specific Securities from the insolvent Investment Firm. The Custodial Regimes and the Trust Regimes may place a higher premium on such recovery in kind than certain Agency Regimes. Distribution of Client Assets in kind may also avoid certain potential taxation issues that might arise from what might be deemed to be sales of such assets.

- **Right of Use**

    - Agency Regimes prohibit an Investment Firm from using client Securities in certain ways, regardless of client consent.

    - In contrast, most Custodial Regimes and Trust Regimes permit an Investment Firm to encumber, rehypothecate, or otherwise use client securities with written client consent (sometimes for all clients, in other cases only for non-retail clients). Depending upon the Regime, the re-hypothecation or other use may result in the amount of Customer Assets in segregation being less than the amount owed to customers.

    - **Positive aspects of prohibiting right of use**. The prohibition against Investment Firm use of Client securities diminishes the likelihood of a shortfall in Client securities, which increases the possibility that such securities will be promptly transferred or distributed if an Investment Firm becomes insolvent. For example, an Administrative Officer could easily locate and liquidate such client securities, and distribute the proceeds from such liquidation on a *pro rata* basis to clients, along with Client Money. Moreover, the prohibition against re-hypothecation eliminates the necessity of accounting for the securities of clients who have granted such rights of use. Without such a prohibition, a complicated process of accounting for distributions to clients will be necessary, including for those clients

who have not granted such rights of use. Consequently, clients may face waiting periods of months, perhaps years, to obtain return of securities.

- **Positive aspects of permitting right of use**. Custodial and Trust Regimes generally give more effect to personal choice in this context. Moreover, they may permit clients to enter into market transactions at lower cost (i.e., because they essentially allow greater leverage), and this may lead to greater market liquidity. For example, a client may choose to permit an Investment Firm to encumber, re-hypothecate, or otherwise use securities in exchange for lower margin or other transaction fees.

- **Holding Client Assets at third-party affiliates**. Most Regimes permit an Investment Firm to hold Client Assets at third-party affiliates.

  - **Positive aspects**. Permitting an Investment Firm to hold Client Assets at third-party affiliates may have certain administrative efficiencies, the benefits of which may be shared with clients.

  - **Negative aspects**. As the 1996 Report notes, "[w]hile there is a widespread commercial practice by investment firms of using related parties for the safekeeping of client assets, the risk to clients through intra-group contagion can be increased."[16]

    - Experience with Lehman (and, earlier, with Enron) suggests that, if an Investment Firm within a corporate group becomes insolvent, it poses a contagion risk to its affiliates such that, due to a loss of confidence by counterparties or lenders, the affiliates are highly likely to become insolvent at the same time or shortly thereafter, posing significant complications with distribution or transfer. This experience is in contrast to cases where Client Assets are lodged with an independent, third-party custodian, which is far less likely to suffer an insolvency contemporaneously with the depositing firm.

    - More generally, there are concerns that an Investment Firm, due to inherent conflicts of interest, may not be able to use the same degree of due diligence when selecting an affiliated third party as custodian as it would when selecting an unaffiliated third party as custodian.

- **Waiver of Client Asset protections**. Most Regimes do not permit clients of an Investment Firm, regardless of their level of financial sophistication, to, in such terms, waive protections of Client Assets. However, as noted above, most Custodial Regimes and Trust Regimes permit an Investment Firm to encumber, rehypothecate, or otherwise use client Securities with written client consent. If an Investment Firm becomes insolvent, then the Regimes may not extend certain Client Asset protections to such Securities.

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16 Ibid. at p. 20.

- **Positive aspects of permitting waivers**. As the 1996 Report observes, "[i]f an investment firm is not required to provide asset protection to professional clients, it can reduce its operational costs accordingly. As long as such cost reductions are reflected in reduced costs for investors, there can be a benefit as well as a cost attached to a lack of client protection."[17]

- **Negative aspects of permitting waivers**. As the 1996 Report states, "[i]f client asset protection is deemed to be an important factor in overall market confidence and integrity and in facilitating the transition of funds from and the isolation of risk to a failing firm, some might argue that such protection should apply regardless of the status of the client."[18]

[17] Ibid. at p. 24.

[18] Ibid.

Chapter 4 Observations on Post-Insolvency Treatment of Client Assets

Set forth below are certain observations on the manner in which participating Regimes treat Client Assets after the insolvency of an Investment Firm.

- **Regulator Control over Insolvency**. Regulators have different degrees of control over the insolvency of an Investment Firm. In certain Regimes, regulators are responsible for (i) placing an Investment Firm into insolvency, (ii) appointing an Administrative Officer, and (iii) supervising such Administrative Officer. In other Regimes, regulators play a less direct role in the insolvency of an Investment Firm (e.g., they may coordinate with, but not supervise, the Administrative Officer). In still other Regimes, regulators play no role in the insolvency of an Investment Firm.

- **The Administrative Officer**

    - **Expertise.** Certain Regimes require that an Administrative Officer for an Investment Firm have prior expertise in handling the insolvency of an Investment Firm. Other Regimes only require that an Administrative Officer meet certain character and creditworthiness qualifications.

    - **Guidance**. Certain Regimes provide detailed statutory, regulatory, and practical guidance on the manner in which the Administrative Officer must handle the insolvency of an Investment Firm. Other Regimes do not provide guidance specific to the insolvency of an Investment Firm.

    - **Liability**. Under certain Regimes, an Administrative Officer has full personal liability for any losses to creditors resulting from any violations of the Regime. Under other Regimes, an Administrative Officer is liable only for gross negligence or willful misconduct.

    - **Discussion**

        - In order to (i) better protect clients of Investment Firms and (ii) maintain the integrity and efficiency of the financial markets, a Regime may wish to ensure that the Administrative Officer has prior expertise in the insolvency of an Investment Firm and can access appropriate guidance regarding such insolvency. Such an Administrative Officer would be more likely to prioritize the expeditious transfer or distribution of Client Assets, and would be better equipped to effectuate such transfer or distribution.

        - If a Regime wishes to facilitate expeditious transfer or distribution of Client Assets, then such Regime may wish to consider subjecting the Administrative Officer to a less strict standard of liability, so the Administrative Officer would have less incentive to freeze accounts containing Client Assets until the Administrative Officer could verify beyond question that such transfer or distribution is completely correct (e.g., that no proprietary assets have been commingled in such accounts).

- **Transfer**

    - In general, the expeditious transfer of Client Assets from an insolvent Investment Firm to a solvent Investment Firm minimizes financial disruption to clients and enhances systemic stability.[19]

    - As mentioned above:

        - Most Trust Regimes do not have an overarching arrangement to facilitate the transfer of Client Assets. However, such Regimes will permit and encourage such transfer on a case-by-case basis, with client consent.

        - Most Custodial Regimes do not have an overarching arrangement to facilitate the transfer of Client Assets. Certain Custodial Regimes do not permit such transfer.

        - Agency Regimes encourage the bulk transfer of Client Assets, favoring speed, rather than conducting a customer-by-customer calculation. Such Regimes have statutory and regulatory frameworks that support such transfer.

    - **Discussion**

        - A case-by-case transfer of Client Assets with client consent has the advantage of maximizing personal choice. For example, one client may choose to transfer its Client Assets to one Investment Firm, whereas another client may choose to transfer its Client Assets to another Investment Firm.

        - However, in a situation where the financial status of an Investment Firm is deteriorating rapidly, a case-by-case transfer of Client Assets with client consent may not be feasible. In such a situation, a bulk transfer may be necessary. Moreover, clients of an insolvent Investment Firm may benefit from having their Client Assets transferred to a solvent Investment Firm with which they might otherwise not choose to do business, with a later opportunity to onward transfer to another Investment Firm of the client's individual choice.

        - A bulk transfer is also advantageous in a situation where an Investment Firm holds certain Client Assets and deposits other Client Assets with a clearing organization for derivatives, which collects Client Assets on a net basis.

- **Avoidance of Preferential Transfers or Distributions**. Most Regimes do not permit the Administrative Officer to avoid preferential transfers or distributions of Client Assets occurring prior to the insolvency of the Investment Firm.

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[19] Of course, the expeditious distribution of Client Assets from an insolvent Investment Firm also minimizes financial disruption to clients and enhances systemic stability. However, this Chapter of the report focuses on transfer because SC3 included a specific question on transfer in the Survey.

- For example, in Trust Regimes and Custodial Regimes, the Administrative Officer has no legal basis for such avoidance, as clients retain unambiguous ownership of segregated Client Assets.

- **Discussion**

  - Legal certainty on the irrevocable nature of such transfers enhances systemic stability.

  - However, if there is a shortfall in Client Assets, permitting clients to keep Client Assets, in excess of their appropriate share of such assets, that were transferred or distributed prior to the insolvency of the Investment Firm may be inequitable to clients that did not receive similar transfers or distributions. Specifically, the latter clients would bear a greater share in the shortfall due to circumstances not within their control.

- **Compensation Scheme**. Most Regimes have a scheme to compensate clients for losses resulting from the insolvency of the Investment Firm.

  - **Discussion**

    - Such schemes often exclude institutional investors or, where institutional investors are included, provide compensation in amounts that would only be significant to retail investors. As set forth in Row 21 of the chart in Appendix A, maximum amounts of compensation ranged from approximately US$15,000 to US$1,000,000.

    - Therefore, such schemes should be seen as complementary to, but not a substitution for, strict segregation requirements.

- **Loss Allocation**. In general, if there is a shortfall in Client Assets, Regimes tend to distribute such Client Assets on a *pro rata* basis.

  - As mentioned above, Trust Regimes and Custodial Regimes tend to divide Client Assets into (i) different asset classes and (ii) different instruments within one asset class. Such Regimes would then distribute Client Assets on a *pro rata* basis only to (i) clients who made contributions to such asset class or (ii) clients who deposited a specific type of instrument.

    - For example, if Client A contributed cash, whereas Clients B and Client C contributed a certain type of Securities, then (i) Client A will not share in a distribution of such Securities, and (ii) Clients B and C will share *pro rata* in such distribution.

  - **Discussion**

    - As mentioned above, such loss allocation increases the likelihood that a client would receive far less than its claim, when large shortfalls exist in

specific asset classes or between different instruments in one asset class, due to reasons not within client control.

Chapter 5 Conclusion

This report, both in the taxonomy and analysis presented above, and in the summaries and detailed responses to questions presented in Appendices A and B, should enhance transparency and the ability of regulators and market participants to understand the methods (and positive and negative aspects of such methods) by which the responding Regimes protect Client Assets, both before and after the insolvency of an Investment Firm.

Glossary

(1) **"Administrative Officer"** refers to the person or entity who is appointed, whether by a court, regulator, creditors, the Investment Firm itself, or otherwise, to assume control of or power over a bankrupt or insolvent Investment Firm. This term includes administrators, debtors in possession, receivers, liquidators, trustees, and similar titles.

(2) **"Client Assets"** refers collectively to Positions, Securities, and Client Money:

- **"Positions"** are contractual rights and obligations arising from transactions entered into by an investment firm on behalf of its clients, including mark to market accruals arising from the change in value of futures, options and/or other derivatives positions;

- **"Securities"** are defined to incorporate securities as that term is defined or understood in each responding jurisdiction; and

- **"Client Money"** refers to funds owed to or held on behalf of clients by an investment firm, and may include margin collateral associated with client positions (both existing and potential), income relating to an investment such as dividends or interest, proceeds of the liquidation of client securities and/or positions, and funds in excess of required margin.

(3) **"Investment Firm"** means an intermediary that holds Client Assets and is engaged in the business of managing client accounts, which could include, without limitation: executing orders on behalf of others, dealing in or distributing Securities (including carrying derivatives positions). In jurisdictions where banks are broadly permitted to engage in such a business, this term includes banks to the extent they are providing such services.

(4) **"Omnibus Account"** means an Investment Firm's account with a third party in which Client Assets are maintained separate from the firm's assets, but are held in the aggregate instead of in accounts designated for individual clients.

(5) **"Regime"** refers to statutes, regulations, rules of exchanges, clearing organizations and other self-regulatory bodies, or other legally binding requirements.

Appendix A - Client Asset Protection Questionnaire Summary

	Australia	**Brazil**
Pre-Insolvency Questions		
Does the Regime require the Client Assets of each client to be placed in an individual account?	No. An Investment Firm may hold Client Assets in an omnibus account or an individual account. The regulator has exempted certain banks from the obligation to hold Client Assets in segregation for wholesale clients (*i.e.* , sophisticated investors). Also, there is no statutory requirement to segregate client positions. The treatment of positions is subject to contractual negotiation between clients and the Investment Firm.	Yes.

How often does the Regime require the Investment Firm to reconcile its books and records with its segregation requirement?	(i) *Investment Firms that are Members of the Australian Securities Exchange ("ASX") or the Australian Clearing House ("ACH").* Daily, by 7:00 PM of next business day. Investment Firm must compare (i) the aggregate balance that it holds in client accounts (whether trust or segregated) with (ii) the corresponding balance shown in internal records. (ii) *Investment Firms that are not Members of ASX or ACH.* No specific requirement, although must maintain "prudent reconciliation processes."	Daily, by the end of the relevant business day.
Does the Regime permit the Investment Firm to temporarily hold less Client Assets than the amount specified in the segregation requirement?	(i) *Investment Firms that are Members of ASX or ACH.* No, an Investment Firm must notify ASX or ACH within two (2) business days if reconciliation reveals deficiency in Client Assets. (ii) *Investment Firms that are not Members of ASX or ACH.* No specific requirement.	No. An Investment Firm must make good any deficiency in Client Assets as soon as such deficiency is discovered. Such deficiency would be treated as a violation of the segregation requirement, although the regulator would retain discretion over whether to initiate an enforcement action.

If a client has a debit balance, does the Regime permit the Investment Firm to deduct such balance in determining its segregation requirement?	(i) No, with respect to Client Assets supporting Securities transactions. An Investment Firm can offset credit and debit balances for the same client. It cannot offset credit and debit balances across different clients. (ii) No, with respect to Client Assets supporting futures transactions. If a client does not satisfy performance bond or settlement obligations, an Investment Firm must deposit an amount equal to the deficiency into the relevant client account.	Yes. With respect to a securities account, the Investment Firm would ask the individual client to pay (i) the amount that he borrowed from the Investment Firm to purchase on margin and (ii) the difference between the market value of the security and the purchase price of the security. With respect to a derivatives account, the Investment Firm would ask the individual client to pay (i) the initial performance bond and (ii) variation margin.
Does the Regime permit the Investment Firm to treat different types of Client Assets (*i.e.* , cash and securities) as fungible?	No.	No. Under the Regime, the Investment Firm would always hold Securities at a third-party custodian. The Investment Firm, however, may itself temporarily hold Client Money. If the Investment Firm experiences insolvency, there may be different consequences for such Securities and Client Money.
Does the Regime permit the Investment Firm to maintain its own assets in the Client Account as a "buffer" against violating segregation requirements?	An Investment Firm is not permitted to deposit proprietary funds into a client account. However, the Investment Firm may delay withdrawal of fees and commissions, thereby creating a "buffer" in the client account to "minimize client impact for errors and for operational efficiency."	No.

Does the Regime permit the Investment Firm to encumber, re-hypothecate, or otherwise use Client Assets?	(i) Yes, with respect to client Securities. (a) The Regime does not limit the right of a client to consent to re-hypothecation of client Securities in a custody or prime brokering agreement. The regulator would deem such Securities to have been transferred outright to the Investment Firm, and Client Asset protections would not apply. (b) If a client does not consent to such an outright transfer, then the Investment Firm may pledge client Securities only to the extent of client obligations to the Investment Firm. (ii) Yes, with respect to Client Money. (a) The Regime permits an Investment Firm to deem, in an agreement governing OTC derivatives, all performance bond or variation payments due and payable at the opening of a position. The Investment Firm could then withdraw such performance bond or payments from the client account, and Client Asset protections would not apply. (b) Otherwise, an Investment Firm may only make restricted investments with Client Money.	Yes, with client authorization.
Does the Regime permit the Investment Firm to hold Client Assets with a third-party affiliate?	Yes. If an Investment Firm is a bank, it may choose to hold Client Assets itself.	Yes.

Does the Regime permit clients to waive any of the Client Asset protection requirements?	No. However, the following practices may cause Client Assets to lose protection if the Investment Firm experiences insolvency: (i) the exemption for certain banks from the obligation to hold Client Assets in segregation for wholesale clients (i.e., sophisticated investors); (ii) re-hypothecation of client Securities with client consent and pledging of client Securities to the extent of client obligations to the Investment Firm; and (iii) the structuring of client agreements to deem performance bond or variation payments due and payable upon the opening of an OTC derivative position. Upon withdrawal, such performance bond or payments no longer constitute Client Assets.	No. However, because an Investment Firm is permitted, with client consent, to re-hypothecate or otherwise use Client Assets, such Client Assets may become unavailable to the client upon the Investment Firm experiencing insolvency.
Under the Regime, what actions may the Regulator take to protect the Clients Assets of an Investment Firm in distress?	The regulator may apply to the court for a restraining order against the Investment Firm with respect to Client Assets if (i) the regulator reasonably believes that there is a deficiency in Client Assets or (ii) the Investment Firm has unreasonably refused to apply (or unduly delayed in applying) Client Asset protections. The regulator may also apply to the court for interim freezing orders.	The regulator may adopt administrative measures, including restriction of activities, where an Investment Firm experiences a financial situation that may compromise creditors. If the Investment Firm is a member of an exchange or clearinghouse, such entity may act as assistants to the regulator.

Post-Insolvency Questions		
Under the Regime, how does an Investment Firm enter the status of "insolvent," "bankrupt," or the equivalent?	In general, either the Investment Firm or its creditors may file a petition for liquidation (*i.e.* , court liquidation, creditors' voluntary liquidation, and members' voluntary liquidation). Only the Investment Firm may file a petition for reorganization (*i.e.* , voluntary administration). The Corporations Act 2001 apply to Investment Firms just like any other company.	The regulator may place an Investment Firm into insolvency, either on its own initiative or at the request of the directors of the Investment Firm.

Under the Regime, what is the process of appointing an Administrative Officer?	(i) *Court Liquidation* . In general (Queensland is different), the court would appoint the Administrative Officer from a list of qualified practitioners. (ii) *Members' Voluntary Liquidation* . The directors of the Investment Firm would choose the Administrative Officer, although members may resolve to appoint an alternative. (iii) *Creditors' Voluntary Liquidation* . The directors of the Investment Firm would choose the Administrative Officer, although creditors may resolve to appoint an alternative. (iv) *Voluntary Administration* . The party seeking to place the Investment Firm into administration would choose the Administrative Officer. In cases (ii), (iii), and (iv), the Administrative Officer would be a Registered Liquidator with the regulator, subject to educational, personal, and practice requirements.	The regulator selects the Administrative Officer, who usually is a current or retired employee of the regulator, with relevant experience.
What guidance is available to such Administrative Officer?	Statute (*i.e.* , the Corporations Act 2001); common law decisions; Insolvency Practitioners Association of Australia Code of Professional Practice; Australian Accounting Standards; and real property legislation of the individual States. There is no guidance specific to Investment Firms.	Statute (*i.e.* , Law n. 6.024)
What is the standard of liability for such Administrative Officer?	Liability for negligence.	Negligence.

How is the regulator involved in the insolvency of an Investment Firm, including in the return of Client Assets?	The regulator continues to supervise the Investment Firm, although it generally does not involve itself in the liquidation of the Investment Firm and the distribution of Client Assets. Nevertheless, as mentioned above, the regulator may petition the court for a restraining order or an interim freezing order with respect to Client Assets, in each case, under specific circumstances.	The regulator supervises the Administrative Officer.
Does the Regime facilitate or encourage the transfer of Client Assets from an insolvent Investment Firm to a solvent Investment Firm?	The Regime does not provide an overarching arrangement for the transfer of Client Assets. However, if the Investment Firm is an ASX member or a member of the Australian Settlement and Transfer Corporation ("ASTC"), then ASX, ACH or ASTC rules may permit the transfer of Client Assets to another participating Investment Firm.	Yes, with client consent.
Under the Regime, are clients at risk of having to return Client Assets (or the value thereof) that were distributed prior to the Investment Firm becoming insolvent?	No, because the Investment Firm holds Client Assets in trust.	Only if the Investment Firm distributed Client Assets by mistake.

Does the Regime have a scheme to compensate clients for losses suffered due to the insolvency of the Investment Firm?	Yes. There are two compensation schemes available to cover losses associated with an Investment Firm that is a member of ASX -- (i) the National Guarantee Fund and (ii) the ASX Futures scheme. The former scheme focuses on losses incurred due to the insolvency of the Investment Firm, whereas the latter scheme is essentially a fidelity fund for retail investors. Neither scheme places a legal limit on maximum individual recovery, although the aggregate size of the scheme sets a practical limit (further practical limits are applicable with respect to individual claims for Securities). However, the compensation scheme generally does not cover claims relating to (i) exchange-traded options or (ii) OTC derivatives. It also does not cover certain clients (*e.g.* , affiliates of the Investment Firm) or financing transactions between clients and the Investment Firm.	Yes. R$60,000 (US$35,000) for clients of firms with access to the exchange.
Does the Regime treat clients differently, in the event of the insolvency of an Investment Firm, based on permissions that such clients granted to the Investment Firm prior to such insolvency?	Yes. Please see above for specific practices that may cause Client Assets to lose protection if the Investment Firm experiences insolvency.	Yes. In the event of Investment Firm insolvency: (i) Client Assets that the Investment Firm has re-hypothecated or otherwise used may not be available to clients; and (ii) Client Money that the Investment Firm has not moved to a segregated account in a third-party depository may not be available to clients.

If there is a shortfall (*i.e.*, client claims exceed Client Assets), then how does the Regime allocate such loss?	(i) *Client Money*. *Pro rata* distribution, with clients becoming unsecured creditors with respect to the shortfall. (ii) *Client Securities*. If the Administrative Officer could trace the shortfall to a specific client, then that client would become an unsecured creditor whereas the remaining clients would receive the Securities that they are due. If the Administrative Officer cannot perform the abovementioned tracing, then clients would share *pari passu* each pool of Client Assets of the same type as that they deposited.	*Pro rata.*

Canada	**China**
(i) No, with respect to fully-paid or excess margin client Securities, which may be (a) registered in client name and held in trust on a client by client basis *OR* (b) registered in the name of the Investment Firm and segregated on a bulk basis. (ii) No, with respect to Client Money constituting a "free credit balance."	(i) In China, an Investment Firm is not a bank entity. (ii) *Client Money* . An Investment Firm must maintain an individual account for Client Money with a third-party depository, on their respective books and records. However, the Investment Firm may actually hold such Client Money in an omnibus account. (iii) *Client Securities* . An Investment Firm must hold client Secrrities in a individual account with a central securities depository.

(i) Twice weekly (on days that the Investment Firm determines), with respect to the Securities that the Investment Firm must segregate on behalf of clients. (ii) Once weekly (on a day that the Investment Firm determines), with respect to the "free credit balance" that the Investment Firm must segregate on behalf of clients. (iii) In the case of both (i) and (ii), daily review of internal compliance with the applicable segregation requirement. (iv) In the case of (i), monthly reconciliation of internal records with external custodial records.	Daily. (i) For *Client Money* , by the end of the business day. (ii) For *Client Securities* , by noon of the next business day.
Yes, if the Investment Firm does not knowingly cause such a deficiency. If an Investment Firm discovers a deficiency in segregated Securities, then it must compensate for such deficiency by the next business day. If an Investment Firm discovers a deficiency in "free credit balance" then it must "expeditiously take the most appropriate action to rectify the deficiency."	No. If the Investment Firm discovers a deficiency in Client Assets , then the Investment Firm must immediately compensate for such deficiency. Furthermore, the Investment Firm must immediately report such deficiency to the regulator.

Yes. An Investment Firm can offset credit and debit balances across different clients.	No. An Investment Firm neither can offset credit and debit balances for the same client nor across different clients.
No, with respect to the segregation requirement. However, as further described below, different types of Client Assets are considered fungible when constituting the client bankruptcy pool.	Client Money is not fungible with Client Securities.
(i) No, with respect to Securities registered in client name and segregated in individual accounts. (ii) No, with respect to Securities registered in the name of the Investment Firm and segregated on a bulk basis. However, under such a segregation Regime, an Investment Firm may move proprietary Securities into a segregated account in satisfaction of a segregation requirement. (iii) No, with respect to "free credit balances."	No. An Investment Firm is not permitted to commingle proprietary assets with Client Assets in individual segregated accounts or omnibus segregated accounts.

(i) Yes, with respect to margin Securities, which the Investment Firm is not required to hold in segregation. (ii) Yes, with respect to "free credit balances" that are up to the sum of (a) eight times the net allowable assets of the Investment Firm and (b) four times the early warning reserve of the Investment Firm, provided that the Investment Firm discloses its right of use. (iii) No, with respect to fully-paid or excess margin client Securities.	No. An Investment Firm cannot use Client Assets even with the relevant client's consent.
Yes, provided that the third party affiliate also qualifies as an acceptable securities location.	Yes. Once an Investment Firm has been placed into insolvency, the regulator may encourage transfer client assets to another solvent Investment Firm on client voluntary bases.

No, except in the following exceptional circumstance: A client waiver may be obtained on a transaction by transaction basis by a Dealer Member allowing it to hold customer securities at a foreign securities location when the governing laws of the country restrict the movement of security investments out of that country, and it is not possible to arrange a prescribed written custodial arrangement for such securities. The customer must acknowledge the risks associated with holding such securities at the specified foreign custodian on behalf of the Dealer Member firm in that country, and provide a written waiver holding the Member harmless in the event of loss of such securities by the foreign custodian.	No.
The Investment Industry Regulatory Organization of Canada (IIROC), a self-regulatory organization, has established early warning thresholds. If an Investment Firm triggers such thresholds, it will become subject to restrictions on its activities and more frequent reporting obligations. If an Investment Firm becomes capital deficient, then it must either correct the situation within two (2) business days or face the suspension of its IIROC license. In general, such suspension would lead to the initiation of insolvency proceedings against the Investment Firm.	The regulator may: (i) restrict the ability of the Investment Firm to undertake certain activities; or (ii) petition for an Investment Firm to be wound-up.

In general, IIROC will suspend the Investment Firm, and will notify the Canadian Investor Protection Fund (CIPF) of the suspension. CIPF will ask the court to appoint a trustee in accordance with Part XII of the Canadian Bankruptcy and Insolvency Act. Part XII of the Canadian Bankruptcy and Insolvency Act is specific to Canadian Securities Firms.	An Investment Firm may enter into compulsory administrative liquidation if the regulator finds: (i) the administrative irregularities or legal violations exceptionally serious ; (ii) the operational risks exceptionally serious; and (iii) the liabilities exceed assets.

In general, CIPF will ask the court to appoint a trustee from one of the major accounting firms in Canada, which must be licensed, free from conflicts with the relevant Investment Firm, and experienced with administering Part XII of the Canadian Bankruptcy and Insolvency Act and with the Canadian investment industry.	If the regulator petitions for a compulsory winding-up , then it may choose an accountant firm or law firm to act as provisional liquidator through certain procedures.
Statute (*i.e.* , Part XII of the Canadian Bankruptcy and Insolvency Act); CIPF Insolvency Procedures Manual; CIPF direction.	Statute; direction from the regulator.
Liability for gross negligence or willful misconduct.	Liability for negligence, default, breach of duty, or breach of trust.

IIROC is not involved in the insolvency of the Investment Firm. Rather, CIPF assumes responsibility for administering such insolvency.	The regulator continues to supervise the Investment Firm, but does not participate directly in the return of Client Assets. Rather, the Investment Protection Fund coordinates with the liquidator to determine the client claims that the Investment Firm would have to pay.
Yes, CIPF and the trustee will attempt to find another Investment Firm that is willing to accept the transfer of Client Assets. To facilitate transfer, CIPF will coordinate with the trustee (rather than each client) to determine the amount of shortfall. CIPF will then fund such shortfall, subject to coverage limitations. Such funding generally permits the trustee to transfer Client Assets in full.	Yes. Once an Investment Firm has been placed into insolvency, the regulator may encourage the transfer of Client Assets to another solvent Investment Firm on client voluntary basis. Before the Investment Firm enters into insolvency, the regulator may approve the transfer of the entire brokerage business of the Investment Firm at risk to another Investment Firm.
Only if distributions of Client Assets were complicated by conflicts of interest or inside information.	No, because Client Assets belong to clients and not the Investment Firm. Also, if a client withdraws Client Assets before the Investment Firm becomes insolvent, such withdrawal would constitute a distribution by the Investment Firm to the client in the ordinary course. Distributions by the Investment Firm in the ordinary course are not subject to avoidance.

Yes, up to CDN$1 million (approximately USD$991,000). CIPF does not cover certain types of clients (*e.g* ., a general partner or director of the insolvent Investment Firm). It also does not cover financing transactions between the client and the Investment Firm.	Yes, the securities investor protection fund is available to compensate clients for losses due to the insolvency of the Investment Firm.
No, because segregation requirements do not vary based on client permission pre-insolvency.	No, because segregation requirements do not vary based on client permission pre-insolvency.

Pro rata. "The bankruptcy act creates a customer pool of assets that is distributed to all customers. The pool includes all cash, securities whether belonging to customers or the firm and whether segregated or not segregated and various other assets. Customers share in that pool based on their client net equity so there is no tracing of lost property to specific clients."	*Client Money.* Distribution depends on the applicable compensation scheme.

France	**Germany**
(i) In France, the market regulator (i.e., the Autorité des marchés financiers) is responsible for the protection of client Securities, whereas the prudential regulator, (*i.e.* , the Autorité de contrôle prudentiel or ACP) is responsible for the protection of Client Money. (ii) *Client Money.* If an Investment Firm is a bank and chooses to act as custodian for Client Money, then it is not subject to a segregation requirement with respect to such Client Money. If an Investment Firm is not a bank, then it must hold Client Money in a segregated account, whether individual or omnibus. (iii) *Client Securities* . Regardless of whether an Investment Firm is a bank, it must ensure that the central securities depository of which it is a member segregates client Securities from proprietary assets, on at least an omnibus basis, and it must itself internally hold Client Securities in a separate, individual account for each client.	Due to the specific regulations in Germany, regulations must be differentiated between Client Money and Client Securities. (i) In Germany, the majority of Investment Firms are banks. Therefore, such Investment Firms need not segregate Client Money. (ii) If a client chooses individual safekeeping, then its Investment Firm must act as custodian for its client Securities. Such Investment Firm must place such client Securities in an individual segregated account. (iii) If a client does not choose individual safekeeping, then an Investment Firm may deposit client Securities in an omnibus segregated account with a third-party depository. With client consent, the Investment Firm may (a) commingle client Securities with proprietary assets at the third-party depository or (b) permit the third-party depository to commingle client Securities with its own assets.

Regularly (*e.g.* , on a daily basis), as regards both Client Securities and proprietary securities, with third parties' records. Although an Investment Firm is required to maintain books and records showing, at any given time, the amount of Client Money and Securities that it must segregate for each client, the Investment Firm is permitted to perform reconciliation on an aggregate basis, but proprietary assets must be held separately from clients' assets (this does not hold for Client Money where the firm is a bank).	As far as Investment firms are banks, the Safe Custody Act requires these as custodians to reconcile their books and records with the requisite requirements without delay; segregation requirements for securities tradings firms are also to be met without delay, see section 34a (1) sentence 1 Securities Trading Act. A securities account statement must be issued to each client at least once a year, usually in January. The client must officially accept the securities account statement.
No. A deficiency in Client Money or client Securities is considered a violation of the Regime. The client would have recourse to the Securities Deposit Guarantee Fund.	No, because the Investment Firm "is required to hold the specific securities deposited by the clients," unless the client agrees to certain exceptions. If the Investment Firm discovers a deficiency in client Securities, such deficiency would be treated as a violation of the segregation requirement. The affected client would have a claim against the Investment Firm for damages.

No. An Investment Firm can offset credit and debit balances for the same client. It cannot offset credit and debit balances across different clients. Moreover, a securities account is not permitted to have a debit balance.	No, as generally the Investment Firm cannot use Client Assets of one client for meeting obligations of other clients. However, contractual obligations may lead to rights in rem of the Investment Firm towards the assets of one client.
No. (i) Client Money is not fungible with client Securities. (ii) In general, a specific client Security would only be fungible with a Security that has the same characteristics.	No. (i) Client Money is not fungible with client Securities. (ii) In general, an Investment Firm "is required to hold the specific securities deposited by the clients." However: (a) A client may consent to a "Deposit with the Right to Change," which means that the Investment Firm could return to clients Securities of the same type, rather than the exact Securities constituting the deposit. (b) A client may also consent to passing full title to the Securities to the Investment Firm or the third-party depository. Such Securities would cease to be Client Assets, and would no longer be subject to
No.	No. An Investment Firm is not permitted to commingle proprietary assets with client Securities in individual segregated accounts or omnibus segregated accounts.

Yes. (i) An Investment Firm may only invest Client Money in "qualifying money market funds." It may not use Client Money in any other manner. (ii) An Investment Firm may re-hypothecate or otherwise use client Securities with client consent. Retail clients must give such consent in writing. If client Securities are being held on an omnibus basis, then the Investment Firm may re-hypothecate or use such Securities only if: (i) all relevant clients have consented or (ii) the Investment Firm implements systems and controls to easily differentiate between those clients that have consented and those that have not.	Yes. (i) As mentioned above, a client may consent to passing full title to Securities to the Investment Firm or the third-party depository. Such Securities would cease to be Client Assets, and would no longer be subject to protection. (ii) A client may also consent to the Investment Firm pledging Securities to another depository to secure a loan that such depository extended (indirectly through the Investment Firm) to the client. (iii) Finally, a client may consent to the Investment Firm pledging Securities to support the liabilities of the Investment Firm to a regulated stock exchange (or clearinghouse), if the client has liabilities to the Investment Firm in the exact same amount.
Yes.	Yes.

No. However, because an Investment Firm is permitted, with client consent, to re-hypothecate or otherwise use Client Assets, such Client Assets may become unavailable to the client upon the Investment Firm experiencing insolvency. In addition, when securities are held abroad for the account of a professional investor, the client and the custodian may agree that responsibilities are shared.	No. However, a client may consent to passing full title to Securities to the Investment Firm or the third-party depository. Such Securities would cease to be Client Assets, and would no longer be subject to protection.
The ACP may request the appointment of a provisional administrator or authorize the commencement of reorganization or liquidation proceedings against an Investment Firm that has become insolvent.	(i) If the Investment Firm fails to meet minimum capital requirements, then the regulator may revoke the banking or investment services license of the Investment Firm. (ii) If the Investment Firm fails to meet funding adequacy ratios, then the regulator may prohibit or limit withdrawals from affiliates, the distribution of profits, or the granting of loans. (iii) If the Investment Firm appears insolvent, then the regulator may take temporary measures to avert danger, such as issuing directions to management, prohibiting deposits and loans, and appointing supervisors. (iv) in case of danger of a collapse of a bank and when such a collapse is expected to have serious negative impact on other financial market actors or the financial market actors or the financial market, the regulator may transfer client assets from the endangered bank to a solvent bank within the rules of a restructuring regime.

(i) Provisional Administrator. Either the Investment Firm or the ACP may request the appointment of a provisional administrator. (ii) Reorganization or Liquidation. The ACP must authorize the commencement (by either the Investment Firm or creditors) of reorganization or liquidation proceedings against an Investment Firm that has become insolvent.	The directors of the insolvent investment firm have the obligation to inform the regulator if the investment firm becomes insolvent. Only the regulater may file a petition for insolvency with the relevant district court.

The ACP selects the Administrative Officer in both a provisional administration and a reorganization or liquidation.	The court appoints - after hearing the regulator - the insolvency administrator, who must "be independent and possess adequate experience."
Statute.	Statute (*i.e.* , the German Insolvency Code).
Strict liability for misconduct.	Liability for the failure to act with the diligence of a scrupulous insolvency administrator.

As mentioned above, the ACP may request the appointment of a provisional administrator or authorize the commencement of reorganization or liquidation proceedings against an Investment Firm that has become insolvent. In addition, the ACP may seek intervention from the Securities Deposit Guarantee Fund, once it becomes clear during provisional administration that the Investment Firm does not have sufficient securities to meet all client claims.	The regulator continues to supervise the Investment Firm, but is not involved in the insolvency proceedings themselves of an Investment Firm after the petition has been granted. However, pursuant to section 5 (1) Deposit Guarantee and Investor Compensation Act, BaFin determines if the insolvency constitutes a compensation event under the Act.
The Regime does not provide an overarching arrangement for the transfer of Client Assets. Work is being conducted on this issue.	The Regime generally focuses on returning Client Money and client Securities to clients. Similarly, Client Positions are liquidated and valued. However, under the provisions of the Restructuring Act, Client Assets may be transferred from an endangered bank to a solvent bank. It covers the cases of such a transfer with and without client consent.
Yes. "The distribution of prior debts to clients before the beginning of a collective bargaining is prohibited. In principle, this distribution is to be null and void. So, the clients are not protected from having to return client assets."	No. As long as the client has not agreed to transfer full title of its Securities to either the Investment Firm or the third-party depository, then such Securities belong to the client, whether held in an individual or omnibus segregated account.

Yes, for retail investors only. Limited to €70,000 (approximately US$93,000). These limits are applicable separately for Client Money and Client Securities (*i.e.* , up to €140,000 for each client).	Yes, a client may be able to claim compensation under the Deposit Guarantee and Investor Compensation Act. Additionally, a client may be able to claim compensation under optional schemes, such as the Deposit Protection Fund of German Banks. Such compensation is limited to (i) € 50,000 (approximately US$64,000) of deposits of Client Money or (ii) 90% of investment losses + € 20,000 (approximately US$25,000).
(i) No, with respect to Client Money. (ii) No, with respect to client Securities. If there is a shortfall in a specific type of client Securities (*e.g.* , caused by the Investment Firm re-hypothecating such client Securities), then all clients (whether they consented to such re-hypothecation), would share *pro rata* in the remaining client Securities of the same type.	The treatment depends on whether or not the client agreed, prior to the insolvency proceedings, 1) to transfer full or partial title of its Securities to either the Investment Firm or the third-party depository or 2) gave the Investment Firm or the third-party depository other rights in rem.

Pro rata .	(i) Client Money: If the Money is held as a deposit with another firm, clients are entitled to the return of their money. If not, pro rata allocation; however compensation under the Deposit Guarantee and Investment Protection Act may apply (see answer to compensation scheme). (ii) Client Securities. Clients are entitled to the return of the exact Securities that they deposited. Therefore, if a client does not permit the Investment Firm to re-hypothecate or otherwise use its Securities, then such client should receive such Securities. If such Securities are not available because of the fraud or negligence of the Investment Firm, then the client is entitled to include such Securities in the claim that it has under the Deposit Guarantee and Investment Protection Act, as far as applicable (see answer to compensation scheme). Otherwise, pro rata allocation will be applicable.

Hong Kong	India
No. An Investment Firm may hold Client Assets in an omnibus account or an individual account.	Yes.

Daily. An Investment Firm must make sure that Client Assets are properly segregated from proprietary assets within one (1) day after receipt. Therefore, an Investment Firm must complete the reconciliation for the day of receipt (*e.g.,* Day X) before the end of the next day (*e.g.* , Day X+1). An Investment Firm must calculate the amount of Client Assets owed to each client, but may reconcile such amount to bank statements or custodial records on an aggregate basis.	Client accounts are required to be reconciled on a continuous basis.
No, if the Investment Firm identifies any deficiency in the amount of client money or client securities that should be held in a segregated account, it should compensate for the deficiency as soon as possible. Such deficiency is considered a violation of the segregation requirement, and the Investment Firm must notify the regulator within one business day.	[No. Any deficiency in this regard is required to be compensated to the investor.

No. An Investment Firm can offset credit and debit balances for the same client. It cannot offset credit and debit balances across different clients.	Yes.
No.	Yes, client assets are fungible between or within asset classes.
No. An Investment Firm must withdraw non-Client Assets from segregated client accounts.	No. The assets deposited by the client should be kept in a separate account distinct from the investment firm's account and from the account of any other clients.

Yes, with client authority but subject to certain restrictions, for example, an Investment Firm is forbidden to deal with Client Assets in accordance with a client's authority if to do so would be unconscionable, or would result in the Investment Firm or its affiliated company having the benefit or use of such assets except in the prescribed manner. If the client money is for meeting settlement or margin obligations to the Investment Firm that would fall due within 2 business days or is for repaying an existing indebtedness due to the firm (such as margin loan), the segregation requirement does not apply to the client money so received or held.	No. In the case of institutional clients, the assets may be maintained with the independent custodians.registered with
Yes.	No. In the case of institutional clients, the assets may be maintained with the independent custodians.registered with SEBI.

No. However, because an Investment Firm is permitted, with client consent, to re-hypothecate or otherwise use Client Securities, such Client Securities may become unavailable to the client upon the Investment Firm experiencing insolvency.	No.
The regulator may: (i) suspend or condition the license of the Investment Firm, if the regulator believes that such Investment Firm is unable to meet its minimum capital requirements; (ii) restrict (through a restriction notice) the ability of the Investment Firm to deal with Client Assets or proprietary assets; (iii) petition for an Investment Firm to be wound up, or (iv) apply to court for appointment of administrator to return client assets to the clients.	The regulator may pass necessary orders under SEBI Act, 1992 including imposing of certain restrictions to protect the interests of investors.

The regulator may petition for a compulsory winding-up of the Investment Firm, if the regulator believes that such petition would be in public interest. The Investment Firm, its administrator or its creditors may also petition for winding-up of the firm, like any other company.	An investment firm is declared a "defaulter" by the stock exchange.

If the regulator petitions for a compulsory winding-up , then it may nominate one or two CPAs to act as provisional liquidators. If no nomination is made by the regulator, the Official Receiver will act as the Administrative Officer upon the petition being granted. The Official Receiver generally contracts administration of the case to experienced private insolvency practitioners. The court may also appoint a liquidator at the time of making the winding up order. If the Investment Firm or creditors thereof petition, they nominate.	The regulator can seek the appointment of an administrative officer. There are also provisions under the Companies Act for liquidation or winding up of the companies.
Statute; rules; HKI-CPA Insolvency Guidance Notes. There is no guidance specific to Investment Firms.	The administrator can manage the affairs of the entity till further arrangements including distribution of assets among the investors. .
Liability for negligence, default, breach of duty, or breach of trust, (unless the court excuses such liability, either wholly or partially, because the Administrative Officer rendered honest and reasonable performance).	The administrator has to work in the interest of investors.

The regulator does not involve itself in the liquidation of the Investment Firm and the distribution of Client Assets but maintains an oversight of the progress of the return of client assets.	The regulator can freeze the accounts of the investment firms and ensure that the client assets are protected. The regulator can also seek the appointment of an administrator. The regulator can also cancel the investment firm's registration certificate.
The Regime does not provide an overarching arrangement for the transfer of Client Assets on a wholesale basis to another Investment Firm. In general, the Administrator would arrange return of client assets to the respective clients according to their instructions. The regulator may facilitate such transfer by explicitly permitting such transfer in the restriction notice issued to the Investment Firm in financial distress.	Yes, it can be done.
No, because the Investment Firm holds Client Assets in trust.	There are no such requirements.

Yes, for retail investors only. Limited to HK$150,000 (approximately US$ 19,000).	In case of stock exchanges, they have set up investor protection funds to compensate the investors subject to certain limits.
Yes, if certain clients permit re-hypothecation of Securities, or otherwise grants the Investment Firm a right of use, the availability of those assets for return to clients may be subject to fulfillment by the Investment Firm of its obligations to the third party.	It depends on facts and circumstances of each case.

If the Administrative Officer could trace the shortfall to a specific client, then that client wouldhave to bear the loss whereas the remaining clients would receive the Securities and Client Money that they deposited with the Investment Firm. If the Administrative Officer cannot perform the abovementioned tracing, then clients would share *pari passu* each pool of Client Assets of the same type (same stock line in the case of securities) as that they deposited.	The assets are distributed pro rata.

Italy	**Japan**
No. (i) An Investment Firm that is a bank may choose to act as custodian for Client Assets. Such Investment Firm must place Client Assets in individual accounts. (ii) An Investment Firm that is not a bank or an Investment Firm that is a bank but that does not choose to act as custodian for Client Assets may deposit Client Assets in an omnibus account with a third-party depository. (a) If the client is not a professional investor, then the Investment Firm must obtain written authorization from the client to such deposit, and the Investment Firm must ensure that Client Assets are used in accordance with the terms of a written client agreement. (b) If the client is a professional investor, then the Investment Firm may effect such deposit based on an oral agreement. (iii) In either case, the Investment Firm must have the ability to identify, at any point in time, the Client Assets (including positions) of each client.	Yes, except that Client Assets supporting Securities-related OTC derivatives traded with professional investors.

On a regular basis, depending on the frequency and volume of executed transactions. An Investment Firm is required to perform reconciliation (a) for each client and (b) in aggregate with respect to each asset class.	Daily, with respect to the amount of Client Assets that the Investment Firm owes (i) to each client and (ii) to all clients. However, the Investment Firm must value the Client Assets that it holds for all clients only once a week.
No. If an Investment Firm discovers a deficiency in Client Assets during reconciliation, then it must inform the regulator and the Bank of Italy. The affected client would have a claim against the Investment Firm for damages.	Yes. If an Investment Firm discovers that (i) the value of Client Assets that it holds for all clients is less than (ii) the amount of Client Assets that it owes to all clients, then the Investment Firm may compensate for the deficiency within three (3) business days after the discovery without being deemed in violation of the Regime.

No. An Investment Firm can offset credit and debit balances for the same client. It cannot offset credit and debit balances across different clients.	No. An Investment Firm can offset credit and debit balances for the same client. It cannot offset credit and debit balances across different clients.
No.	No.
No. If an Investment Firm discovers an excess in Client Assets, then it must inform the regulator and the Bank of Italy. Such excess would be considered an irregularity.	No.

Yes, with client consent. Retail clients must give such consent in written form.	Yes, with client consent.
Yes.	Yes.

No. However: (i) A client may consent to the Investment Firm re-hypothecating or otherwise using Client Assets. Therefore, such Client Assets may become unavailable to the client upon the Investment Firm experiencing bankruptcy. (ii) As described further below, regardless of whether a client has an individual account or an omnibus account, such client may be adversely affected by the choices of other clients (*i.e.* , to permit re-hypothecation) upon the Investment Firm becoming insolvent, because such client will share *pro rata* with other clients if the Investment Firm has a shortfall in Client Assets.	No. However, because an Investment Firm is permitted, with client consent, to re-hypothecate or otherwise use Client Assets, such Client Assets may become unavailable to the client upon the Investment Firm experiencing insolvency.
(i) The chairman of the regulator may, in situations of danger for clients or markets, appoint a provisional administrator to manage an Investment Firm for a maximum of sixty (60) days. Such provisional administrator must be a public official. (ii) In addition, both the regulator and the Bank of Italy may prohibit or restrict the Investment Firm from undertaking certain activities (including entering into new transactions).	If an Investment Firm has net capital less than ¥50 million (approximately US$ 0.5 million), then the regulator may rescind the registration of the Investment Firm or suspend the activities of the Investment Firm for no more than six (6) months. If the Investment Firm has a capital-to-risk ratio less than 100%, then the regulator may suspend the activities of the Investment Firm for no more than three (3) months, and may rescind the registration of the Investment Firm thereafter.

(i) The Ministry of Finance may place an Investment Firm into special administration or compulsory administrative liquidation upon petition from either the regulator or the Bank of Italy. The Ministry of Finance may initiate such proceedings even if the Investment Firm is not insolvent. (a) An Investment Firm may enter into special administration (for a max. of one (1) year) if (i) the regulator or the Bank of Italy (a) finds serious administrative irregularities or legal violations or (b) expects serious capital losses, or (ii) the Board of Directors, the shareholders (through extraordinary meeting), or the provisional administrator appointed by the regulator requests such administration. (b) An Investment Firm may enter into compulsory administrative liquidation if (i) the regulator or the Bank of Italy finds (a) the administrative irregularities or legal violations exceptionally serious or (b) the capital losses exceptionally serious, or (ii) the Board of Directors, the shareholders (through extraordinary meeting), the provisional administrator, the Administrative Officers of the special administration, or the ordinary liquidators request such liquidation. (ii) If the Investment Firm is insolvent, then the Administrative Officers (from the special liquidation or compulsory administrative liquidation), the creditors, or the public prosecutor is permitted to petition the Bankruptcy Court to declare such insolvency. Other than making such formal declaration, the Bankruptcy Court is not involved in the administration or liquidation of an Investment Firm. Rather, the Bank of Italy supervises such administration or liquidation. Therefore, the insolvency Regime applicable to an Investment Firm is different from the insolvency Regime applicable to other companies.	The Investment Firm (or, in certain circumstances, its creditors or stockholders) files a petition with the court.

The Bank of Italy appoints the Administrative Officer in a special administration or a compulsory administrative liquidation.	The court selects the Administrative Officer (who often is a lawyer).
Statute (*i.e.* , the Consolidated Banking Law); direction by the Bank of Italy. The Bank of Italy shall establish an oversight committee to monitor and assist the Administrative Officer.	Statute. There is no guidance specific to Investment Firms.
Personal liability for failure to follow directions from the Bank of Italy. The Bank of Italy must provide prior authorization for civil law actions against the Administrative Officer.	Liability for breach of duty of due care of a prudent manager.

The Bank of Italy continues to supervise the Investment Firm, and will direct the special administration or the compulsory administrative liquidation.	The regulator continues to supervise the Investment Firm, but does not participate directly in the return of Client Assets. Rather, the Investment Protection Fund coordinates with the Investment Firm to determine the client claims that the Investment Firm would most likely not be able to satisfy in full. The Investment Protection Fund would then pay such claims, up to the maximum level of coverage.
Yes, the Bank of Italy must authorize the transfer of Client Assets. Such transfer may occur at any stage of the special administration or the compulsory administrative liquidation, even before the Administrative Officer determines a statement of liability for the Investment Firm. In general, formalities relating to such transfer (*i.e.* , notification of clients) are streamlined.	The Regime does not provide an overarching arrangement for the transfer of Client Assets.
No, because Client Assets belong to clients and not the Investment Firm. Also, if a client withdraws Client Assets before the Investment Firm becomes insolvent, such withdrawal would constitute a distribution by the Investment Firm to the client in the ordinary course. Distributions by the Investment Firm in the ordinary course are not subject to avoidance.	No, because the Investment Firm holds Client Assets in trust.

Yes, for retail investors only. Limited to €20,000 (approximately US$26,000).	Yes. Limited to ¥10 million (approximately US$119,000). However, the compensation scheme does not cover claims relating to (i) OTC derivatives or (ii) derivatives transactions on foreign exchanges.
No. If there is a shortfall in Client Assets (*e.g.*, caused by the Investment Firm re-hypothecating client Securities), then all clients, whether their Client Assets were held in individual accounts or omnibus accounts with a third-party, would share *pro rata* in the remaining Client Assets.	Yes, if certain clients permit re-hypothecation of Securities, or otherwise grants the Investment Firm a right of use. *See below*.

Pro rata.	(i) *Client Money. Pro rata* allocation. (ii) *Client Securities.* Clients are entitled to the return of the exact Securities that they deposited. (a) Therefore, if a client does not permit the Investment Firm to re-hypothecate or otherwise use its Securities, then such client should receive such Securities. If such Securities are not available because of the fraud or negligence of the Investment Firm, then the client is entitled to include such Securities in the claim that it files with the Investment Protection Fund. (b) However, if a client does permit the Investment Firm to re-hypothecate or otherwise use its Securities, and if such Securities are not available in the event of the insolvency of the Investment Firm, then the client cannot include such Securities in the claim that it files with the Investment Protection Fund.

Mexico	Singapore
No. An Investment Firm may hold Client Assets in an omnibus account or an individual account.	No. Moneys and assets received by the Investment Firm on account of its customers may be commingled and deposited in the same trust or custody account.

Daily, generally by the end of the next business day.	Daily computation, before noon of the next business day, of the client moneys and assets maintained in trust and custody accounts is required of a CMS licensee conducting regulated activities in respect of trading in futures contracts and in respect of leveraged foreign exchange trading. An Investment Firm must calculate the amount of Client Assets owed to each client, but may reconcile such amount to bank statements or custodial records on an aggregate basis.
No, a deficiency in client assets is considered a violation in our Securities Law	No. An Investment Firm must make good any deficiency in Client Assets as soon as such deficiency is discovered. Such deficiency would be treated as a violation of the segregation requirement.

No. An Investment Firm can offset credit and debit balances for the same client. It cannot offset credit and debit balances across different clients.	No. An Investment Firm can offset credit and debit balances for the same client. It cannot offset credit and debit balances across different clients.
No. (i) Client Money is not fungible with client Securities. (ii) In general, a specific client Security would only be fungible with a Security that has the same characteristics.	Moneys and assets received by the Investment Firm on account of its customers may be commingled and deposited in the same trust or custody account.
No.	Yes.

Yes, with client consent.	The Investment Firm may only deal with the client moneys and assets as set out under the Singapore Securities and Futures (Licensing and Conduct of Business) Regulations ["SFR"]. Please refer to the Regulations, available on www.mas.gov.sg, for the detailed requirements.
Yes.	Yes.

No. However, because an Investment Firm is permitted, with client consent, to re-hypothecate or otherwise use Client Assets, such Client Assets may become unavailable to the client upon the Investment Firm experiencing insolvency.	The Singapore SFR does not cater for any situation or condition under which clients may choose to waive the requirements.
Depending on the ratio of (i) the capital of the Investment Firm to (ii) the capital requirement of the Investment Firm, the regulator can require a deteriorating Investment Firm to take (or to abstain from taking) multiple actions, including modification of business activities.	The regulator may require that the Investment Firm to transfer all or a portion of Client Assets to another CMS licensee; impose conditions and restrictions on the operation of the Investment Firm, or direct the Investment Firm to cease operations, if the Investment Firm (i) fails to fulfill the base capital requirement or (ii) holds financial resources less than the total risk requirement or 120% of such requirement.

An Investment Firm may become subject to bankruptcy proceedings in two ways: (i) *Administrative Intervention.* The regulator may administratively intervene in the Investment Firm when it believes that irregularities would affect stability. The regulator would appoint an inspector-manager to operate the Investment Firm, and to attempt to correct the aforementioned irregularities. If the inspector-manager is not able to correct such irregularities in nine (9) months, then the regulator would revoke the authorization of the Investment Firm. Upon such revocation, the Investment Firm would be placed in liquidation, without a separate insolvency proceeding. (ii) *Liquidation* . The shareholders and creditors of the Investment Firm may request that the Ministry of Finance declare that the Investment Firm is insolvent. The Ministry of Finance would then petition the court to place the Investment Firm in liquidation.	The provisions of the Singapore Companies Act (Cap. 50) are base-line requirements which apply to all companies in Singapore, including CMS licensees. Liquidation and judicial management of a CMS licensee is governed by the Singapore Companies Act, which may be found at http://statutes.agc.gov.sg/.

(i) *Administrative Intervention.* The regulator may designate the inspector-manager from a list of qualified individuals supplied by self-regulatory organizations. (ii) *Liquidation* . The shareholders or creditors of the Investment Firm may appoint a liquidator, which may be vetoed by the Ministry of Finance.	The appointment of a judicial manager in the case of a judicial management of the company, and a liquidator in a winding-up of the company are governed under the Singapore Companies Act.
Statute; direction from the regulator with respect to administrative intervention; guidance from the Ministry of Finance with respect to liquidation.	The powers and duties of the judicial manager and the liquidator are as set out in the Singapore Companies Act.
Full personal liability.	Under the Singapore Companies Act, for judicial management, upon an application by a creditor or member of the company, the Singapore Court may look into how the judicial manager has managed the affairs, business or property of the company, and make such order as it thinks fit.

(i) *Administrative Intervention* . The regulator would supervise the inspector-manager, including any efforts that the inspector-manager makes to transfer Client Assets. (ii) *Liquidation.* The regulator would attempt to facilitate any transfer of Client Assets that the Administrative Officer, the Ministry of Finance, and the court deem appropriate.	The regulator continues to supervise the Investment Firm as long as it is licensed, and will coordinate with relevant parties as necessary.
Yes. (i) *Administrative Intervention.* As mentioned above, the inspector-manager may attempt to transfer Client Assets. Usually, such transfers would occur within two (2) days. (ii) *Liquidation.* If an Investment Firm is in liquidation, the Administrative Officer may need to propose a mechanism and timeline for transfer. The Administrative Officer must then seek approval from the Ministry of Finance and the court.	The regulator may require that the Investment Firm to transfer all or a portion of Client Assets to another CMS licensee; impose conditions and restrictions on the operation of the Investment Firm, or direct the Investment Firm to cease operations, if the Investment Firm (i) fails to fulfill the base capital requirement or (ii) holds financial resources less than the total risk requirement or 120% of such requirement.
No.	In relation to a company which is being wound up, there are express provisions provided in the Singapore Companies Act against transactions giving an undue preference, transactions at an undervalue, and fraudulent trading. Notwithstanding, the laws relating to the distribution of the assets of a person on insolvency, bankruptcy or winding up shall not interfere with finality of settlement of securities in accordance with the business rules of a designated clearing house.

No.	Yes. Limited to S$20,000 under the Singapore Deposit Insurance Scheme for banks. In addition, non-accredited investors may under certain circumstances claim compensation from the fidelity fund established by an Approved Exchange under the Singapore Securities and Futures Act.
No, our regime doesn't treat clients differently.	This would depend on the terms and conditions of the client's agreement with the CMS licensee.

If an Investment Firm is in liquidation, the Administrative Officer may have the authority to satisfy the shortfall using the unsecured proprietary assets of the Investment Firm. If the shortfall exceeds such assets, then the clients would share in the shortfall on a *pro rata* basis.	In the winding up of a company, the priority for payment of debts is expressly provided in the Singapore Companies Act. Preferential creditors such as employees are paid ahead of other unsecured debts. All creditors of equal rank are paid pari passu in equal proportions.

Spain	Switzerland
Yes. Investment Firms are required to hold Client Assets in individual accounts, except when they are investing on behalf of clients in jurisdictions other than Spain that require omnibus segregated accounts. In that case, the Investment Firm must obtain written authorization from client. However, as described below, if an Investment Firm experiences an insolvency, clients will be treated as unsecured creditors with respect to Client Money, regardless of whether an Investment Firm is a bank. The same is not the case for Client Assets.	(i) An Investment Firm is not required to segregate Client Money. (ii) Client Securities and Positions are deemed "client property."

An Investment Firm must maintain Client Money in bank accounts, investment funds, or short term repo transactions, separated from its own accounts. In this manner, Client Money should be at any moment segregated from the proprietary money of the Investment Firm. Reconciliation, due to client´s transactions, should be made as often as necessary.	Daily. An Investment Firm is required to perform reconciliation on an aggregate basis.
(i) No, with respect to client Securities. A deficiency in client Securities is considered a violation of the Regime. The Investment Firm must make good any such deficiency from proprietary assets. (ii) No, with respect to Client Money, if the Investment Firm is not a bank. (iii) Not applicable with respect to Client Money, if the Investment Firm is a bank.	No. A deficiency in client Securities or Positions is considered a violation of the Regime. If the Investment Firm becomes insolvent, the regulator would deem the proprietary capital and assets of the Investment Firm to be "client property," as necessary to compensate for the deficiency in client Securities and Positions.

Yes. But the Investment Firm is only offsetting credit and debit balances for the same client, as the Investment Firm is required to hold Client Assets in individual accounts.	No. The Investment Firm must deduct the debit balance from Client Money. As mentioned above, the Investment Firm need not segregate Client Money. The Investment Firm may deem Securities of the client with the debit balance to be collateral for such balance. Such action would not affect clients with credit balances.
No. (i) Client Money is not fungible with client Securities. (ii) The Securities deposited by one client is not fungible with the Securities deposited by another client, even if such Securities have the same characteristics.	No. As mentioned above, the Investment Firm is not required to segregate Client Money. Client Securities and Positions are deemed "client property."
No, not foreseen in current regulation.	If the Investment Firm becomes insolvent, the regulator may deem the proprietary capital and assets of the Investment Firm to be "client property."

Yes, the Investment Firm may lend client Securities, with client consent.	Yes, with client consent.
Yes, but in this case, the third-party affiliate should be an entity qualified to hold Client Money or Securities (*i.e.,* regulated entity).	Yes.

Yes. (i) A retail client, who meets certain sophistication requirements, can waive specific protections. Such a client would be unable to claim against the compensation scheme. (ii) A professional client can also request to be treated as a retail client. (iii) The above requests must be made in writing.	Not applicable, as the Regime does not require pre-insolvency segregation of Client Assets.
(i) *Non-Bank Investment Firms.* The regulator may adopt administrative measures, including restriction of activities, if it believes that the financial situation of an Investment Firm has deteriorated. For example, the regulator could even remove the Board of Directors of an Investment Firm and appoint a new one. (ii) *Bank* . The Bank of Spain is entitled to take similar administrative measures.	The regulator may decree all necessary protective measures, including limiting the business activities of the Investment Firm.

(i) *Non-Bank Investment Firms* . The regulator may file a petition to place such an Investment Firm into insolvency. (ii) *Banks.* The Bank of Spain may file a petition to place such an Investment Firm into insolvency. (iii) For either (i) and (ii), the creditors, shareholders, and management may file a petition to place such an Investment Firm into insolvency.	The regulator commences and conducts insolvency proceedings. Therefore, such proceedings are different for Investment Firms than other companies.

In general, the court is responsible for the nomination or appointment of three bankruptcy officials: (i) an auditor or economist; (ii) a lawyer; and (iii) a creditor. With respect to a non-bank Investment Firm, the auditor or economist would generally be an employee of the regulator or a person that the regulator nominates. The lawyer would be a person nominated by the Investors Compensation Scheme. With respect to a bank, the auditor or economist would generally be an employee of the Bank of Spain or a person that the Bank of Spain nominates. The lawyer would be a person nominated by the Deposit Guarantee Fund.	The regulator appoints the Administrative Officer from a pool of qualified candidates.
Statute.	Statute; direction from the regulator.
Liability for negligence.	Governed by the Government Liability Act.

As mentioned above, the regulator (or the Bank of Spain, as applicable) may petition to place an Investment Firm into insolvency. The regulator (or the Bank of Spain, as applicable) may nominate bankruptcy officials. The regulator (or the Bank of Spain) is not directly involved in the transfer or return of Client Assets.	The regulator supervises the Administrative Officer and must approve any plan for distribution or restructuring.
Yes. Once an Investment Firm has been placed into insolvency, the National Securities Market Commission (without prejudice to the Bank of Spain) may immediately transfer client Securities to another solvent Investment Firm. Such transfer may require client consent, however. Client Money is not subject to transfer, only to return. If the return to the client is lower than the amount held at the Investment Firm, the compensation scheme should compensate the client up to the sum of 100,000 euros.	No. The Regime focuses on returning Client Money and client Securities to clients. Similarly, Client Positions are liquidated and valued.
Yes. "As far as the CNMV can proceed to transfer client securities and financial instruments to another intermediary in case of insolvency it is difficult to foresee a return. Notwithstanding, the judge has the power to order that return and, under exceptional circumstances, such measure can be taken."	Only if distributions of Client Assets were complicated by conflicts of interest or inside information.

Yes, for retail investors only. The Regime maintains two compensation schemes -- *i.e.* , the Investor Compensation Scheme applicable to the clients of Investment Firms that are not banks and the Deposit Guarantee Fund for clients of Investment Firms that are banks. Each scheme covers a maximum amount of €100,000 (approximately US$132,000).	(i) In the event that an Investment Firm becomes insolvent, then a maximum of CHF 100,000 (approximately US$102,000) of Client Money would become immediately available for preferential distribution to each eligible client. If the Investment Firm cannot make such amount available, then the Deposit Protection would advance such amount to clients, in exchange for assuming the preferential claim of clients. (ii) There is no similar compensation scheme for client Securities and Positions.
Possibly, depending on the contractual arrangements between the Investment Firm and each client (pledges, motgages, etc.).	No. In the event that an Investment Firm becomes insolvent, the Administrative Officer would exclude from the estate securities (whether proprietary or client in origin) corresponding to client Securities. The excluded securities would be promptly distributed to clients.

(i) *Client Money.* Distribution up to the limit of the applicable compensation scheme. (ii) *Client Securities* . The court will determine the applicable criteria. "Judge criteria should apply. Pro rata distribution could be the criteria, but prior to applying that criteria qualifications between creditors should be made."	(i) If a client is owed Client Money in excess of CHF 100,000 (approximately US$90,000) (*i.e.* , the amount guaranteed by Deposit Protection), then the client is entitled to recover the excess *pro rata* with other unsecured creditors. (ii) If there is a shortfall in securities deemed client Securities, then the client is entitled to a *pro rata* distribution of each relevant security. The client is then entitled to recover any excess claim *pro rata* with other unsecured creditors.

United Kingdom	US-CFTC
No. An Investment Firm may hold Client Assets in an omnibus account or an individual account.	No. An Investment Firm may hold Client Assets securing commodity futures in an omnibus account. It may also hold Client Assets securing foreign futures in a separate omnibus account.

(i) "As often as necessary." For the majority of Investment Firms, the regulator has construed this requirement to mean daily reconciliation, which must be completed by the end of the following business day. (ii) For Client Money, the Investment Firm must determine internal compliance with the segregation requirement for each client. (ii) For client Securities, the Investment Firm is permitted to determine internal compliance with the segregation requirement on an aggregate basis. (iv) For both Client Money and client Securities, the Investment Firm must regularly reconcile its internal records with external custodial records.	Daily, by noon of the next business day. Although an Investment Firm is required to maintain books and records showing, at any given time, the amount of (i) Client Assets that it must segregate for each client with respect to commodity futures and (ii) Client Assets that it must set aside for each client with respect to foreign futures, the Investment Firm is permitted to perform reconciliation on an aggregate basis.
No. (i) If the Investment Firm discovers a deficiency in Client Assets during internal reconciliation, then the Investment Firm must (a) identify the reason for the deficiency, (b) compensate for the deficiency by the close of business on the day that it performs the reconciliation, and (c) notify the regulator. (ii) If the Investment Firm discovers a deficiency in Client Assets while reconciling internal records with external custodial records, then the Investment Firm must compensate for the deficiency as soon as possible, in addition to identifying the reason for the deficiency and notifying the regulator.	No. If the Investment Firm discovers a deficiency in Client Assets during internal reconciliation, then the Investment Firm must immediately compensate for such deficiency. Furthermore, the Investment Firm must immediately report such deficiency to the regulator.

No. An Investment Firm can offset credit and debit balances for the same client. It cannot offset credit and debit balances across different clients.	No. An Investment Firm can offset credit and debit balances for the same client. It cannot offset credit and debit balances across different clients.
No. (i) Client Money is not fungible with client Securities. (ii) In general, a specific client Security would only be fungible with a Security that has the same characteristics. (iii) A client could contractually arrange for the Investment Firm to hold the exact Security deposited by the client. Such an arrangement is generally rare.	Yes. In general, Client Assets are fungible.
Yes.	Yes. The Regime strongly encourages the Investment Firm to create a "buffer."

Yes. (i) The Regime permits clients to grant the Investment Firm the right to use Client Assets. If the Investment Firm asserts such right to use, then such Client Assets would no longer be subject to protection. (ii) The Regime permits certain sophisticated clients to convey to the Investment Firm full title to Client Assets. Once the conveyance is made, such assets cease to be Client Assets and are no longer subject to protection. (iii) The regulator is considering possible changes to the Regime.	Yes. (i) An Investment Firm is permitted to invest Client Money, subject to certain restrictions with respect to Client Money supporting commodity futures. (ii) If an Investment Firm purchases certain instruments with Client Money, it can re-hypothecate such instruments. However, the Investment Firm must place into segregation an amount equal to the full balance due from the Investment Firm to the client, after application of haircuts.
Yes. The regulator is considering imposing limitations on the amount of Client Assets that an Investment Firm may hold with a third-party affiliate.	Yes.

Yes. As mentioned above, the Regime permits certain sophisticated clients to convey to the Investment Firm full title to Client Assets. Once the conveyance is made, such assets cease to be Client Assets and are no longer subject to protection. Also, the Regime permits clients to grant the Investment Firm the right to use Client Assets. If the Investment Firm asserts such right to use, then such Client Assets would no longer be subject to protection.	No.
The regulator may require the Investment Firm to, among other things, raise capital, modify its business, transfer business, return Client Assets, or enter insolvency proceedings.	If an Investment Firm fails to comply with net capital rules, then it must (i) cease conducting business and (ii) transfer all Client Assets. The Investment Firm itself or its designated self-regulatory organization would actually arrange for the transfer of Client Assets, and the regulator would facilitate such transfer as necessary.

(i) The Investment Firm may petition the court to enter an administration order. As mentioned above, the regulator may direct the Investment Firm to file such petition. (ii) A qualifying creditor may petition the court to enter a liquidation (or winding-up) order with respect to the Investment Firm. (iii) In general, Investment Firms enter administration rather than liquidation.	(i) In general, an Investment Firm enters into bankruptcy in the same manner as any other company -- *i.e.* , either the Investment Firm itself files a voluntary bankruptcy petition or the creditors of an Investment Firm file an involuntary bankruptcy petition. (ii) However, an Investment Firm must be liquidated and cannot be reorganized. Also, if an Investment Firm has engaged, is engaging, or is about to engage in a violation of the Regime, then the regulator may petition the court for an appointment of a receiver. If appropriate, the receiver would then file a voluntary bankruptcy petition on behalf of the Investment Firm.

Either the court or the Investment Firm selects the Administrative Officer. Administrative Officers must pass examinations to become a licensed Insolvency Practitioner, and must be members of the Insolvency Practitioners Association (IPA).	The United States Trustee, an executive branch official, appoints the Administrative Officer from a standing panel. The regulator consults with the United States Trustee to provide for the appointment of an Administrative Officer that is familiar with the commodity futures markets and the role of the Investment Firm in such markets.
Statute. IPA Statements of Insolvency Practice and Guidance. There is no guidance specific to Investment Firms.	Statute (*i.e.* , Subchapter IV of Chapter 7 of the Bankruptcy Code) and regulations provide specific guidance for an Administrative Officer liquidating an Investment Firm.
Full personal liability.	Liability for gross negligence or willful disregard of fiduciary duties.

The regulator continues to supervise the Investment Firm, but does not play a direct role in the return of Client Assets.	The regulator would be involved in discussions with the Administrative Officer, the designated self-regulatory organization of the Investment Firm, and the derivatives clearing organization of the Investment Firm to facilitate efficient and orderly transfer or distribution of Client Assets. Additionally, the regulator has the right to appear in court.
The Regime does not provide an overarching arrangement for the transfer of Client Assets. The regulator "would form a view of the transfer in light of supervisory, policy and legal issues and act accordingly."	Yes. Both the applicable statute (*i.e.* , Subchapter IV of Chapter 7 of the Bankruptcy Code) and the regulations require the Administrative Officer to attempt to transfer Client Assets. Whether the Administrative Officer would successfully effect such transfer strongly depends on whether a deficiency exists in Client Assets. If no deficiency exists, then transfers of Client Assets have historically been practicable.
No, because the Investment Firm holds Client Assets in trust.	No.

Yes, for retail investors only. Limited to £50,000 (approximately US$79,000).	No.
Yes, if the client has either (i) conveyed to the Investment Firm full title to Client Assets or (ii) granted the Investment Firm a right to use Client Assets, which the Investment Firm has exercised.	If a client permits, either explicitly or implicitly, an Investment Firm to hold Client Assets in another jurisdiction, then such client may suffer "sovereign loss" first, if the Investment Firm becomes insolvent. In general, "sovereign loss" refers to any loss generated by the application of the law of the jurisdiction to Client Assets, in a manner that is different from the application of United States law.

(i) *Client Money* . *Pro rata* distribution, with clients becoming unsecured creditors with respect to the shortfall. (ii) *Client Securities.* If the Administrative Officer could trace the shortfall to a specific client, then that client would become an unsecured creditor whereas the remaining clients would receive the Securities that they deposited with the Investment Firm. If the Administrative Officer cannot perform the abovementioned tracing, then clients would share *pari passu* each pool of Client Assets of the same type as that they deposited.	*Pro rata* .

US-SEC
No. An Investment Firm may hold client Securities on a customer omnibus basis at a "good control location" (e.g., a custodial bank) when the assets must be kept free of lien.

(i) The Investment Firm must do a daily possession and control calculation. Additionally, the Investment Firm must "make and keep current...ledger accounts itemizing separately each cash and margin account of every customer of the broker-dealer. The ledger should include all purchases, sales, receipts and deliveries of securities and commodities for the account and all debits and credits to such account." The ledger must be updated daily. (ii) On a weekly basis, the Investment Firm must do a calculation to ensure that it holds sufficient Client Assets to cover its Reserve Computation. In general, the Reserve Computation aggregates credits and debits across all clients. The Investment Firm must maintain Client Assets in a special reserve account in an amount equal to the excess (if any) of aggregate credits over debits. The deposit of Client Assets occurs one day after the Reserve Computation is made.
Yes if there is a deficiency after the Reserve Computation is made and before the Client Assets are deposited. However, there are numerous cushions built into the Customer Protection Rule to account for this time lag and any other inaccuracies. For a large Investment Firm, this cushion is substantial.

Yes. An Investment Firm's obligation with respect to protecting customer assets may be reduced, within limits, to reflect debit balances.
No. Client Money is not fungible with client Securities. Further, an Investment Firm's possession and control requirement is determined separately for each individual security.
Yes. The Regime encourages the Investment Firm to create a "buffer" by building a 3% buffer into the Net Capital Rule. However, the assets are segregated for the exclusive benefit of customers and cannot be returned to the Investment Firm's proprietary accounts unless all customer obligations have been met.

Yes, within limits and with client consent, but only if the client owes a debit to the Investment Firm.
Yes, provided the affiliate qualifies as an approved custodian, such as a bank or broker-dealer.

No.
(i) An Investment Firm that fails to comply with net capital rules must cease conducting business. (ii) An Investment Firm that is otherwise in financial difficulty may be required by its self-regulatory organization to reduce the scope of its business. (iii) The regulator may petition the court for a freeze on the assets of the Investment Firm. (iv) If it appears that the Investment Firm may not survive its financial difficulty, the regulator must contact the Securities Investor Protection Corporation. "If the firm holds customer cash and securities, the goal is to have these accounts transferred to a solvent broker-dealer in an orderly self-liquidation or prior to a liquidation under SIPA" (the Securities Investor Protection Act).

Investment Firms must be liquidated and cannot be reorganized. The Securities Investor Protection Corporation may petition a federal district court to place the Investment Firm in liquidation. Liquidation proceedings are different for Investment Firms than for other companies.

The Securities Investor Protection Corporation chooses (i) the Administrative Officer and (ii) counsel to the Administrative Officer.
The Securities Investor Protection Act provides specific procedures for the liquidation of an Investment Firm. Additionally, the Securities Investor Protection Corporation provides guidance to the Administrative Officer and has related rules regarding liquidations.
Liability for gross negligence or willful disregard of fiduciary duties.

The regulator oversees the Securities Investor Protection Corporation, which, in turn, oversees the Administrative Officer. The regulator may also appear in court, as a party to the liquidation of the Investment Firm. The Investment Firm also remains subject to SEC oversight as a registered broker-dealer.
The Regime aims to effect transfer of Client Assets. "In general, if the books and records of the broker-dealer are in order and customer accounts are properly margined, the trustee likely can transfer the accounts to another broker-dealer in about a week in a process known as a bulk transfer...If a bulk transfer is not possible, the trustee returns customer securities and cash directly to customers through a claims process."
Generally no, but in very limited circumstances the Administrative Officer would have authority to sue for the return of such assets.

Yes, coverage for shortfall in Client Assets of up to $500,000 per client, with a maximum of $250,000 allocated to claims for Client Money.
No.

There would be a pro rata distribution that would be supplemented up to $500,000 per account.

Appendix B – Survey Responses on Client Asset Protection

Australia

Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets

I. Background

This questionnaire seeks information to aid in understanding the responding jurisdictions' techniques for protecting Client Assets in the event of the insolvency and/or winding up of an Investment Firm, and distributing them to the client. It is not intended to require information concerning the general legal framework for insolvency, except to the limited extent necessary to understand how rules for the protection of Client Assets fit within that framework.

Definitions.

(1) **"Administrative Officer"** refers to the person or entity who is appointed, whether by a court, regulator, creditors, the Investment Firm itself, or otherwise, to assume control of or power over a bankrupt or insolvent Investment Firm. This term includes administrators, debtors in possession, receivers, liquidators, trustees, and similar titles.

(2) **"Client Assets"** refers collectively to Positions, Securities, and Client Money:

- "**Positions"** are contractual rights and obligations arising from transactions entered into by an investment firm on behalf of its clients, including mark to market accruals arising from the change in value of futures, options and/or other derivatives positions;

- "**Securities"** are defined to incorporate both securities and derivatives, as those terms are defined or understood in the responding jurisdiction; and

- "**Client Money"** refers to funds owed to or held on behalf of clients by an investment firm, and may include margin collateral associated with client positions (both existing and potential), income relating to an investment such as dividends or interest, proceeds of the liquidation of client securities and/or positions, and funds in excess of required margin.

(3) **"Investment Firm"** means an intermediary that holds Client Assets and is engaged in the business of managing client accounts, which could include, without limitation: executing orders on behalf of others, dealing in or distributing Securities (including carrying derivatives positions). In jurisdictions where banks are broadly permitted to engage in such a business, this term includes banks to the extent they are providing such services.

(4) **"Omnibus Account"** means an Investment Firm's account with a third party in which Client Assets are maintained separate from the firm's assets, but are held in the aggregate instead of in accounts designated for individual clients.

(5) **"Regime"** refers to statutes, regulations, rules of exchanges, clearing organizations and other self-regulatory bodies, or other legally binding requirements.

II. Survey Questions *Where appropriate, please provide citations to statutes, regulations, or other authorities supporting your answers below.*

Context

1. *Please provide a brief overview setting forth the defining characteristics of your jurisdiction's approach to protecting Client Assets.*

In answering the remaining questions: *(1) Please provide details, as appropriate, where the regime in your jurisdiction applies different treatment or results base on differences in:* *a. Categories of client assets* *b. Models of trading (e.g. exchange traded versus over the counter)* *c. Categories of clients (e.g. retail versus sophisticated)* *(2) You are requested to provide details of the regime in your jurisdiction. You are additionally invited to provide information explaining how the regime is applied in practice, through e.g. informal arrangements between governmental entities.*

Key definitions for the purposes of this response:

The Corporations Act 2001 (the Act) is the primary legislation for securities regulation. The Act is supplemented by the Corporations Regulations 2001 (Regulations). In this paper, a reference to a section is a reference to a section of the Act and a reference to a regulation is a reference to a regulation of the Regulations, unless otherwise indicated.

Securities cover different financial instruments depending on the context it is used in the Act. For the purposes of the provisions relating to protection of client assets, security means:
(a) a share in a body;
(b) a debenture of a body;
(c) a legal or equitable right or interest in a share or debenture;
(d) an option to acquire, by way of issue, one of the above securities;
(e) a right (whether existing or future and whether contingent or not) to acquire, by way of issue, one of the above securities or certain interests in certain registered or unregistered managed investment scheme.

Derivatives are broadly defined in the Act and are also subject to specific inclusions and exclusions. However, generally a derivative is an arrangement where:
(a) the value of which is ultimately derived from, or varies according to, the value of one or more assets, rates, indices or other underlying element; and
(b) one or both parties, at some future time, may have to provide cash or other consideration (excluding any initial or periodic consideration that is fixed at the time agreement is entered into) to the counterparty or a substitute counterparty (such as the

clearing house), that consideration ultimately being determined in whole or part by reference to the derived value element.

A person carrying on the business covered under the definition of Investment Firm (described above) would need to hold an Australian financial services licence (AFS licence). This is a licence issued by ASIC which authorises the entity (and their representatives) to provide specific financial services to clients. In this response, a reference to Investment Firm is a person who is an AFS licence holder.

The following regulatory, market exchange and supervisory bodies are referred to in this response:

ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange Ltd, the main securities and derivatives exchange in Australia
ACH	Australian Clearing House Ltd, a subsidiary of ASX who provides all clearing services for transactions entered into on ASX's financial products markets
CHESS	Clearing House Electronic Sub-register System, a dematerialised register operated by the ACH for securities, options and warrants transactions (but not other derivatives).
ASTC	Australian Settlement and Transfer Corporation Ltd, a subsidiary of ASX who provides all settlement services for transactions entered into on ASX's financial products markets
SFE	Sydney Futures Exchange, part of ASX and the main derivatives exchange in Australia
SFECC	Sydney Futures Exchange Clearing Corporation Ltd, the clearing house for the SFE

Australia's approach to the protection of Client Assets is broadly as follows:

a) The Act sets out an overarching regime for the protection of client money and client property (including securities) (client money provisions). The relevant provisions are largely principles-based, primarily aimed at ensuring that client assets are held separately from the Investment Firm's own, that client assets are held on trust for the benefit of the client and that client assets are only used as permitted under the relevant provisions. Specific provisions apply to client money on the one hand, and other property on the other. The client money and client property provisions do not distinguish between retail and wholesale clients.[1]

b) The main securities and futures exchanges impose further requirements applicable for transactions on those exchanges.

c) Client money is money paid to an Investment Firm:

[1] ASIC has given specific exemptions to licensees who are an Australian authorised deposit-taking institution (ADI) from the obligation to hold client money and client property on trust in certain circumstances for wholesale client (essentially a sophisticated investor).

a. in connection with either a financial service that has been provided (or that will or may be provided) to a client or a financial product held by a client; and
b. by a client or a person acting on behalf of a client or to the Investment Firm in the Investment Firm's capacity as a person acting on behalf of the client.

d) The client money provisions do not apply to:
   a. money paid by way of remuneration payable to the Investment Firm;
   b. money paid to reimburse (or discharge a liability incurred by) the Investment Firm for payment made to acquire a financial product (or to indemnify the Investment Firm in respect of such a liability);
   c. money paid to acquire a financial product or an increased interest in a financial product from the Investment Firm;
   d. loan money;
   e. money deposited to the credit of a deposit product with the Investment Firm; or
   f. property other than money (e.g. share certificates).

e) Client property is property (other than money) that is given to a Investment Firm:
   a. in connection with either a financial service that has been provided (or that will or may be provided) to a client or a financial product held by a client; and
   b. by a client or a person acting on behalf of a client or to the Investment Firm in the Investment Firm's capacity as a person acting on behalf of the licence; and
   c. the Investment Firm is accountable for the property.

f) The Act does not set out treatment of client positions – this is left to contractual terms between the Investment Firm and the client.

g) As there are specific provisions for client money and other property (such as securities), this response separately deals with client money and client property. For the reasons already noted, segregation of client positions is not dealt with. In this response, a reference to Client Assets is a reference to both client money and client property.

   Investment Firms must comply with the client money and client property provisions and a breach of these provisions may constitute a civil or criminal offence for which an Investment Firm may face civil or criminal penalties. As part of our supervisory functions, ASIC can seek information from Investment Firms on compliance with the client money and client property provisions. Auditors of Investment Firms must comment on an Investment Firm's compliance with the client money and client property provisions (see further below under question 2).

h) We note that client money issues do not generally arise for general securities transactions subject to exchange rules for on-exchange transactions. This is because money paid to acquire a financial product is not client money. To the extent that money is paid before a security is issued (e.g. application money under an initial public offering of securities), there are particular provisions that apply to the holding of application money – in essence requiring the money to be held in a

trust account and a requirement to return the application money if the product is not issued within a certain period of time.

i) In addition, the ASX, ACH and ASTC impose further obligations on Investment Firms who are also market, clearing and/or settlement participants respectively. These obligations are contained within the ASX Market Rules, ACH Clearing Rules and ASTC Settlement Rules (collectively referred to as the ASX Operating Rules) and specify quite specifically how market participants are required to deal with margining obligations, holding client money and holding client property. For example, for market transactions on the ASX - an Investment Firm must establish a trust account for money received in connection with dealings in Cash Market Transactions or Options Market Transactions (ASX Market Rule 7.11.3). Cash received from clients must be paid into trust for cash securities before the trade day plus 3 days (T+3) for settlement. The funds are then only permitted to be withdrawn from the trust account as part of the settlement process on T+3.

j) The ASX Operating Rules supplement the principles in the Act and are contractually enforceable by the ASX. The ASX operating rules can only take effect after they have not been disallowed by the Minister.

Pre-Insolvency

2. *Does the regime in your jurisdiction require an Investment Firm to hold special authorization (i.e., a specific form of license or registration) to be permitted to hold Client Assets?*

    a. *If special authorization is required, what requirements (both initial and ongoing) is an Investment Firm required to comply with to hold such authorization?*

    b. *If special authorization is not required, how, if at all, is this activity supervised by a regulator?*

Prior to being issued an AFS licence, applicants will be assessed to ensure that they:

a) are competent to carry on the kind of financial services business they are applying for;
b) have sufficient financial resources to carry on the business they are proposing; and
c) are able to meet their other obligations as an Investment Firm should a licence be granted

Although Investment Firms will generally require, given the nature of their business, an AFS licence with *specific authorisations* to deal and advise in securities and derivatives (thereby also permitting them to hold client securities), they do not require specific authorisations to hold client money or client property.

Notwithstanding this, each Investment Firm is required to comply with general licensee obligations which include, among other things, the requirement for Investment Firms to comply with the client money and client property provisions and further to that, a requirement to report significant breaches to ASIC, which may include breaches of the client money and client property provisions.

There are also minimum financial requirements. Specifically, if an Investment Firm holds client assets over $100,000, including money in a client money account, the Investment Firm must have surplus liquid funds (SLF) of at least $50,000. This does not apply to an Investment Firm who is registered as a market and clearing participant with the ASX, ACH and ASTC respectively or who is otherwise regulated by the Australian Prudential Regulatory Authority (APRA) (essentially authorised deposit-taking institutions (ADIs), insurance companies and superannuation entities). Investment Firms coming within these categories will have to comply with ASX requirements or APRA requirements, as the case may be.

Further, all Investment Firms must also have their financial statements audited and must lodge with ASIC a true and fair profit and loss statement and balance sheet together with an auditor's report containing the information and matters required by the regulations (s989B). As part of this, the auditor's report must contain a statement of the auditor's opinion of:

d) the effectiveness of internal controls used by the Investment Firm to comply with the client money and client property provisions;
e) whether each client money account required to be maintained by the Investment Firm has been operated and controlled in accordance with the client money and client property provisions; and
f) whether all necessary records, information and explanations were received from the Investment Firm,

(reg 7.8.13).

In addition to Australia's AFS licensing regime, Investment Firms who directly execute, clear or settle securities/derivatives in relation to products traded on the ASX will also need to be admitted as a participant of the ASX, ACH and ASTC respectively (as applicable). As a Participant of the ASX, ACH and ASTC (as applicable) the Investment Firm is required to comply with the relevant ASX Operating Rules on an ongoing basis.

Additionally, for ASX Market Participants that are not recognised as Principal Traders only and ACH Clearing Participants, there is an annual requirement for an independent auditor's report on their financial statements and their internal control procedures designed to ensure compliance with requirements of Divisions 2, 3, 4, 5, 6 and 7 of Part 7.8 of the Act other than s991A (which relates to unconscionable conduct).

3. *Does the Regime in your jurisdiction require that Client Assets be maintained separately from the assets of an Investment Firm? If so, please provide a description of the process by which segregation is accomplished, and of the applicable requirements.*

Client money must be held on trust by the Investment Firm for the benefit of that client. It must be paid into a separate account, which is generally a trust account but can be operated as a client segregated account in certain circumstances (referred to in this response as a client money account). Part 7.8 of the Act (and related regulations) set out the requirements of this account. A client money account must be established as one of the following:

(a) an account with an Australian ADI;

(b) an account with an approved foreign bank (there are currently no approved foreign banks for this purpose);

(c) a cash management trust; or

(d) a cash common fund.

Client property must be held subject to the Regulations, the terms and conditions on which the property was given to the Investment Firm and any subsequent instructions given by the client.

The Regulations essentially require that the client property must be held on trust for the benefit of the person who is entitled to it. The Regulations specify different requirements for custody arrangements, the precise requirements depending on specific agreement between the Investment Firm and client. There is no absolute requirement for the property to be held with a third party custodian or with an Australian ADI.

The Investment Firm must not deposit client property as security for a loan or advance to the Investment Firm unless:

(a) the client owes the Investment Firm an amount in connection with a transaction entered into by the Investment Firm on the client's behalf;

(b) the Investment Firm gives the client a written notice that identifies the property and states that the Investment Firm proposes to deposit it as security for a loan or advance to the Investment Firm; and

(c) the amount, or total of the amounts, that the client owes on the day of the deposit is at least the amount of the loan or advance.

Client property so deposited must be withdrawn within one business day after the client repays its obligation and the Investment Firm must update the client every three months that the property has not been withdrawn (if the loan or advance continues).

a. *Must the Client Assets of one client be maintained separately from those of other clients?*

   i. *Are Investment Firms allowed to hold Omnibus Accounts?*

   ii. *What measures are used to protect the Client Assets of each client from losses due to the activities of other clients?*

Client Money must be paid into a client money account and kept segregated from the Investment Firm's own funds. This can be an omnibus account so that the client money of a number of clients is commingled into the one client money account.

Client money is taken to be held in trust for the benefit of the client, except for that portion of money paid to an Investment Firm for margins required under the operating rules of a clearing or settlement facility: reg 7.8.01(5).

There are restrictions on permitted withdrawals from a client money account. Payments may be made out of a client money account in any of the following circumstances:

- making a payment to, or in accordance with the written direction of, a person entitled to the money;
- defraying brokerage and other proper charges;
- paying to the Investment Firm money to which the Investment Firm is entitled;
- making a payment of moneys due to an insurer in connection with a contract of insurance;
- making a payment that is otherwise authorised by law;
- paying to the Investment Firm money to which the Investment Firm is entitled pursuant to the operating rules of a financial market;
- making a payment to another Investment Firm provided that the receiving Investment Firm is notified that the money has been withdrawn from client money and pays it into its client money account.

Note: See reg 7.8.02.

If the money required to be placed in a client money account relates to a derivative or a dealing in a derivative, the Investment Firm may use the money for the purpose of meeting obligations incurred by the Investment Firm in connection with margining, guaranteeing, securing, transferring, adjusting or settling dealings in derivatives by the Investment Firm, including dealings on behalf of people other than the client (s981D).

This permitted use does not, however, extend to obligations incurred by the Investment Firm's own (or proprietary) trading in derivatives, that is, trading by the Investment Firm using its own money so as to make a profit for itself.

It does, however, mean that client money belonging to one client may be used for meeting margin obligations of other clients, exposing the client to the risk that they may not receive

all the money held by the Investment Firm on their behalf in the client money account if there is a deficit in the client money account and the Investment Firm becomes insolvent or is otherwise unable to pay the deficiency.

Note also that in some cases, an Investment Firm in the OTC derivatives market may provide in their client agreement that margin payments are due and payable at the opening of a position. These amounts are then withdrawn from the client money account (and cease to be client money). On the close of a position, any gain would then need to be returned to the client money account.

With respect to ASX futures transactions or option market transactions over an underlying financial product which is a futures market contract, client money must be paid into a client money account and be kept segregated from the licensee's own funds. This can be either a trust account or a client segregated account.

If an ASX Participant invests money from a clients' segregated account pursuant to s981C(a), the investment must be readily realisable and at least 50 percent of the money invested under that section must be invested on 24 hour call terms.

If an ASX Participant client does not satisfy its margin or settlement obligations the ASX Participant must pay into the client's segregated account the lesser of:

- the amount of the request; or
- the amount which the Participant would be obliged to request from the client on the following day.

b. *Please describe any requirement that an Investment Firm must reconcile the Client Asset account. For example:*

i. *How do you calculate the amount of Client Assets that a firm is required to hold in one or more accounts segregated for the benefit of clients?*

   a. *Are required Client Assets fungible between or within asset classes, or is the Investment Firm required to hold, e.g., the specific assets deposited by the client?*

   b. *How is the reconciliation conducted (e.g., on an aggregate basis, or a client-by-client basis)?*

   c. *If a client has a debit balance (i.e., the client owes the Investment Firm), is such balance deducted in determining the amount the Investment Firm is required to hold?*

ii *Timing issues:*

   a. *How often is reconciliation required (e.g., daily, weekly, monthly).*

   b. *When is such reconciliation required (e.g., noon of the following business day, the tenth business day of the following month).*

   c. *Is the Investment Firm required to make good any deficiency from their own funds? If so, in what period? Is any payment by the Investment Firm thereby deemed to be Client Money?*

Investment firms who are executing brokers and/or clearing participants are subject to ASX/ACH's reconciliation obligations. Specifically, the ACH Clearing and ASX Market Rules require an Investment Firm to perform a reconciliation of the aggregate balance held in client segregated accounts and trust accounts as set out in ASX Market Rules and Procedures and the ACH Clearing Rules and Procedures. A schedule of required reconciliations and timings is set out below:

Period	When	Trust accounts	ASX Futures – client segregated accounts
Daily reconciliation	The reconciliation must be prepared by 7pm on the Trading Day after the Trading Day to which the reconciliation relates	MR 7.11.10 ; CR 4.23.6 Reconcile the accuracy of the **aggregate balance** held by it at the close of business on each business day **in clients' trust accounts maintained** v's corresponding balance as recorded in the **Participant's accounting records**	MR 7.11.9 ; CR 4.23.5 Reconcile the accuracy of the **aggregate balance** held by it at the close of business on each business day **in client segregated accounts** v's corresponding balance as recorded in the **Participant's accounting records**
Weekly reconciliation	By 7pm on the Trading Day after the last business day of each week (e.g. by 7pm Monday)	Reconcile the accuracy of the balance held by it at the close of business on the last business day of each week in trust for each client in a trust account maintained pursuant to the rules v's the corresponding balance as recorded in the **Participants accounting records**	No express obligation
Quarterly schedule	By no later than 5 Business days after *31 March;* *30 June;* *30 September; and* *31 December* in each year.	Prepare a schedule as at the quarter end showing the respective amounts held in the Market Participant's trust account on behalf of clients together with the names of the particular client in respect of each amount	No express obligation

Importantly, the ASX Market Rules and ACH Clearing Rules impose an obligation for a Responsible Executive (RE) of the Investment Firm to provide a daily statement as to the accuracy of the reconciliations and imposes an obligation on the Investment Firm to notify the ASX/ACH in the requisite time of two business days if they have not performed a reconciliation in accordance with the ASX Market Rules or the ACH Clearing Rules, if there is a deficiency of funds or they are unable to reconcile.

The Responsible Executive is, in relation to a market/clearing participant (or otherwise Investment Firm for the purpose of this response), an individual who is shown as having executive responsibility for the supervision and control of all or part of the business of that market participant in the copy of the market/clearing participant's management structure

provided to ASX/ACH or who is otherwise notified to ASX/ACH from time to time as having that responsibility.

A summary of the notification obligations are set out below:

Notification Obligations - ASX Futures – Segregation Account		
	ASX Market Rule	ACH Clearing Rule
Reconciliation has not been performed in accordance with the rules	7.11.11(a)	4.23.7(a)
Total Deposits is less than total Third Party Client Monies	7.11.11(c)	4.23.7(c)

Notification Obligations – TRUST		
	ASX Market Rule	*ACH Clearing Rule*
Reconciliation has not been performed in accordance with the rules	7.11.11(b)	4.23.7(b)
Deficiency of funds, deficiency in respect to any particular client, or unable to reconcile	7.11.11(d)	4.23.7(d)

As already stated, with respect to ASX futures transactions or option market transactions over an underlying financial product which is a futures market contract, where a client of the ASX Participant does not satisfy its margin or settlement obligations the ASX Participant must pay into the client's segregated account the lesser of:

- the amount of the request; or
- the amount which the Participant would be obliged to request from the client on the following day.

The Act does not contain specific requirements for reconciliation for an Investment Firm that is not subject to the ACH/ASX rules. However, an Investment Firm must, as part of its general duties, keep financial records that correctly record and explain all money received or paid by the Investment Firm in relation to a client money account. We consider that this includes prudent reconciliation processes.

iii. *Is an Investment Firm permitted or encouraged to maintain any of their own assets in a Client Asset account (e.g., as a "buffer")? If so, are any such assets so transferred then deemed to be Client Assets? Is there a requirement to remove any excess assets?*

The client money provisions do not permit Investment Firms to deposit funds belonging to the Investment Firm into client money accounts, by way of "buffer" or otherwise. There is no specific requirement for an Investment Firm to remove any excess assets, although if mixed money or unidentified money is paid into a client money account, then the Investment Firm needs to remove the part of the mixed money/unidentified money that is not client money as soon as practicable. Many Investment Firms maintain a buffer in their client money accounts to minimize client impact for errors and for operational efficiency – sometimes by deferring withdrawal of fees or commissions to which they are entitled.

As already stated, with respect to ASX futures transactions or option market transactions over an underlying financial product which is a futures market contract, where a client of an ASX Participant does not satisfy its margin or settlement obligations the ASX Participant must pay into the client's segregated account the lesser of :

- the amount of the request; or
- the amount which the Participant would be obliged to request from the client on the following day.

c. *Can the Investment Firm use Client Assets of one client for meeting obligations of another client? If so, how?*

Yes, an Investment Firm can use Client Assets of one client for meeting obligations of another client in certain circumstances involving derivatives.

Specifically, if the client money or client property relates to a derivative or a dealing in a derivative, the Investment Firm may use the money for the purpose of meeting obligations incurred by the Investment Firm in connection with margining, guaranteeing, securing, transferring, adjusting or settling dealings in derivatives by the Investment Firm, including dealings on behalf of people other than the client (s981D).

Note that if client property relates to a derivative or a dealing in a derivative, the Investment Firm may use the property concerned for the purpose of meeting obligations incurred by the Investment Firm in connection with margining, guaranteeing, securing, transferring, adjusting or settling dealings in derivatives by the Investment Firm, including dealings on behalf of people other than the client (s984B)).

d. *Are there any restrictions on the ability of the Investment Firm (or other party holding Client Assets) to invest, encumber, rehypothecate, stock-lend, or otherwise deal with, the Client Assets? If so, please describe.*

Client money

Client money is, and investments made with client money are, not capable of being attached or otherwise taken in execution; or of being made subject to a set-off, charge or charging order, or to any process of a similar nature, except at the suit of a person who is otherwise entitled to the money or investment. This money is taken to be held on trust by the Investment Firm: s981H. This applies to client money paid to an Investment Firm, whether it is currently in the Investment Firm's account or before or after it is in the account. It also applies to interest and investment returns on client money, or the proceeds of realisation of such investments, and to investments made in accordance with the Regulations.

There are provisions allowing investment of client money subject to the conditions in the Act and Regulations. In brief, the following kinds of investment may be made in relation to an account maintained for s981B:

- investment in any manner in which trustees are for the time being authorised by law to invest trust funds;
- investment on deposit with an eligible money market dealer;
- investment on deposit at interest with an Australian ADI;
- the acquisition of cash management trust interests;
- investment in a security issued or guaranteed by the Commonwealth or a state or territory;
- investment on deposit with a clearing and settlement facility.

Note: See reg 7.8.02.

An Investment Firm must not invest client money in any of the above ways unless the money is money to which the client is entitled and the Investment Firm has obtained the client's written agreement to the following matters:

- the making of the investment;
- how earnings on the investment are to be dealt with (including whether or not the earnings are to be shared, and whether or not the earnings are to be paid into the account);
- how the realisation of the investment is to be dealt with (including whether or not the capital invested, and the proceeds of the investment, are to be deposited into the account);
- how any losses made on the investment are to be dealt with (including the circumstances in which the Investment Firm is required to pay an amount equal to the

difference between the amount invested and the amount received, into the account or otherwise); and

- the fee (if any) that the Investment Firm proposes to charge for the investment.

Interest or other earnings on permitted investments of client money or the proceeds of the realisation of such an investment must be dealt with in accordance with the written agreement between the Investment Firm and the client: reg 7.8.02(8).

"Investment" for this purpose does not include the making of an investment in accordance with the specific direction of a client. Rather this would be considered to be a withdrawal from the client money account in accordance with the written direction of a person entitled to the money.

If money in a client money account has been invested, the investment is taken to be subject to a trust in favour of each person who is entitled to be paid money from the client money account to the extent that the person is entitled to the money: regs 7.8.03(5) and 7.8.04.

Note that for Investment Firms that are ASX Participants, they are subject to additional restrictions under the ASX Operating Rules. As noted above, if an ASX Participant invests money from a clients' segregated account pursuant to s981C(a), the investment must be readily realisable and at least 50 percent of the money invested under that section must be invested on 24 hour call terms.

Client property

An Investment Firm must ensure that client property is only dealt with in accordance with the Regulations and subject to the requirements in the Regulations, in accordance with the terms and conditions on which the property was given to the Investment Firm and any subsequent instructions given by the client (s984B).

Client property must not be lodged as security for a loan or advance to the Investment Firm unless:

(a) the client owes the Investment Firm an amount in connection with a transaction entered into by the Investment Firm on the client's behalf;

(b) the Investment Firm gives the client a written notice that identifies the property and states that the Investment Firm proposes to deposit it as security for a loan or advance to the Investment Firm; and

(c) the amount, or total of the amounts, that the client owes on the day of the deposit is at least the amount of the loan or advance.

Client property so deposited must be withdrawn within one business day after the client repays its obligation and the Investment Firm must update the client every three months that the property has not been withdrawn (if the loan or advance continues).

Client property protection would also be subject to the specific agreement between the client and the Investment Firm. There is no restriction on parties including a rehypothecation right (a right to borrow the property) in a custody agreement or a prime

broking agreement. If the Investment Firm exercises this right, there would be an outright transfer of the client property to the Investment Firm and the client property protections would not apply.

Note also there is a specific exemption for securities held under a prime brokerage agreement by an Investment Firm who is an Australian ADI for a wholesale client who has agreed that the Investment Firm does not need to hold the property on trust.

e. *What are the requirements, if any, for clearinghouses or other central counterparties to maintain the separate identification of collateral posted by the Investment Firm for its Client Positions?*

The primary requirement at both ACH and SFECC is to be able to differentiate between collateral provided by the Investment Firm and client collateral. This supports the risk mitigation and default management policy of being able to apply Investment Firm collateral against client obligations but not vice versa. Both CCPs' collateral management systems are also able to track the legal owners of all collateral pledged as both of the settlement / asset registration systems (CHESS and EXIGO) operate on a name-on-register basis (as opposed to the holding of securities in "street" name).

4. *Are Investment Firms permitted to transfer to, or hold Client Assets in, another jurisdiction? If so, does the Regime in your jurisdiction require Investment Firms to preserve the separate identification of:*

    a. *Client Assets transferred to or located in other jurisdictions?*

    b. *Client Assets that have been transferred to the Investment Firm from other jurisdictions and that have been identified as Client Assets in those jurisdictions?*

    If so, please provide details of those requirements.

As noted above, client money must be held in a client money account with limited institutions. The effect of this requirement is that client money cannot be held outside Australia unless:

- it is held with a branch of an Australian ADI; or
- Specific authorisation is obtained from ASIC.

There is provision for the Investment Firm to hold client property outside Australia. Specifically, if the client requests the Investment Firm, in writing, to deposit the property in safe custody in the place where the property was deposited with, or received by, the Investment Firm:

a) the Investment Firm must deposit the property in accordance with the request; and

b) if the Investment Firm does not comply with the request for any reason, the Investment Firm must notify the client, as soon as practicable, of the failure to comply with the request.

5. *If the Regime in your jurisdiction permits or requires Client Assets to be held by third party custodians:*

a. *Please describe the requirements, if any, concerning the qualifications of such custodians e.g., licensing, creditworthiness. May the Client Assets be kept with an affiliate of the Investment Firm?*

Client money must be deposited into a client money account as noted above. There is provision for an Investment Firm to pay client money to another Investment Firm, but in such event, the client money must be paid into a client money account, as described above.

There are no restrictions on an Investment Firm that is an Australian ADI or is part of a group with an Australian ADI from maintaining its client money account with itself or the group Australian ADI. In such event, they would still be subject to the restrictions under the client money provisions.

There is provision for client property to be held with a custodian, although that must be done in accordance with the specific instructions of the client and in the manner agreed with the client.

A custodian would need to separately hold an AFS licence with a specific authorisation that permits the custodian to 'provide a custodial or depository service' – irrespective of whether the service is an incidental part of the custodian's business. It would also need to have at least $5 million net tangible assets at all times.

However, an Investment Firm who:

- provides custodial or depository services that are merely incidental to the provision of another financial service; or
- are providing the services on behalf of an investor directed portfolio service,

are not subject to the increased financial resource requirement of maintaining at least $5 million net tangible assets.

b. *Please describe any requirements concerning the custody agreement between intermediary and custodian. In particular, may the custodian be permitted to place a lien, charge or other encumbrance on Client Assets? If so, please explain.*

The Act does not have any specific requirements for the custody agreement. See above for restrictions on dealing with client assets.

6. *Under what circumstances, if any, is an Investment Firm required to disclose to clients information related to the protection of the client's assets? What is the nature of such required disclosures? How do any such required disclosures apply to Client Assets held in another jurisdiction?*

Exchange traded

Where an Investment Firm is operating in the capacity as an ASTC Sponsoring Participant[2], they are required to have the client sign the minimum terms in the Sponsorship Agreement. Within the mandatory provisions of a Sponsorship Agreement some of the items required to be disclosed and to which are relative to this paper are as follows:

- Provisions which identify the CHESS holdings of the Participant Sponsored holder to which the Sponsorship Agreement related by specifying the HINs for those holdings
    - Provisions which identify the existence, extent and circumstances in which any right of the sponsoring Participant to exercise a power of sale in respect of a Participant Sponsored Holders Financial Products will be exercised;
    - Provisions outlining initiation of Transfer or Conversion into or out of the Participant sponsored Holding
    - Procedures relating to the lodgement of Financial Products in a Participant Sponsored holding as cover for written positions in the Australian Options Market
    - Procedures relating to the provision of a charge or any other interest in the Financial Products in a Participant sponsored holding;
    - Procedures relating to the creation of Subpositions over Financial Products in a Participant Sponsored Holding
    - ASTC Settlement Rule 7.2.3 Events of Participant suspension from the Settlement Facility, subject to an assertion of an interest in Financial Products controlled by the Sponsoring Participant, where the assertion is made by either a liquidator, receiver, administrator or trustee of that Participant:
        - The Participant Sponsored holder has the right, within 20 Business Days of ASTC giving Notice of suspension, to give Notice to ASTC to request the holdings be removed from the CHESS Subregister; or from the control of the suspended Sponsoring Participant to the control of another Sponsoring Participant or;
        - Where the Participant Sponsored Holder does not give Notice ASTC may effect a change of Controlling Participant under ASTC Rule 12.19.11.

[2] Sponsoring Participant means a Participant (or for the purpose of this paper an Investment Firm) that establishes and maintains a CHESS Holding of a person that has a current Sponsorship Agreement with a Participant as required under the ASTC Rules. CHESS stands for the Clearing House Electronic Sub register System operated by: a) ACH for the purpose of clearing Cash Market Transactions and Cash CCP Transactions; and
b) ASTC for the purpose of settling transactions in Approved Financial Products Transferring Financial Products and registering Transfers.

- The Sponsorship Agreement must include provisions relating to the Participant sponsored Holder's rights to make a claim for compensation (ASTC Rule 7.2.4, including but not limited to:
    - Identification of compensation arrangements which apply, or if no such arrangements apply a statement to that effect
    - If the Participant is required to lodge a Sponsorship Bond, a statement to the effect that the Participant Sponsored Holder may be entitled to make a claim to ASTC under that bond;
    - If the Participant is a Market Participant of ASX or a Clearing Participant of ACH, a statement to the effect that a Sponsored holder may be entitled to make a claim on the National Guarantee Fund for compensation in the circumstances specified in Part 7.5 Division 4 of the corporations Regulations and where the Participant is not a Market of Clearing Participant a statement to the effect that the Participant sponsored holder is not entitled to make a claim on the National Guarantee Fund for compensation.

Exchange traded Options, Warrants and ASX Futures

Pursuant to ASX Market Rule 7.1.2 before entering into a Market Transaction the Investment Firm must:

- where the client is a Retail Client, in respect of Options Market Contracts, Warrants and Futures Market Contract; or
- where the client is a Wholesale Client, in respect of Futures Market Contracts

enter into a Client Agreement in relation to the relevant Market Transactions. That agreement must, amongst other things, include the mandatory provisions outlined in the Market Rules. Note the mandatory provisions in the Futures Agreement and the Wholesale Options Agreement (not mandatory) refer to client property and funds. The Retail Client Options Agreement is silent on this however it is a mandatory requirement for the Retail Client to receive a copy of the current explanatory booklet in respect of Options, LEPO's and Warrants (as applicable) published by ASX and these do contain certain disclosures about margin, protection and compensation arrangements. These booklets can be accessed at the following addresses:

http://www.asx.com.au/products/pdf/UnderstandingOptions.pdf

http://www.asx.com.au/products/pdf/UnderstandingLEPOs.pdf

http://www.asx.com.au/products/pdf/understandingwarrants.pdf

OTC products

An Investment firm offering financial products that are derivatives to retail clients must generally provide a product disclosure statement (PDS) to the retail client before the financial product is acquired. The Act specifies the type of matters that must be included in the PDS, which, among other things, includes details of the financial product being offered, its characteristics or features, significant benefits and any significant risks, including in relation to a client's money. ASIC has proposed guidance to the effect that this would include clear disclosure about the handling of client money.

7. *Under what conditions, if any, may clients choose to waive any of the Client Asset protection requirements applicable in your jurisdiction (also known as "opting out")? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?*

There is no specific mechanism for clients to opt out of the client asset protection requirements, however, the following practices can have the effect that money that the Investment Firm is holding may not be subject to the client money protections:

(a) as noted above, an Investment Firm may withdraw client money from a client money account if it is entitled to the money – some Investment Firms have written their client agreements to provide that margin payments are due and payable on opening a position, such that on opening of the position, the money ceases to be client money;

(b) an Investment Firm can obtain a written direction to make a payment out of a client money account – ASIC has indicated in draft guidance that a broad authorisation may conflict with an Investment Firm's general licensee obligations; and

(c) ASIC has given limited relief for Australian ADIs dealing with wholesale clients.

There are different market practices as to whether an Investment Firm specifies that margin payments are due to the Investment Firm while the derivative position is open. We are aware that some Investment Firms in the OTC derivatives market operate in this way.
Client property protection would also be subject to the specific agreement between the client and the Investment Firm. There is no restriction on parties including a rehypothecation right (a right to borrow the property) in a custody agreement or a prime broking agreement. If the Investment Firm exercises this right, there would be an outright transfer of the client property to the Investment Firm and the client property protections would not apply.

8. *Under what circumstances, if any, is an Investment Firm required to notify the regulators, or the market generally, of material changes in their financial position or ability to continue to carry on business? What is the nature of such required disclosures?*

Investment Firms (other than those regulated by APRA) must notify ASIC if any event occurs that may make a material adverse change to the financial position of the Investment Firm by comparison with its financial position. This must be notified at the time of the application for an AFS license and in any case not later than 3 business days, after the Investment Firm becomes aware of the event.

Additional disclosures may also occur under the following general requirements.

First, an Investment Firm must give ASIC a written report as soon as practicable, and in any case within 10 business days of becoming aware of a significant breach (or likely significant

breach) of a number of its obligations, including its obligations to comply with the client asset protection provisions and, if the Investment Firm is not regulated by APRA, also its obligation to have adequate resources to provide the financial services covered by its licence.

Any notification of such a breach would need to describe the breach, provide details as to why the Investment Firm considered it significant, how the breach was identified, how long the breach lasted, how it has been rectified and any steps that have been, or will be, taken to ensure future compliance with the obligation.

ASIC has published Regulatory Guide 78 *Breach reporting by AFS licensees* (RG 78) which sets out ASIC's interpretation on this requirement.

Second, an Investment Firm must prepare true and fair profit and loss and balance sheet statements. The Investment Firm must also have these statements audited, which will involve the auditor forming a view as to whether the statements present a true and fair view. Both the accounts and the audit report must be lodged with ASIC.

The auditor of the Investment Firm is also under an obligation to notify ASIC of any contraventions or suspected contraventions of the client money provisions and client property provisions of the Act (including the Regulations) to ASIC. The auditor must report to ASIC within 7 days of becoming aware of a matter, contravention or suspected contravention (s990K).

Further, the auditor must notify in relation to any matter that, in the opinion of the auditor, "has adversely affected, is adversely affecting or may adversely affect the ability of the [Investment Firm] to meet the Investment Firm's obligations as a licensee".

There are obligations outlined in the ASX Market, ACH Clearing and ASTC Settlement Rules which require the ASX Participant to notify ASX in the event of *material changes in their financial position or ability to continue to carry on business.* Below is a schedule of such notifications and their applicability to each of the Rule books.

Notification Required	**ASX Market Rules**	**ACH Clearing Rules**	**ASTC Settlement Rules**
GENERAL NOTIFICATIONS			
Breaches/regulatory action			
A Regulated Person must notify ASX in writing immediately if it:			
a) becomes aware it has breached any Rules that classify a Significant breach	√ 28.2.3	√ 19.2.3	√ 12.18.1
b) as a Clearing Participant, circumstance exists which constitutes an event of default under the operating rules of an Approved Clearing facility	√ 28.2.3	√ 19.2.3, 15.1, 15.3	
c) or any of its employees, any Clearing Participant through which it is clears market transactions, or their employees, becomes subject to disciplinary action by an exchange, market operator, clearing and settlement	√ 4.4.1, 4.4.2 and 28.2.3	√ 19.2.3, 4.7.1	√ 12.18.1

facility			
d) suspects, or is aware of, any fraudulent or other unprofessional conduct by its employee(s)	√ 28.2.3	√ 19.2.3	√ 12.18.1
Financial position/ability to comply with Rules			
Immediate written notification required where Regulated Person is aware of, or suspects the existence of an event or circumstance, which, potentially or actually, adversely affects its solvency or its ability to comply with the Rules.	√ 28.2.3	√ 19.2.3	√ 12.18.1
Immediate written notification required where the Participant reasonably suspects that the Payments Provider that provides a Payment Facility for the Participant will or may not authorise a net payment			√ 12.18.1
Risk Based Capital Requirements			
Immediate notification to ASX (Prudential Risk Management) where, for the Regulated Person, Core Liquid Capital falls below minimum required	√ S1A.2.2(1)(a)	√ S1.2.2(1)(a)	
Immediate notification to ASX (Prudential Risk Management) where, for the Regulated Person, Liquid Capital divided by Total Risk Requirement is equal to or falls below 1.2	√ S1A.2.2(1)(b)	√ S1.2.2(1)(b)	
NTA Requirements			
Immediate notification required where the NTA falls below minimum amount required	√ S1B.5.1	√ S2.5.1	
Immediate notification required where the NTA is less than 150% of the minimum amount required	√ S1B.5.2(a)	√ S2.5.2(a)	
After notifying under S1B/S2.5.2(a), immediate notification required if the NTA then decreases by more than 20% since the amount last notified	√ S1B.5.2(b)	√ S2.5.2(b)	
Notify of intention to commence a business activity that will require a risk calculation under ASX Rule S1A/ACH Rule S1 for which the Participant has not previously demonstrated its ability to calculate and monitor	√ Condition of Rule S1A authorisation letter	√ Condition of Rule S1 authorisation letter	
Other Capital Requirements			
Immediate notification to ASX (Prudential Risk Management) in the event that the Participant ceases to be subject to the Other capital Regime	√ 6.3.6	√ 5.2.6	
Immediate notification to ASX (Prudential Risk Management) in the event that the Participant fails to comply with the Other Capital Regime	√ 6.3.7	√ 5.2.7	

For the purpose of above significance the following factors are required to be considered:

	ASX Market Rules	ACH Clearing Rules	ASTC Settlement Rules
SIGNIFICANCE TEST			
Factors for consideration:			
The number of similar breaches	√ 28.2.3	√ 19.2.3	√ 12.18.3
The frequency of similar breaches	√ 28.2.3	√ 19.2.3	√ 12.18.3
The impact of the breach on the Participant's ability to comply with any other Rule or Procedure or to conduct its business operations	√ 28.2.3	√ 19.2.3	√ 12.18.3
The extent to which the breach indicates that a Participant's arrangements to ensure compliance with the Rules and Procedures is inadequate	√ 28.2.3	√ 19.2.3	√ 12.18.3
The actual or potential financial loss to clients of the Participant arising from the breach	√ 28.2.3	√ 19.2.3	√ 12.18.3
The actual or potential financial loss to the Participant arising from the breach	√ 28.2.3	√ 19.2.3	√ 12.18.3
Any other matter specified by ASX from time to time	√ 28.2.3	√ 19.2.3	√ 12.18.3

Additionally, for ASX Market Participants that are not recognised as Principal Traders only and ACH Clearing Participants, there is an annual requirement for an independent auditor's report on their financial statements and their internal control procedures designed to ensure compliance with requirements of Divisions 2, 3, 4, 5, 6 and 7 of Part 7.8 of the Act other than s991A (which relates to unconscionable conduct).

9. *For an Investment Firm whose financial situation is seen to have deteriorated (e.g., capital has fallen below certain thresholds), what actions, if any, may the firm's regulators take to protect Client Assets?*

Neither ASX nor ASIC have specific authority to take action to protect client assets where the financial situation of an Investment Firm is seen to have deteriorated.

However, ASIC has the power to apply to the Court for an order restraining dealings with a client money account where:

(a) there are reasonable grounds for believing that there is a deficiency in a client money account; or

(b) there has been undue delay, or unreasonable refusal, on an Investment Firm's part in paying, applying or accounting for money as required under the client money provisions.

ASIC is also able to apply for interim freezing orders. The Court is also empowered to give directions regarding the distribution of client money (s983A - 983E).

Post-Insolvency

10. Please describe the process by which an Investment Firm enters the status of "insolvent" or "bankrupt" or the equivalent. For example, is a petition filed by the firm's regulator or some other administrative agency, by creditors of the firm, or otherwise? Is a decree entered by a court? Is this process different from the process applicable to entities that are not Investment Firms?

An Investment Firm may be wound up or an Administrative Officer may also be appointed by a creditor holding security over the Investment Firm's property.

Winding Up of Investment Firms

Investment Firms are typically companies and their winding up is dealt with under the Act. The process for winding up is the same regardless of the company being an Investment Firm or not.

A company may be wound up as follows:

1. Court Liquidation / Winding Up - A creditor may file a winding up application in a state Supreme Court or the Federal Court of Australia for the appointment of a liquidator to a company. This is usually based on a failure to comply with a statutory demand in respect of a debt owed to a creditor although it can be based on the solvency of the company generally or where the Act presumes that a company is insolvent. Winding up of a company usually results in a distribution of the assets of the company and the eventual deregistration of the company.

2. Creditors Voluntary Liquidation / Winding Up – The company by special resolution passed by its members may appoint a liquidator. The liquidator must then convene a meeting of creditors. The liquidator takes control of the company's affairs with a view to winding it up, realising all company assets and distributing any available proceeds to creditors. Again, in almost all instances at the end of the liquidation process the company is deregistered.

3. Members Voluntary Liquidation / Winding Up – The company by special resolution passed by its members may appoint a liquidator. A declaration of solvency must also be made by a majority of directors. If during the winding up process it is determined that the company cannot pay its debts within 12 months, the liquidator must convene a meeting of members and then creditors to resolve to convert the winding up to a creditors' voluntary winding up. Creditors at this meeting may change the liquidator.

4. Voluntary Administration – A company may appoint a voluntary administrator pursuant to s436A where the board has resolved that they are of the opinion that the company is insolvent or is likely to become insolvent at some future time and that an administrator should be appointed. The object of voluntary administration ("VA") is to maximise the chances of the company, or as much as possible of its business, continuing in existence or, if that is not possible, there being a better return to creditors and members than from the immediate winding up of the company. This is achieved as follows:

    a. When appointed the administrator assumes control of the company and the imposition of a moratorium in respect of it that stays proceedings, restricts the enforcement of charges and otherwise protects the company's property. This gives the administrator sufficient time to investigate the company's affairs and report to the creditors regarding the company's future. The creditors then decide whether the company should execute a deed of company arrangement ("DOCA"), the VA should end or the company should be wound up;

    b. A DOCA approved by creditors must identify the property that is to be available to pay creditors' claims, the nature and duration of any moratorium period, the extent to which the company is to be released from debts, conditions for the deed to come into and continue in operation, the circumstances in which the DOCA terminates, the order in which property will be made available to meet creditors' claims and the day on which creditors' claims must have arisen for them to be admissible. A DOCA is therefore quite broad and can provide for:

        i. allowing the company to continue to trade so that it can be sold as a going concern: and/or

        ii. the restructure of the company's affairs so that it can be returned to solvency.

11. *Please describe the process by which the Administrative Officer (as defined above), if any, is selected. What qualifications, if any, must an Administrative Officer have? Who selects the Administrative Officer?*

    Subject to the type of winding up as noted in question 10, above the Administrative Officer is selected as follows:

    1. Court liquidation – in Queensland the applicant will seek the consent of a Liquidator in the event that the petition is successful. In other states a rotational system is in place where the Court selects the Liquidator from a list of qualified practitioners that have consented to such appointment.

    2. Members Voluntary Liquidation – the Investment Firm's directors seek the consent of a Liquidator which is tabled at the meeting convened to consider the resolution to wind the company up. Members may seek the consent of an alternative Liquidator and resolve to appoint that person if they so wish.

3. Creditors Voluntary Liquidation – the Investment Firm's directors seek the consent of a liquidator and resolve to place the company into liquidation and appoint that person to act as Liquidator. Any creditor entitled to attend and vote at the meeting may obtain the consent of a replacement liquidator and seek a resolution to so replace the existing liquidator.

4. Voluntary Administration – The Administrator's consent is sought by the party that is proposing to make the appointment, i.e. the directors, secured creditor or liquidator. Importantly, the appointed Administrator may be replaced by a resolution of creditors at a first meeting of creditors. Additionally, creditors may resolve to appoint a different practitioner to act as Administrator of any Deed of Company Arrangement accepted by them or if the company is placed into liquidation appoint a different person act as Liquidator.

Liquidator Qualifications

A natural person may be registered as a Registered Liquidator with ASIC if they satisfy a number of educational and experience criteria. To act as a Voluntary Administrators the person must be a Registered Liquidator.

These qualifications are:

Education:

i) Have completed a 3 year course of study in accountancy; or

ii) Have completed a 4 year course of study in commercial law (including company law)

at a specified Australian university or tertiary education institution (s1282(2)).

Or has other qualifications and experience that in the opinion of ASIC, are equivalent

Experience:

Be experienced in winding up bodies corporate and have the necessary Personal and Practice Capacities.

Personal capacities include:

- Have worked in corporate insolvency for 5 years full time over the last 10 years.
- Have 3 years of corporate experience at a very senior level over the last 5 years.
- Worked under the supervision of a registered liquidator in Australia or an equivalently qualified overseas practitioner.
- Person has demonstrated skill and diligence and sound judgment in complex matters while working at a very senior level.

Practice capabilities relate to adequate:

- Human resourcing, including supervision and training.

- Internal control procedures.
- Operational control procedure and manuals for conducting the various forms of external administrations.
- Risk management.

12. What are the duties of the Administrative Officer?

The Administrative Officer who is a liquidator has the following duties:

1. To lodge a notice of appointment.
2. Realise all company property that is capable and commercial to realise. The Liquidator is under an obligation to obtain market value for the company's assets and if there is no market value, to obtain the best possible price in the circumstances. The liquidator also has a related duty to preserve the company's assets.
3. Keep books and accounts
4. Investigate the company's affairs to identify any antecedent transactions and to investigate if it is commercial to pursue a recovery of property or compensation with respect to such transactions.
5. Investigate the actions of the company's directors and officers to establish if they have discharged their duties under the law and if not if it is commercial to pursue damages against those directors and officers.
6. Report to creditors during the course of the winding up as needed to ensure creditors are kept property appraised of the status of the administration and the likely return on their claims.
7. To disclaim onerous property
8. Distribute funds to creditors as soon as practicable in accordance with the priority provisions set out under the Act.
9. Provide a report to ASIC detailing the results of the liquidator's investigations. Bring about the deregistration of the Company

a. What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?

An Administrative Officer's duties are principally set out in Act and related common law decisions interpreting those provisions.

Pursuant to s180 officers of a corporation (including an Administrative Officer) must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise in such a position. Additionally there are specific duties to obtain market value for goods sold by the various types of Administrative Officer that may be appointed.

Additional guidance is provided by the following:

- Insolvency Practitioners Association of Australia Code of Professional Practice.
- Australian Accounting Standards
- Individual states real property legislation.

b. *Under what standard (e.g., strict liability, negligence), if any, is the Administrative Officer, pursuant to the Regime in your jurisdiction, subject to personal liability for failure to properly perform his or its duties?*

An administrative officer owes a statutory duty of care and diligence. An administrative officer can also be found in common law liable for negligence. An administrative officer who is negligent can also be found to be personally liable in certain circumstances.

13. *What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?*

a. *Does the regulator continue to supervise the Investment Firm?*

b. *How, if at all, is the regulator involved in the process of returning Client Assets?*

ASIC maintains a supervisory role of the Administrative Officer, as does the Court, generally not getting involved in the winding up of an Investment Firm or the distribution of assets. ASIC reserves the right to intervene in any winding up.

Note that ASIC has the power to apply to the Court for an order restraining dealings with a client money account where:

(a) there are reasonable grounds for believing that there is a deficiency in a client money account; or

(b) there has been undue delay, or unreasonable refusal, on an Investment Firm's part in paying, applying or accounting for money as required under the client money provisions.

ASIC is also able to apply for interim freezing orders. The Court is also empowered to give directions regarding the distribution of client money (s983A – 983E).

14. *Does the Regime in your jurisdiction facilitate or encourage the transfer of Client Assets from an Investment Firm which has become bankrupt or insolvent to a solvent Investment Firm?*

As a general matter, there is no overarching arrangement where Client Assets of one Investment Firm may be transferred to a solvent Investment Firm.

Note that for ASX Participants, the ASX Operating Rules describe events which may otherwise be regarded to be an event of default, or otherwise an event of non compliance, and in response to these events, the ASX (ASX Market Rule 28.4.1, 28.4.2, 28.4.4), ACH (ACH Clearing Rules Section 15) or as applicable ASTC (ASTC Settlement Rules 12.19) has certain rights to take certain actions. By way of example this could include action such as:

- Cancellation of Derivatives Market Transactions effected by the Market Participants which has not been reported to an approved Clearing Facility for registration;
- Suspend or Terminate the Market Participants admission or impose restrictions on its rights or privileges as a Market Participant
- Take any other action, or take no action, or direct the Market Participant to take any action or no action, in order to eliminate or minimize risk with respect to Market Transactions entered into by the Market Participant or which ASX considers appropriate for the protection of ASX, an Approved Clearing Facility, the Market or other Market Participants
- Demand immediate payment of any net amount payable by the Clearing Participant
- Refuse to register Derivative Market Contracts reported for registration in the Participants name or allocated to the Participant
- Close out, exercise or allow to expire, or terminate the positions
- Transfer any or all: Cash CCP Transactions and/or Derivatives CCP Contracts to another Participant
- Sell all or part of the collateral
- Suspend Batch Settlement or Real Time Gross Settlement
- Where an ASTC Participant has been suspended by ASTC (including for bankruptcy or insolvency) ASTC has powers to: Transfer client holdings to another ASTC Participant; or
- Convert the holdings from the CHESS sub-register under the control of the Participant to the Issuer Sponsored subregister (ASTC Settlement Rules 12.19.10 and 11).

a. *What steps, if any, are prerequisite to accomplishing such a transfer? In general, how long does it take to accomplish those steps?*

Not applicable.

b. *What factors, if any, affect the time period required to accomplish such a transfer?*

Not applicable.

15. *To what extent are clients at risk of, or protected from, having to return Client Assets (or the value thereof) that were distributed to the client prior to the insolvency proceeding?*

    Not applicable.

16. *To what extent, if at all, does the Regime in your jurisdiction provide compensation to clients from other sources (for example, an investor protection or similar fund) for loss of Client Assets? Please discuss the scope of protections, conditions on such protection, and the limits of compensation (e.g., maximum compensation per client).*

The National Guarantee Fund is a compensation fund that is available to meet valid claims arising from dealings with ASX Participants, and subject to certain conditions, enables the clients of market participants to claim payment in cash or delivery of securities in certain events, including: loss resulting from a market participant becoming insolvent.

The Fund is administered by Securities Exchanges Guarantee Corporation Ltd (SEGC). SEGC is a subsidiary of ASX, but operates independently and in accordance with Division 4 of Part 7.5 of the Act.

There are four subdivisions of Division 4 of Part 7.5 of the Regulations which set out the types of claims which you may make on SEGC. In general terms, Subdivision 4.9 provides for compensation for loss that results if an ASX Participant becomes insolvent and fails to meet its obligations to a person who had previously entrusted property to it.

The property must have been entrusted in the course of or in connection with the Dealer's business of dealing in securities and the property must have been received by the Dealer on your behalf or as trustee for you. Money loaned to a Dealer is specifically excluded.

This type of claim generally occurs if there is a shortfall of money in the trust account of the Dealer or if there is a shortfall in securities in the custodian holdings of the Dealer.

You cannot make a claim if:

• before the Dealer became insolvent, the trust property ceased to be under the sole control of the Dealer; or

• your act or omission directly or indirectly resulted in circumstances which, in the opinion of SEGC or the court, materially contributed to the Dealer becoming insolvent.

Note that this protection applies in relation to property entrusted to a Participant of ACH as well as property entrusted to a Market Participant of ASX.

SEGC generally settles valid claims under this Subdivision by replacing the property. If the property is securities and replacement securities cannot be obtained, SEGC will pay compensation for the loss.

Except in very limited circumstances the National Guarantee Fund does not cover Exchange Traded Options nor does it cover over-the-counter derivatives transactions.

With respect to ASX Futures, the ASX Supplemental Compensation Fund has been designed to provide a degree of financial protection for retail clients who have entrusted property to a stockbroker in respect of actual or proposed dealings in futures on ASX Limited.

The Fund is essentially a fidelity fund. Claims on the Fund are likely to be made by clients of Market Participants who have trading permission to deal in futures on behalf of clients.

The Fund is designed to deal with claims that arise from a client suffering a loss as a result of giving money or other property to a stockbroker and that money or property being misappropriated. Also covered is the situation where a client gives a stockbroker authority over property and there is subsequent fraudulent misuse of the authority by the stockbroker.

17. *Are there circumstances in which clients are treated differently based on permissions they have granted pre-bankruptcy. E.g., if any re-hypothecation has been entered into (or a 'right-to-use' exercised), please explain the client's position under the Insolvency Regime in such event.*

The client money and client property provisions protect client money retained in a client money account and client property that can be separately identified.

Client money

The Act provides for how client money is to be dealt with if an Investment Firm:

- ceases to be licensed (including a cessation because the Investment Firm's AFS licence has been suspended or cancelled);
- becomes insolvent under an administration, has an administrator or receiver appointed or is subject to similar proceedings; or
- ceases to carry on an activity authorised by the AFS licence and is paid money in relation to that activity.

In such event, the account is taken to be subject to a trust in favour of the person for each person who is entitled to be paid money from a client money account: reg 7.8.03(4).

The Act specifies an order of payment and provides that client money is to be paid as follows:

- the first payment is of money that has been paid into the account in error;
- if money has been received on behalf of insured persons in accordance with a contract of insurance, the second payment is payment to each insured person entitled to receive money from the client money account in respect of claims that have been made and then in respect of other matters;
- the next payment is payment to each person who is entitled to be paid money from the client money account;
- if the money in the client money account is not sufficient to be paid in accordance with paragraph (a), (b) or (c), the money must be paid in proportion to the amount of each person's entitlement; and
- if there is money remaining in the account after payments made in accordance with the above, the remaining money is taken to be money payable to the Investment Firm.

Note: See reg 7.8.03(6).

These rules override anything to the contrary in the *Bankruptcy Act* or in company law: reg 7.8.03(7). This includes distribution of the general pool of assets described under question 21.

Client property

If a client has granted a rehypothecation right and the Investment Firm has exercised that right, then the client is unlikely to have any preference to the property transferred. They will be an unsecured creditor for any amounts owing, including the value of the property transferred pursuant to the rehypothecation right.

Other client property that is separately identifiable would fall outside of the general pool of assets and, subject to verifying ownership, the Administrative Officer would return the client property to the relevant clients.

18. *Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?*

Not applicable.

19. *What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?*

As noted under question 17 above, if there is any shortfall in the client money account, the money is paid pro rata to persons entitled. There is no basis for treating specific clients differently. Clients would then become unsecured creditors for any shortfall and distribution would be subject to the payment of expenses as described under question 21.

The Investment Firm may be liable to the imposition of a penalty of $550 for failing to comply with the relevant obligations in Pt 7.8.

Where the officers of the Investment Firm have breached their duties this may give rise to a claim for compensation under any Directors and Officers Insurance policies held.

20. *If there is a shortfall, i.e., if claims by clients exceed resources dedicated to paying such claims (whether from Client Assets, investor protection fund, or otherwise), how are Client Assets distributed? E.g., is there a pro rata distribution of Client Assets, are there priorities between classes of clients, is there a priority distribution ahead of the distribution of the general estate/distribution to unsecured creditors?*

Please see our answer to questions 17 and 18 above.

21. *Please explain how claims of clients are ranked in the insolvency process relative to those of other creditors. Does your insolvency regime rank domestic creditors above foreign creditors?*

Refer to question 17 above for the distribution of client money.

As for the distribution of the general pool of assets, the following debts and claims must be paid in priority to all other unsecured debts and claims (s556). The debts of a class referred to in each of the undermentioned paragraphs rank equally between themselves and are to be paid in full, unless the property of the company is insufficient to meet them, in which case they should be paid proportionately (s559):

(a) the expenses (except deferred expenses) properly incurred by a liquidator or other relevant authority in preserving, realising or getting in property of the company, or in carrying on the company's business;

(b) if the Court ordered the winding up — the costs in respect of the application for the order (including the applicant creditor's costs in petitioning the court for the winding up (s466));

(c) the debts incurred by a Voluntary Administrator of the company they are indemnified for under s443D(a), even if the administration ended before the relevant date, except expenses covered by (a) above and deferred expenses — these are the debts for which the administrator is personally liable under s443A (general debts for services rendered, goods bought, property hired, leased, used and occupied) and s443B (payments for property used or occupied or in the possession of the company, after seven day breathing space).

(d) Repealed;

(da) if the Court ordered the winding up — costs and expenses that are payable under s475(8) out of the company's property — these are costs and expenses of a person making or concurring in making a report as to affairs, or other report under s475 (usually by the company director detailing the company's assets and liabilities), and, subject to the rules, payable by the liquidator/provisional liquidator in such amounts as he considers reasonable;

(db) costs and expenses payable under s539(6) — being the costs of an audit of liquidators/provisional liquidators accounts, if undertaken, as fixed by ASIC;

(dc) Repealed;

(dd) any other expenses (excluding those mentioned above), except deferred expenses, (see below), properly incurred by a liquidator or other relevant authority;

(de) deferred expenses as defined below, being primarily remuneration of a liquidator or other relevant authority;

(df) if a committee of inspection has been appointed for purposes of the winding-up — expenses incurred by a person as a member of the committee;

(e) wages and superannuation contributions payable by the company in respect of services rendered to the company by employees before the relevant date — but subject to the limitations on excluded employees detailed below;

(f) amounts due in respect of injury compensation, being compensation the liability for which arose before the relevant date;

(g) all amounts due on or before the date of liquidation to or in respect of an employee for leave of absence, being amounts due by virtue of an industrial instrument. This applies whether the employee is remunerated by salary, wages, commission or otherwise here again excluded employees may be limited in their claims;

(h) retrenchment payments payable to employees of the company — excluded employee limitations also apply;

`*relevant date''* is defined in relation to a winding up. It means the day on which a winding up is taken to have begun. There is an exception to this statement which relates to the determination of the ``relevant date" for debts and claims which arise while a company is subject to a deed of company arrangement immediately before it goes into liquidation. Pursuant to s553(1B) the ``relevant date" in these circumstances is the date on which the deed terminates.

Note that a *relevant authority*, in relation to a company, means any of the following:

(a) a liquidator or provisional liquidator of the company;

(b) if winding up began within two months after the end of a period of official management — an official manager;

(c) an administrator of the company, even if the administration ended before the winding up began;

(d) an administrator of a deed of company arrangement executed by the company, even if the deed terminated before the winding up began.

Deferred expenses, in relation to a company, means expenses properly incurred by a relevant authority, in so far as they consist of:

(a) remuneration, or fees for services, payable to the relevant authority; or

(b) expenses incurred by the relevant authority in respect of the supply of services to the relevant authority by:

(i) a partnership of which the relevant authority is a member; or

(ii) an employee of the relevant authority; or

(iii) a member or employee of such a partnership; or

(c) expenses incurred by the relevant authority in respect of the supply to the relevant authority of services that it is reasonable to expect could have instead been supplied by:

(i) relevant authorities; or

(ii) a partnership of which the relevant authority is a member; or

(iii) an employee of the relevant authority; or

(iv) a member or employee of such a partnership

Employees are entitled to receive priority repayment if they are owed:

• any amounts which are classifiable as an **expense properly incurred by a liquidator or other relevant authority** in preserving, realising or getting in property of the company, or in carrying on the company's business pursuant to s556(1)(a)

• any amounts which are classifiable as a **debt incurred by a voluntary administrator** for which he or she is liable to be indemnified by s443A (ie for services rendered) pursuant to s556(1)(c)

• any amounts classifiable as an **expense properly incurred by a liquidator or other relevant authority**, pursuant to s556(1)(dd), or

• **wages** and **superannuation contributions payable** by the company in respect of services rendered to the company by employees **before** the relevant date, but **not exceeding $2,000** in respect of an excluded employee attributable to non-priority days (s556(1)(e)(1A))

• amounts **due on or before** the relevant date to or in respect of any *employee* (whether remunerated by salary, wages, commission or otherwise) for **leave of absence**, being amounts due by virtue of an industrial instrument (s556(1)(g)). But "excluded" employees are **limited to $1,500**, attributable to non-priority days (s556(1B))

• **retrenchment payments payable**; but "excluded employees" are **not allowed to rank for any retrenchment amount** attributable to non-priority days (s556(1)(h)(1C)).

As client money is held on trust, the money would be part of the moneys to be dealt with under the winding up but the order of distribution is as noted under question 17 above rather than falling to the general pool.

There is no differentiation between a domestic creditor and a foreign creditor.

III. Pertinent references

Please provide, for any statutes, regulations, or other authorities or texts that are referred to in your response, electronic copies (in English translation, if available), or URL links to available copies. How might a person outside your jurisdiction most readily get access to such items? Are there treatises that would be useful for obtaining a general understanding of client asset protection in your jurisdiction?

Set out in the table below is the internet references to the legislation, regulations and rules referred to in our response

CORPORATIONS ACT 2001	http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/
CORPORATIONS REGULATIONS 2001 - made under the Corporations Act 2001	http://austlii.law.uts.edu.au/au/legis/cth/consol_reg/cr2001281/index.html
ASX Market Rules (ASX MR)	http://www.asx.com.au/supervision/rules_guidance/market_rules.htm
ACH Clearing Rules (ACH CR)	http://www.asx.com.au/supervision/rules_guidance/clearing_rules.htm
ASTC Settlement Rules (ASTC SR)	http://www.asx.com.au/supervision/rules_guidance/astc_rules.htm
ASIC Regulatory Guide	http://www.asic.gov.au/asic/asic.nsf/byheadline/Regulatory+guides?openDocument
Securities Exchanges Guarantee Corporation Ltd (SEGC)	http://www.segc.com.au/

Brazil

Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets

I. Background

This questionnaire seeks information to aid in understanding the responding jurisdictions' techniques for protecting Client Assets in the event of the insolvency and/or winding up of an Investment Firm, and for promptly transferring such assets to a solvent Investment Firm or distributing them to the client. It is not intended to require information concerning the general legal framework for insolvency, except to the limited extent necessary to understand how rules for the protection of Client Assets fit within that framework.

Definitions.

(1) **"Administrative Officer"** refers to the person or entity who is appointed, whether by a court, regulator, creditors, the Investment Firm itself, or otherwise, to assume control of or power over a bankrupt or insolvent Investment Firm. This term includes administrators, debtors in possession, receivers, liquidators, trustees, and similar titles.

(2) **"Client Assets"** refers collectively to Positions, Securities, and Client Money:

- "**Positions"** are contractual rights and obligations arising from transactions entered into by an investment firm on behalf of its clients, including mark to market accruals arising from the change in value of futures, options and/or other derivatives positions;

- "**Securities"** are defined to incorporate both securities and derivatives, as those terms are defined or understood in the responding jurisdiction; and

- "**Client Money"** refers to funds owed to or held on behalf of clients by an investment firm, and may include margin collateral associated with client positions (both existing and potential), income relating to an investment such as dividends or interest, proceeds of the liquidation of client securities and/or positions, and funds in excess of required margin.

(3) **"Investment Firm"** means an intermediary that holds Client Assets and is engaged in the business of managing client accounts, which could include, without limitation: executing orders on behalf of others, dealing in or distributing Securities (including carrying derivatives positions). In jurisdictions where banks are broadly permitted to engage in such a business, this term includes banks to the extent they are providing such services.

(4) **"Omnibus Account"** means an Investment Firm's account with a third party in which Client Assets are maintained separate from the firm's assets, but are held in the aggregate instead of in accounts designated for individual clients.

(5) **"Regime"** refers to statutes, regulations, rules of exchanges, clearing organizations and other self-regulatory bodies, or other legally binding requirements.

II. Survey Questions *Where appropriate, please provide citations to statutes, regulations, or other authorities supporting your answers below.*

Context

1. Please provide a brief overview setting forth the defining characteristics of your jurisdiction's approach to protecting Client Assets.

In answering the remaining questions:

(1) Please provide details, as appropriate, where the Regime in your jurisdiction applies different treatment or results based on differences in:

a. Categories of Client Assets;

b. Models of trading (e.g., exchange-traded versus over-the-counter).

*c. Categories of clients (*e.g.*, retail versus sophisticated)*

(2) *You are requested to provide details of the Regime in your jurisdiction. You are additionally invited to provide information explaining how that Regime is applied in practice, through,* e.g., *informal arrangements between governmental entities.*

The issue of protecting client assets is addressed both by federal laws (Law n. 6024/74, n. 9447/97 and n. 11.101/05) and regulations (several rules issued by the National Monetary Council - CMN, the Brazilian Central Bank – BCB and the Brazilian Securities and Exchange Commission – CVM).

The regulatory body in charge of the intervention, liquidation and temporary administration regimes of Investment Firms is the Brazilian Central Bank, due to Law n. 6024/74 provisions. The scope of this provision includes all financial institutions, what means, in practical terms, the relevant portion of Brazilian financial intermediaries.

There are formal arrangements between BCB and CVM, including the exchange of information concerning institutions subject to both authorities.

As a general provision, all client assets must be adequately safeguarded and properly accounted for. In addition, differently from other jurisdictions, all client assets must be segregated in individual accounts, at the intermediary level, at custodian level and at the depository institution level (at the same time). By no means clients assets are allowed to be held in shared accounts or accounts registered in the name of the intermediary. This rules applies to securities, derivatives, cash and any other financial asset, no matter the client is a retail, institutional, local or foreigner. There is also no distinction between exchange or OTC markets concerning this issue.

Pre-Insolvency

2. Does the regime in your jurisdiction require an Investment Firm to hold special authorization (*i.e.*, a specific form of license or registration) to be permitted to hold Client Assets?

Yes. Only authorized financial institutions and intermediaries are allowed to offer investment or credit services (the authority in charge of issuing this license varies according to the market segment, BCB, CVM or both, depending on the market segment).

a. If special authorization is required, what requirements (both initial and ongoing) is an Investment Firm required to comply with to hold such authorization?

According to the market segment, the requirements are different. In general, these include a formal request, copy of bylaws, identification of controlling shareholders and management, a general plan of operation (business plan), filing bylaws and other relevant documents in the Public Commerce Registry, identification of offices that will be used, identification of independent auditor, evidence of subscribed capital, track records, a presentation of management expertise, financial soundness, compliance with capital requirements, a description of internal compliance and controls systems. The request is subject to a "fit and proper" analysis.

b. If special authorization is not required, how, if at all, is this activity supervised by a regulator?

Not applicable.

3. Does the Regime in your jurisdiction require that Client Assets be maintained separately from the assets of an Investment Firm? If so, please provide a description of the process by which segregation is accomplished, and of the applicable requirements. Specifically:

a. Must the Client Assets of one client be maintained separately from those of other clients?

Yes. All clients assets must be maintained separately, in individual accounts, not only at the Investment Firm level, but also at the custodiant and depositary level. The separation of accounts must be effective, and neither the Investment Firm nor third parties may use clients assets without client's formal and specific consent.

i. Are Investment Firms allowed to hold Omnibus Accounts?

No, in the Brazilian market no Omnibus Accounts are allowed. All assets must be registered and kept in individual accounts.

ii. What measures are used to protect the Client Assets of each client from losses due to the activities of other clients?

As all assets are kept in individual accounts, the risk is segregated, what includes the sub-custodian, custodian and depositary levels. For CCP purposes, there is also an individual control of trades, positions and margins, as each client of an Investment Firm has one individual account.

b. Please describe any requirement that an Investment Firm must reconcile the Client Asset account. For example:

In the Brazilian case, this situation would apply only to cash maintained by clients at securities or futures brokers, as for all other situations the assets (securities, derivatives and other financial assets) are kept in individual accounts, registered in the name of the final client at the different levels (Investment Firm, Custodiant, Sub-Custodiant and Depositary Institution). In this sense, all positions within these different institutions must match.

i. How do you calculate the amount of Client Assets that a firm is required to hold in one or more accounts segregated for the benefit of clients?

In the case of cash, the amount of Client Assets must match the value of cash deposited by the brokerage house in a bank.

A) Are required Client Assets fungible between or within asset classes, or is the Investment Firm required to hold, *e.g.*, the specific assets deposited by the client?

In this specific case, as it only applies to cash, they are fungible. But as a general provision, all assets of the same characteristics are fungible.

B) How is the reconciliation conducted (*e.g.*¸ on an aggregate basis, or a client-by-client basis)?

On a client-by-client basis, as the brokerage house must keep individual accounts for clients.

C) If a client has a debit balance (*i.e.*, the client owes the Investment Firm), is such balance deducted in determining the amount the Investment Firm is required to hold?

Yes, as this situation would apply only for cash.

ii Timing issues:

A) How often is reconciliation required (*e.g.*, daily, weekly, monthly).

The reconciliation must be performed on a daily basis, if no specific situation (e.g. risk exposure, margin calls, etc.) requires continuous follow up.

B) When is such reconciliation required (*e.g.*, noon of the following busness day, the tenth business day of the following month).

Please see previous answer.

C) Is the Investment Firm required to make good any deficiency from their own funds? If so, in what period? Is any payment by the Investment Firm thereby deemed to be Client Money?

If a deficiency is identified, the Investment Firm should it make good as soon as possible. In this case, the cash deposited will be considered client money.

iii. Is an Investment Firm permitted or encouraged to maintain any of their own assets in a Client Asset account (*e.g.*, as a "buffer")? If so, are any such assets so transferred then deemed to be Client Assets? Is there a requirement to remove any excess assets?

No.

c. Can the Investment Firm use Client Assets of one client for meeting obligations of another client? If so, how?

No, it would be considered a violation of regulations.

d. Are there any restrictions on the ability of the Investment Firm (or other party holding Client Assets) to invest, encumber, rehypothecate, stock-lend, or otherwise deal with, the Client Assets? If so, please describe.

Yes, but only if (i) there is a specific authorization issued by the client, (ii) due to a court order or (iii) it is related to a contractual arrangement, related to a client position, trade or other obligation (e.g. margins, collateralization, etc.).

e. What are the requirements, if any, for clearinghouses or other central counterparties to maintain the separate identification of collateral posted by the Investment Firm for its Client Positions?

In Brazil all clearinghouses and other central counterparties must keep individual accounts, segregated by final client.

As such, all positions are controlled on an individual basis and not by intermediary or clearinghouse member. This individual control applies to all collateral posted by the investment firm, as the client must be identified to the CCP.

4. Are Investment Firms permitted to transfer to, or hold Client Assets in, another jurisdiction? If so, does the Regime in your jurisdiction require Investment Firms to preserve the separate identification of:

Yes, but there are no specific provisions concerning this issue, so the local general requirements apply.

a. Client Assets transferred to or located in other jurisdictions?

Please see previous answer.

b. Client Assets that have been transferred to the Investment Firm from other jurisdictions and that have been identified as Client Assets in those jurisdictions?

If so, please provide details of those requirements.

Please see previous answers.

5. If the Regime in your jurisdiction permits or requires Client Assets to be held by third party custodians:

a. Please describe the requirements, if any, concerning the qualifications of such custodians e.g., licensing, creditworthiness. May the Client Assets be kept with an affiliate of the Investment Firm?

According to Brazilian regulations, only authorized financial institutions may act as custodians. The authorizations are restricted to banks, broker-dealers, exchanges and clearinghouses, according to technical and financial requirements.

In order to obtain a license, the custodian must present to the relevant authority (CVM) (i) a general description of the services that will be provided, the controls that will be implemented and the IT infrastructure, (ii) a description of its internal governance structure, (iii) a designation of the executive in charge of this service/area, (iv) a list of relevant positions of the custodian as a shareholder in public companies, (v) a presentation of the training program of its staff, (vi) copy of contracts that will be used in providing this service, (vii) a description of the internal audit program, (viii) the designation of external auditors and (ix) an auditor report concerning the adequacy of implemented internal controls and IT infrastructure in order to perform the custodian services.

b. Please describe any requirements concerning the custody agreement between intermediary and custodian. In particular, may the custodian be permitted to

place a lien, charge or other encumbrance on Client Assets? If so, please explain.

Yes, but only with authorization of the client. There are no specific requirements concerning the contractual relationship between the custodian and the Investment Firm, but general requirements of the Brazilian Civil Code apply.

6. Under what circumstances, if any, is an Investment Firm required to disclose to clients information related to the protection of the client's assets? What is the nature of such required disclosures? How do any such required disclosures apply to Client Assets held in another jurisdiction?

The terms and conditions of the services provided by the Investment Firm or third parties (e.g. custodians) are detailed in the contracts signed by the client. In addition, for some specific investments, the Investment Firm must disclose that no protection from Deposit Insurance ("Fundo Garantidor de Créditos") applies.
There are no specific provisions concerning assets held in another jurisdiction.

7. Under what conditions, if any, may clients choose to waive any of the Client Asset protection requirements applicable in your jurisdiction (also known as "opting out")? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

Under Brazilian rules, this situation is not possible.

8. Under what circumstances, if any, is an Investment Firm required to notify the regulators, or the market generally, of material changes in their financial position or ability to continue to carry on business? What is the nature of such required disclosures?

Periodical financial information must be provided to relevant authorities (CVM, BCB and SROs). The clearinghouses also monitor the financial soundness of their clearing members and any situation must be reported to CVM and BCB.

In addition, according to Section 2 of Law n.6.024, an Investment Firm must notify BCB of an insolvency situation.

9. For an Investment Firm whose financial situation is seen to have deteriorated *(e.g.*, capital has fallen below certain thresholds), what actions, if any, may the firm's regulators take to protect Client Assets?

For that purpose, BCB may adopt administrative measures according to Law n. 6.024 regime, including injunctions, investigatory and sanctioning procedures, and restriction of activities. In a case of a formal recognition of insolvency, BCB may take control of the firm, by removing members of the board and top management and appointing an external administrator ("Administrative Officer").
If the Investment Firm is and exchange or clearinghouse member, part of this function may be performed by these institutions, that would act as BCB's assistant.

Post-Insolvency

10. Please describe the process by which an Investment Firm enters the status of "insolvent" or "bankrupt" or the equivalent. For example, is a petition filed by the firm's regulator or some other administrative agency, by creditors of the firm, or otherwise? Is a decree entered by a court? Is this process different from the process applicable to entities that are not Investment Firms?

The process is far different from the one applicable to non financial institutions (Law n. 11.101). According to Law n. 6.024, there is no need that a decree is entered by a court. The declaration of an insolvency status is a matter of extra-judicial proceedings, performed by the BCB.
One possibility is that the petition is filed by the Investment Firm. But BCB may declare the administrative intervention *ex officio*, in the following situations: (i) presence of any financial situation that may compromise the stability, liquidity and the protection of the Investment Firm creditors, (ii) whenever detected any serious law violations, (iii) when any serious loss faced by the Investment Firm changes considerably and in an abnormal way the risk offered to its creditors and (iv) when within 90 days of a cancelation of the license of an Investment Firm, its dissolution process was not initiated.

11. Please describe the process by which the Administrative Officer (as defined above), if any, is selected. What qualifications, if any, must an Administrative Officer have? Who selects the Administrative Officer?

The Administrative Officer is selected by the BCB. Law n. 6.024 does not establish the minimum qualifications for an Administrative Officer, but this person is usually a BCB employee of a former (retired) BCB employee, with experience in the financial market sector.

12. What are the duties of the Administrative Officer?

a. What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?

As a general provision, Law n. 6.024 states that the Administrative Officer must safeguard the interests of the investors as well as manage the assets and liabilities of the Investment Firm in order to drive the liquidation process (if this is the case). As immediate measures, the Administrative Officer must (i) gather all books, records and documents of the Investment Firm, (ii) prepare updated financial statements of the Investment Firm, listing all available assets, including those that are held by third parties. Within 60 days after the intervention, the Administrative Officer must present to BCB a report addressing (i) the financial situation of the Investment Firm, (ii) any violation of laws and regulations that were identified, (iii) a proposition of additional measures that should be adopted.

b. Under what standard (*e.g.*, strict liability, negligence), if any, is the Administrative Officer, pursuant to the Regime in your jurisdiction, subject to personal liability for failure to properly perform his or its duties?

The Administrative Officer has personal responsibility under negligence standards.

13. What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?

a. Does the regulator continue to supervise the Investment Firm?

Yes. As the Administrative Officer is appointed by the BCB (the relevant authority in this case) and is obliged to report any developments on a periodical basis or whenever the situation requires, the regulator is able to supervise the intervention process very closely.

b. How, if at all, is the regulator involved in the process of returning Client Assets?

Please refer to previous answer.

14. Does the Regime in your jurisdiction facilitate or encourage the transfer of Client Assets from an Investment Firm which has become bankrupt or insolvent to a solvent Investment Firm?

Yes, this is the ordinary approach. But the Investment Firm (in and intervention situation, the Administrative Officer) must obtain clients instructions concerning this transfer.

a. What steps, if any, are prerequisite to accomplishing such a transfer? In general, how long does it take to accomplish those steps?

The assets must be registered in the client account, and the transfer must be authorized by the Administrative Officer. There is no provision addressing the minimum or maximum period of time, but it must be done without undue delay.

b. What factors, if any, affect the time period required to accomplish such a transfer?

Usually the most relevant factors are the quality of internal controls of the Investment Firm, and if any misuse of clients assets were detected. These aspects would demand further work by the Administrative Officer, in order to assure that the appropriated assets are transferred to clients.

15. To what extent are clients at risk of, or protected from, having to return Client Assets (or the value thereof) that were distributed to the client prior to the insolvency proceeding?

In the case of financial institutions, unless any inappropriate distribution is detected by the Administrative Officer, there is no such risk.

16. To what extent, if at all, does the Regime in your jurisdiction provide compensation to clients from other sources (for example, an investor protection or similar fund) for loss of Client Assets? Please discuss the scope of protections, conditions on such protection, and the limits of compensation (*e.g.*, maximum compensation per client).

There are two mechanisms in place:

(i) "Fundo Garantidor de Créditos" (FGC): it is a deposit guarantee system, that applies to (a) demand deposits or deposits drawn on prior notice, (b) deposits in

current account of deposits for investments, (c) savings account deposits, (d) time deposits, with or without the issuance of certificates, (e) deposits in accounts not draw able by means of checks and which are used for the registration and control of flows of funds for the purpose of paying salaries, wages, retirement payments, pension payments and other similar obligations, (f) bills of exchange, (g) real estate bills, (h) mortgage bills and (i) real estate credit bills. The payout polices are set per person or account (some restrictions apply) and the coverage is limited to R$ 60,000.00 (approximately US$ 37,350.00). It applies to all financial institutions that offer these investment alternatives, basically banks, savings and loans and financial institutions in the real estate segment. The rules concerning the FGC are issued by the National Monetary Council (Resolution n. 3.251/04), but it works as a private company.

(ii) "Mecanismos de Ressarcimento de Prejuízos"(MRP): it is another guarantee system, but with a more limited and restricted approach. It applies only to Investment Firms with direct access to the Brazilian exchange (BM&FBOVESPA), with equal coverage limit (R$ 60,000.00 or US$ 37,350.00) per person. The assets classes under protection are those ones listed in the exchange (basically securities and derivatives).

17. Are there circumstances in which clients are treated differently based on permissions they have granted pre-bankruptcy. *E.g.*, if any re-hypothecation has been entered into (or a 'right-to-use' exercised), please explain the client's position under the Insolvency Regime in such event.

There is no general provision concerning this issue, but a different treatment would depend on the existence of separate contractual arrangements between the client, the Investment Firm and third parties.

18. Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?

For these circumstances, there are no specific protection regimes under the Brazilian law. In this case, the foreign provisions would be applicable.

19. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?

No, there is no differentiation between clients but this situation would result in (i) an enforcement procedure conducted by the relevant authorities (BCB, CVM or both), and (ii) civil actions and/or (iii) criminal investigation.

20. If there is a shortfall, *i.e.*, if claims by clients exceed resources dedicated to paying such claims (whether from Client Assets, investor protection fund, or otherwise), how are Client Assets distributed? *E.g.*, is there a pro rata distribution of Client Assets, are there priorities between classes of clients, is there a priority distribution ahead of the distribution of the general estate/distribution to unsecured creditors?

As all client assets must be held in individual accounts in all situations, except for fraud or serious internal controls failure, this situation is not expected. Anyway, the situation would be addressed by the Administrative Officer, under the supervision of BCB. The most likely procedure would be (i) to give priority to

clients (and not to ordinary creditors) and (ii) a pro rata distribution among clients, if the assets of the Investment Firm are not enough to pay all clients` claims.

21. Please explain how claims of clients are ranked in the insolvency process relative to those of other creditors. Does your insolvency regime rank domestic creditors above foreign creditors?

There is no distinction between domestic and foreign clients, but foreigners must appoint a legal representative in the country in order to deal with administrative matters concerning assets distribution. For assets held by the Investment Firm acting as a sub-custodian, custodian or a depositary, the claims of clients are ranked first. But for other situations, the payment of credits is ranked by Law n. 11.101/05, and secured creditors have priority over unsecured and subordinated creditors.

III. Pertinent references

Please provide, for any statutes, regulations, or other authorities or texts that are referred to in your response, electronic copies (in English translation, if available), or URL links to available copies. How might a person outside your jurisdiction most readily get access to such items? Are there treatises that would be useful for obtaining a general understanding of client asset protection in your jurisdiction?

No English translations were identified for most part of the laws and regulations. The URL links are:

Law n. 6.024: http://www.planalto.gov.br/CCIVIL/LEIS/L6024.htm

Law n. 11.101: http://www.planalto.gov.br/ccivil_03/_Ato2004-2006/2005/Lei/L11101.htm

Fundo Garantidor de Créditos: ww.fgc.org.br/

Canada

Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets

I. Background

This questionnaire seeks information to aid in understanding the responding jurisdictions' techniques for protecting Client Assets in the event of the insolvency and/or winding up of an Investment Firm, and for promptly transferring such assets to a solvent Investment Firm or distributing them to the client. It is not intended to require information concerning the general legal framework for insolvency, except to the limited extent necessary to understand how rules for the protection of Client Assets fit within that framework.

Definitions.

(1) **"Administrative Officer"** refers to the person or entity who is appointed, whether by a court, regulator, creditors, the Investment Firm itself, or otherwise, to assume control of or power over a bankrupt or insolvent Investment Firm. This term includes administrators, debtors in possession, receivers, liquidators, trustees, and similar titles.

(2) **"Client Assets"** refers collectively to Positions, Securities, and Client Money:

- "**Positions"** are contractual rights and obligations arising from transactions entered into by an investment firm on behalf of its clients, including mark to market accruals arising from the change in value of futures, options and/or other derivatives positions;

- "**Securities"** are defined to incorporate both securities and derivatives, as those terms are defined or understood in the responding jurisdiction; and

- "**Client Money"** refers to funds owed to or held on behalf of clients by an investment firm, and may include margin collateral associated with client positions (both existing and potential), income relating to an investment such as dividends or interest, proceeds of the liquidation of client securities and/or positions, and funds in excess of required margin.

(3) **"Investment Firm"** means an intermediary that holds Client Assets and is engaged in the business of managing client accounts, which could include, without limitation: executing orders on behalf of others, dealing in or distributing Securities (including carrying derivatives positions). In jurisdictions where banks are broadly permitted to engage in such a business, this term includes banks to the extent they are providing such services.

(4) **"Omnibus Account"** means an Investment Firm's account with a third party in which Client Assets are maintained separate from the firm's assets, but are held in the aggregate instead of in accounts designated for individual clients.

(5) **"Regime"** refers to statutes, regulations, rules of exchanges, clearing organizations and other self-regulatory bodies, or other legally binding requirements.

II. Survey Questions *Where appropriate, please provide citations to statutes, regulations, or other authorities supporting your answers below.*

Context

1. Please provide a brief overview setting forth the defining characteristics of your jurisdiction's approach to protecting Client Assets.

The Securities Industry in Canada is regulated at the Federal, Provincial and industry (self-regulated) levels.

The regime in our jurisdiction does not apply different treatment or results based on differences in categories of client assets, models of trading or categories of clients. The entities ensuring the protection of clients assets are SROs (segregation of client assets, capital requirements), Federal government (Bankruptcy Act) and the Canadian Investor Protection Fund.

The Canadian Investor Protection Fund is an industry sponsored fund that provides compensation to clients up to a specific amount should a Dealer Member faces insolvency. The Regime does not apply any different approach in terms of protecting client assets.

In answering the remaining questions:

(1) Please provide details, as appropriate, where the Regime in your jurisdiction applies different treatment or results based on differences in:

a. Categories of Client Assets;

b. Models of trading (e.g., exchange-traded versus over-the-counter).

*c. Categories of clients (*e.g., *retail versus sophisticated)*

(2) You are requested to provide details of the Regime in your jurisdiction. You are additionally invited to provide information explaining how that Regime is applied in practice, through, e.g., *informal arrangements between governmental entities.*

Pre-Insolvency

2. Does the regime in your jurisdiction require an Investment Firm to hold special authorization (*i.e.*, a specific form of license or registration) to be permitted to hold Client Assets?

Yes – dealer members are registered with the provincial securities commissions in the category of investment dealers.

a. If special authorization is required, what requirements (both initial and ongoing) is an Investment Firm required to comply with to hold such authorization?

Yes – all dealer members must comply with the rules and regulations of IIROC and the securities commissions. IIROC is a self-regulatory organization recognized by the securities commissions which has been delegated oversight responsibilities of this category of securities registrant.

b. If special authorization is not required, how, if at all, is this activity supervised by a regulator?

N/A

3. Does the Regime in your jurisdiction require that Client Assets be maintained separately from the assets of an Investment Firm? If so, please provide a description of the process by which segregation is accomplished, and of the applicable requirements. Specifically:

a. Must the Client Assets of one client be maintained separately from those of other clients?

For securities held registered in client name and held pursuant to a safekeeping agreement – they must be held in trust on a client by client basis.

For securities held in nominee name – they are aggregated on a security by security basis and held in bulk segregation for customers. Note that securities are generally held in nominee name.

IIROC rules require that for securities held in bulk segregation on behalf of customers that they be held at specified acceptable securities locations pursuant to a written custodial agreement that such securities are held free of any liens and encumbrances and can be readily returned on demand.

The term bulk segregation is used for securities that are registered in the firm's name or its nominee name. Securities in bulk segregation accounts can be moved freely, because they are always in negotiable form. Under a bulk segregation system, in which firm inventory and customer asset holdings of the firm may be commingled, fully paid customer securities and excess margin securities must be separately identifiable as segregated on the records of the firm, including stock records, customer ledgers, and statements of accounts.

Example: Clients A and D together own 375 shares and these securities are fully paid. The quantity held in segregation at the custodian shows 175 shares. The shortfall or segregation deficiency is 200 shares. The firm must immediately take corrective action by looking through its record for 200 shares that can be moved into a segregation account on behalf of the 2 clients. The securities owned by these client accounts are "commingled" into one segregation box account or location. This is what is meant by bulk segregation

Bulk Segregation Calculation

Not all client securities held by a member firm are fully paid. If the firm carries margin accounts (margin accounts are accounts in which Dealers Members offer clients to extend credit to their customers to leverage the purchase of securities. They can offer credit up to the amount of loan value of the securities in the account. The loan value is determined by using a margin rate that is established under Rule 100.) , or clients fail to settle trades, the quantity of securities owned by clients need not all be segregated by the firm. The segregation calculation becomes more complex as it is determined on a client-by-client basis.

In accordance with IIROC Regulations 2000.4 and 2000.5, all member firms are required to determine the securities to be segregated at least twice a week. Member firms must also do a daily review of compliance with segregation requirements for clients' securities according to the latest determination under Regulation 2000.6, with a view to identifying any deficiency in segregated securities and correcting the deficiency.

The triggers for identifying customer segregation requirements are driven by net loan value in the account of a customer. The net loan value in a customer account is calculated as:

> **[Loan value of all long security positions including non-marginable securities (market value – margin amount) *minus* the loan value of all short positions (market value + margin) *plus* the credit money balance *minus* debit money balance in the account]**

Rule of thumb:

- ***When the net loan value is greater than zero, segregation is required.***

  This means that there is an amount of fully paid or partially paid securities that require to be set aside so that the firm does not use the amount of securities required to be segregated for any purpose.

- ***When the net loan value is equal to zero, segregation is not required.***

  This means that there is no amount of fully paid or partially paid securities that require to be set aside and the firm can use all securities in the account for any purpose.

- ***When the net loan value is less than zero, desegregation is allowed.***

  This means that there is no fully paid or partially paid securities that requires to be set aside. In fact, to the extent that any securities have been segregated, the firm may choose to desegregate them in order to free them for any purpose.

For example, assume the following customer money and security position to illustrate simple segregation calculation:

Money balance	$75,000	debit
Long Securities market value 50,000 XYZ @ $5.00	$250,000	
Loan value (50% margin) (Note: loan value per share $2.50)	$125,000	

1. The loan value required to be segregated equals:

Net loan value – client debit balance = $125,000 – $75,000 = $50,000

2. Segregation share requirement:

$$\frac{\text{Segregation dollar requirement}}{\text{Loan value per share}} = \frac{\$50{,}000}{\$2.50} = 20{,}000 \text{ shares}$$

This analysis shows up on a report usually called the "Segregation Allocation Report." This report goes by different names, depending on the EDP service bureau used by the member firm.

The following is an example of information shown on a segregation deficiency report for any given security:

Security # 123
XYZ Corporation

Customer A/C	Last Transaction	Held in Segregation	Required to Segregate
0123	06/13/96	20,000	20,000
1432	05/01/96	30,000	30,000
0987	07/10/96	50,000	50,000
1639	07/25/96	150,000	200,000
	Total	250,000	300,000
	Net deficiency:	**50,000**	

The net deficiency of 50,000 represents the shortfall in the number of shares that should be held in a segregated box account as calculated based on the segregation algorithm performed for each customer account for this particular security.

Detailed Segregation Examples

The following are two additional detailed examples of segregation calculations.

EXAMPLE 1 - Customer account statement

Cash Balance Dr <Cr>	Holdings	Quantity	Price ($)	Loan Rate	Market Value ($)	Loan Value ($)
762	A Co.	10	2.00	50%	20.00	10.00
	B Co.	<20>	35.00	150%	<700.00>	<1050.00>
	C Co.	100	37.00	50%	3700.00	1850.00
	D Co.	400	1.00	0	400.00	0
	E Co.	800	1.45	0	1160.00	0
	F Co. Bond	2000	95.00	90%	1900.00	1710.00
					Security Loan Value	**2520.00**
Net Loan Value = Total Loan Value - Debit Balance = 2520 – 762 = 1758						

Assume the segregation sequence as selected by the firm sequence is equities (lowest market price to highest) and then debt (lowest market price to highest).

Segregation calculation

Security	Total Loan Value by security ($)	Net loan value remaining after deducting security loan amount to segregate ($)	Loan value to segregate [loan amount divided by loan value of one share]	Quantity Required to Segregate
		NLV = 1758		
D Co.	0	0	0	400*
E Co.	0	0	0	800*
A Co.	10	1758 - 10 = 1748	10 / 1 = 10	10
C Co.	1,850	1748 - 1748 = 0	1748 / 18.5	95
F Co.	1,710	0	0	0

* Non-marginable securities must be segregated to the extent that the account is not under-margined.

EXAMPLE 2 - Customer account statement

Cash Balance Dr <Cr>	Holdings	Quantity	Price ($)	Loan Rate	Market Value ($)	Loan Value ($)
2500	H Co.	100	5.00	50%	500.00	250.00
	I Co.	150	7.00	50%	1050.00	525.00
	J Co.	200	10.00	50%	2000.00	1000.00
	K Co. Bond	2500	100%	90%	2500.00	2250.00
					Security Loan Value	**4025.00**
Net Loan Value = $4025.00 - $2500.00 = $1525.00						

Assume the segregation sequence as selected by the firm sequence is equities (lowest market price to highest) and then debt (lowest market price to highest).

Segregation calculation

Security	Loan Value by security ($)	Net loan value remaining after deducting security loan amount to segregate ($)	Loan value to segregate [loan amount divided by loan value of one share]	Quantity Required to Segregate
		NLV = 1525		
H Co.	250.00	1525 – 250 = 1275	250 / 2.50	100
I Co.	525.00	1275 – 525 = 750	525 / 3.50	150
J Co.	1000.00	750 – 750 = 0	750 / 5.00	150
K Co. Bond	2250.00	0	0	0

In terms of segregation in a commodity account, IDA (predecessor of IIROC) had issued a notice in 1993 stating that:

The purpose of this notice is to remind member firms of the treatment of segregation of client securities for commodity accounts on the same basis as all other client accounts held by a member.

Segregation requirements for securities held for margin purposes for commodity accounts

must *be segregated on behalf of clients to the extent that the client has excess margin in its commodity account. Member firms must monitor the trading activities and margin requirements for all commodity positions held on a client-by-client basis.*

Where margin deposits at a clearing corporation or at a correspondent broker include client fully paid or excess margin securities, such securities should be placed in segregation for the client in accordance with IDA Regulation 2000. These client securities, usually T-Bills, must ***not*** *be allowed to be used as margin deposits to satisfy a clearing corporations or correspondent brokers margin requirements for all open commodity futures/option contract positions held by the firm or its undermargined client commodity accounts.*

In order to satisfy any margin deposit requirement at a clearing corporation or correspondent broker, a firm may use its own funds, securities, client future margin receipts or securities of undermargined accounts.

To the extent that trades in future contracts are communicated to a correspondent broker for execution on a fully disclosed basis, the firm must ensure that any client excess margin securities held by the correspondent broker are being monitored and segregated in accordance with IDA Regulation 2000.

General Restrictions

As per IIROC Rule 2000.8, it would be a serious offense to knowingly create or increase a segregation deficiency:

2000.8. In complying with its obligation to segregate client securities in accordance with Rules 17.3 and 2000, each Dealer Member shall ensure that:

(a) A segregation deficiency is not knowingly created or increased;

(b) No securities held by the Dealer Member are delivered against payment for the account of any client if such securities are required to satisfy the segregation requirements of the Dealer Member in respect of any client;

(c) All free securities (i.e. fully paid and unencumbered securities which have not been sold or are not required for margin) received by the Dealer Member shall be segregated.

Firms are required to have good systems in place to prevent any breach in the segregation requirements.

Corrective Action for Segregation Deficiencies (IIROC Rule 2000.9)

If there is a requirement for segregation, the member must immediately take the appropriate action required to settle the segregation deficiency. This would include in order of priority:

- *Call loan: the member must call back the securities from call loan the next business day following the determination of the deficiency.*
- *Securities loan: the member must call back the securities from a stock loan or arrange to borrow the securities of the same issue type to cover the deficiency.*
- *Short inventory: if there is an inventory short position, the firm must immediately buy in or borrow the securities to cover the deficiency. The firm must have controls in place to*

prevent this occurrence, as any prolonged deficiency would constitute a violation of the criminal code.

- *Fails: if there is a fail and the member has not received the securities within 15 business days of settlement, the member must borrow the securities of the same issue or buy in the securities.*
- *Stock dividends and stock splits: if the securities have not been received within 45 business days, a confirmation must be obtained. If no confirmation is received, the position must be transferred to a difference account.*
- *Difference account: each member must maintain a difference account. If the securities recorded in the difference account have not been obtained by the member within 30 days, the member must borrow the securities of the same class or series or must buy in the securities.*

IIROC Segregation Rule References

The IIROC rule references for each of the main components in calculating segregation deficiencies or excess margin by security is as follows:

Segregation Requirements

- *Bulk Segregation Calculation (IIROC Regulation 2000.5)*
- *Frequency of Calculation (IIROC Regulation 2000.6)*
- *Internal controls (IIROC Rule 2600, Policy 3, Statements 4 and 5)*

Segregation Locations

- *Acceptable external locations (IIROC Regulation 2000.1)*
- *Acceptable internal locations (IIROC Regulation 2000.2)*
- *Internal Controls (IIROC Rule 2600, Policy 3, Statements 4 and 5)*

Segregation Deficiencies/Excess

- *Correction of Segregation Deficiency (IIROC Regulations 2000.8-9)*
- *Internal Controls (IIROC Rule 2600, Policy 3, Statements 4 and 5)*

Priority for Segregation and Desegregation

IIROC Regulation 2000.5 permits a member firm to select among the securities carried for the client account to segregate or desegregate (as the case may be). The determination of the requirement to segregate or desegregate is based on the settlement date positions and the money balance of customer accounts.

Most member firms, through their EDP service provider, set procedures for sequencing and prioritizing the segregation of securities. This gives a member firm flexibility to segregate securities that have a low loan value before securities with a high loan value. This is important, because the firm, in funding its day-to-day operations, can more easily bank high-quality securities than lower-quality securities. For example, it may want to segregate equities in a customer account before debt, or desegregate government guaranteed debt

securities before equity securities. The same holds true for segregating low-unit-value securities before high-unit-value securities.

Another important rule is that securities that must be segregated on a settlement date basis, but sold by the member firm on behalf of a customer, must remain segregated until one business day before the settlement date. Securities segregated for a client may not be removed from segregation as a result of the purchase of any securities by the client until the settlement date. For example, if a client sells a security today to settle three business days from now, the security must remain in segregation until one day before the settlement date. Otherwise, it provides an opportunity for a firm to desegregate the securities on the trade date and use them for another purpose, such as a call loan, until the settlement date. This is in contravention of the criminal code. The reverse also holds true: a purchase of a security that is unpaid should not result in the lien of a member firm against other fully paid securities of the client, leaving an opportunity to desegregate the securities before the settlement date.

Implications for Short Sales

It is illegal for a member firm to short an inventory position and use client fully paid securities to settle. A segregation deficiency is created if a member enters into an obligation to sell a security which it does not own for a client for full payment. To resolve this deficiency, the firm must:

1. *Immediately borrow the same securities in sufficient quantity to satisfy the segregation deficiency.*
2. *If the securities cannot be borrowed, then the firm must segregate securities "in kind" or equivalent cash for the same value and properly execute trust documents with the client.*

The latter option may be prohibitive from an administrative standpoint. To avoid segregation deficiencies created by a firm short selling inventory to a client, proper internal controls should be implemented. This involves co-ordination between the retail sales force and the traders responsible for the firm inventory positions before executing a client order.

Internal Control Standards

Given the importance of the rules involving segregation of client fully paid and excess margin securities as set out in IIROC Rules 17.3 and 17.3A, the SROs introduced minimum standards of internal controls over the segregation of client securities. Many of the industry guidelines established in 1985 were codified into regulation format in 1994 as IIROC Rule 2600, Policy 3, Statements 4 and 5.

IIROC Rule 2600, Policy 3, Statement 4, sets out the following minimum policies and procedures:

1. *At least twice weekly the information system produces a report of items requiring segregation.*
2. *Items requiring segregation are placed in "acceptable securities locations" as defined in the regulation on a timely basis.*
3. *Written custodial agreements with applicable regulatory provisions exist for securities held at acceptable securities locations.*

4. *Only authorized personnel move securities into or out of segregation box or physical locations.*
5. *There is regular supervisory review of compliance with segregation requirements for clients' securities and of the completeness and accuracy of segregation reports.*
6. *If a segregation deficiency exists, the most appropriate and expeditious action prescribed by regulation to settle the deficiency is taken.*
7. *Management has set reasonable guidelines so that any material segregation deficiency is reported to senior management on a timely basis.*
8. *At least annually there is a documented supervisory review of firm policies and procedures to identify and correct any divergence from regulatory requirements.*

Approach to cash segregation

Generally speaking, a Dealer Member may use client cash in the normal course of its business up to a certain limit based on a firm's financial position. The free credit limit for a firm is Net Allowable Assets times a factor of 8, plus Early Warning Reserve times a factor of 4. The factors of 8 and 4 are commensurate with the leverage ratios established for financial institutions under the Basel Accord.

Excess free credit balances must be segregated in the form of government securities with a term of one year or less, or in the form of cash in a trust account with an Acceptable Institution.

The approach to cash segregation, referred in the IIROC Rules as free credit segregation, is defined in IIROC Rule 1200 which stipulates:

> *1200.1. For the purposes of this Rule 1200, "free credit balances" shall mean:*
>
> *(a) For cash and margin accounts - the credit balance less an amount equal to the aggregate of (i) the market value of short positions, and (ii) margin as required pursuant to the Rules on those short positions; and*
>
> *(b) For commodity accounts - the credit balance less an amount equal to the aggregate of (i) margin required to carry open futures contracts and/or futures contract option positions, (ii) less any equity in such contracts, (iii) plus any deficits in such contracts, provided that such aggregate amount may not exceed the dollar amount of the credit balance.*
>
> *1200.2*
>
> *1200.2. Each Dealer Member which does not keep its clients' free credit balances segregated in trust for clients in an account with an acceptable*

institution separate from the other monies from time to time received by such Dealer Member shall legibly make a notation on all statements of account sent to its clients in substantially the following form:

Any free credit balances represent funds payable on demand which, although properly recorded in our books, are not segregated and may be used in the conduct of our business.

1200.3

1200.3. No Dealer Member shall use in the conduct of its business clients' free credit balances in excess of the aggregate of the following amounts:

(a) Eight times the net allowable assets of the Dealer Member; plus

(b) Four times the early warning reserve of the Dealer Member.

Each Dealer Member shall hold an amount at least equal to the amount of clients' free credit balances in excess of the foregoing either (a) in cash segregated in trust for clients in a separate account or accounts with an acceptable institution; or (b) segregated and separate and apart as the Dealer Member's property in bonds, debentures, treasury bills and other securities with a maturity of less than one year of or guaranteed by the Government of Canada, a province of Canada, the United Kingdom, the United States of America and any other national foreign government (provided such other foreign government is a member of the Basle Accord).

1200.4

1200.4. Dealer Members shall determine at least weekly the amounts required to be segregated in accordance with Rule 1200.3.

1200.5

1200.5. Dealer Members shall review on a daily basis compliance with Rule 1200.3 against the latest determination under this Rule 1200 of amounts to be segregated with a view to identifying and correcting any deficiency in amounts of free credit balances to be segregated.

1200.6

1200.6. In the event that a deficiency exists in amounts of free credit balances required to be segregated by a Dealer Member, the Dealer Member shall expeditiously take the most appropriate action to rectify the deficiency.

i. Are Investment Firms allowed to hold Omnibus Accounts?

Yes, however IIROC dealers are only permitted to operate omnibus accounts on a fully paid basis. It is not permitted to operate omnibus accounts on margin. Omnibus account means an account carried by or for Dealer Member in which the transactions of two or more persons are combined and effected in the name of a Dealer Member without disclosure of the identity of such persons. It is the opposite of a fully disclosed account.

ii. What measures are used to protect the Client Assets of each client from losses due to the activities of other clients?

As stated above, margin omnibus accounts are not permitted. This eliminates the risk of one client financing the activities of another in such an account type.

b. Please describe any requirement that an Investment Firm must reconcile the Client Asset account. For example:

i. How do you calculate the amount of Client Assets that a firm is required to hold in one or more accounts segregated for the benefit of clients?

A) Are required Client Assets fungible between or within asset classes, or is the Investment Firm required to hold, *e.g.*, the specific assets deposited by the client?

No. The dealer member is required to hold the specific security asset class deposited or fully paid for by each client.

B) How is the reconciliation conducted (*e.g.*¸ on an aggregate basis, or a client-by-client basis)?

Dealer members disclose in their stock record every client that holds a position for a specific security asset class. The aggregate of all such holdings are held at an acceptable internal or external securities location which is reconciled on a monthly basis through security count or third party custody record

C) If a client has a debit balance (*i.e.*, the client owes the Investment Firm), is such balance deducted in determining the amount the Investment Firm is required to hold?

Yes – securities required to be segregated in a margin account are calculated based on the total loan value of all securities held in the account (minus the account debit balance) divided by the loan value of the security. The priority or sequencing of which securities are segregated or desegregated first is typically driven by the lowest to highest loan value of securities in the account. For further details, please see answer to II.3. a above. IIROC Regulation 2000.5 permits a dealer member to select among the securities carried for the client account to segregate or desegregate (as the case may be). The determination of the requirement to segregate or desegregate is based on the settlement date positions and the money balance of customer accounts. Most dealer members, through their EDP service provider, set procedures for sequencing and prioritizing the segregation of securities. This gives a member firm flexibility to segregate securities that have a low loan value before securities with a high loan value. This is important, because the dealer member, in funding its day-to-day operations, can more easily bank high-quality securities than lower-quality securities. For example, it may want to segregate equities in a customer account before debt, or desegregate government guaranteed debt securities before equity securities. The same holds true for segregating low-unit-value securities before high-unit-value securities.

ii Timing issues:

A) How often is reconciliation required (*e.g.*, daily, weekly, monthly).

Dealer members are required to calculate segregation requirements at least twice weekly (any day selected by dealer member)...

The reconciliation of securities held at external locations must be performed monthly.

B) When is such reconciliation required (*e.g.*, noon of the following business day, the tenth business day of the following month)?

The segregation calculation must be performed at least twice weekly. Segregation deficiencies must be immediately corrected by the next business day.

Corrective actions include buying in the securities or borrowing to meet segregation requirements on a security by security class.

The reconciliation of securities held in segregation to external custodians must be completed within 30 days following month-end after which a capital charge against the dealer member's regulatory capital is applied based on the market value of unreconciled positions representing a loss to the dealer member.

C) Is the Investment Firm required to make good any deficiency from their own funds? If so, in what period? Is any payment by the Investment Firm thereby deemed to be Client Money?

As per Question 3biiB above, corrective actions include buying in the securities or borrowing to meet segregation requirements on a security by security class should

a deficiency be found. Segregation deficiencies must be corrected by next business day.

Systemic deficiencies in the timely segregation of customer securities represents a material breach of IIROC rules and result in enforcement action against the firm. A systemic deficiency is not defined in the Rules. However, it would mean that there would be recurring problems in doing the segregation appropriately.

iii. Is an Investment Firm permitted or encouraged to maintain any of their own assets in a Client Asset account (*e.g.*, as a "buffer")? If so, are any such assets so transferred then deemed to be Client Assets? Is there a requirement to remove any excess assets?

No – IIROC rules do not permit the segregation of customer specific asset class securities in kind. The firm cannot put its own inventory into a client account. However, under a bulk segregation system, in which firm inventory and customer assets holdings of the firm may be commingled, all assets are looked at together and once the required amount to be held in segregation is in fact in segregation, there is no segregation deficiency. The firm can buy-in or borrow securities to cover an under-seg position.

c. Can the Investment Firm use Client Assets of one client for meeting obligations of another client? If so, how?

No – all customer securities required to be held in segregation cannot be used to meet the obligations of the firm or other customers.

d. Are there any restrictions on the ability of the Investment Firm (or other party holding Client Assets) to invest, encumber, rehypothecate, stock-lend, or otherwise deal with, the Client Assets? If so, please describe.

Yes – it is not permitted to use customer fully paid or excess margin securities (excess margin: loan value amount exceeding the debit balance in a margin account) to encumber or hypothecate or lend. This would represent a material breach of IIROC rules and cause for enforcement action against the dealer member. On the other hand, if the securities are not required to be in segregation, that is if they are not fully paid or there is no excess margin, then the Dealer member may use those securities in the normal course of business and may use those securities in financing transactions.

As per IIROC Rule 27, whenever a client is indebted to a Dealer Member, such Dealer Member shall have the right from time to time, in its discretion, to raise money on such securities and to carry such securities in its general loans, and to pledge and repledge such securities in such manner and to such reasonable amount and for such purpose as it may deem advisable. Those details are usually part of the Margin Agreement part of the account opening package.

d. What are the requirements, if any, for clearinghouses or other central counterparties to maintain the separate identification of collateral posted by the Investment Firm for its Client Positions?

Yes - the central counterparty must track security holdings by dealer member. The dealer member in turn maintains records of the individual customer holdings.

4. Are Investment Firms permitted to transfer to, or hold Client Assets in, another jurisdiction? If so, does the Regime in your jurisdiction require Investment Firms to preserve the separate identification of:

   a. Client Assets transferred to or located in other jurisdictions?

   IIROC has specific criteria for custodians which must qualify as "acceptable securities locations" both domestic and in foreign jurisdictions. The custody arrangement must be in writing and preserve the legal rights of custody of customer securities.

   b. Client Assets that have been transferred to the Investment Firm from other jurisdictions and that have been identified as Client Assets in those jurisdictions?

   Yes – the same segregation requirements and custody requirements apply.

   If so, please provide details of those requirements.

   The security location must qualify as "acceptable securities locations". This includes those entities considered suitable to hold securities on behalf of a Member, for both inventory and client positions, without capital penalty, given that the locations meet the requirements outlined in the segregation rules of IIROC.

   Specifically, the requirement for a written custody agreement outlining the terms upon which such securities are deposited and including provisions that no use or disposition of the securities shall be made without the prior written consent of the Member and the securities can be delivered to the Member promptly on demand.

5. If the Regime in your jurisdiction permits or requires Client Assets to be held by third party custodians:

   a. Please describe the requirements, if any, concerning the qualifications of such custodians e.g., licensing, creditworthiness. May the Client Assets be kept with an affiliate of the Investment Firm?

   The regime in our jurisdiction permits client assets to be held by third party custodians, including any affiliate of the Dealer member, given that the third party custodian can be defined as an acceptable securities location. Are referred to as "acceptable securities locations" entities considered suitable to hold securities on behalf of a Member for both inventory and client positions, without capital penalty. The locations must meet the requirements outlined in the segregation rule and the notes and definitions of the Joint Regulatory Financial Questionnaire and Report, including, but not limited to, the requirement for a written custody agreement outlining the terms upon which such securities are deposited.

   Acceptable securities locations include the following:

1. *Depositories and Clearing Agencies*

2. *(a) Acceptable Institutions which in their normal course of business offer custodial security services; or*

   (b) Subsidiaries of Acceptable Institutions provided that each such subsidiary, together with the Acceptable Institutions, has entered into a custodial agreement with the member containing a legally enforceable indemnity by the Acceptable Institution in favor of the Member covering all losses, claims, damages, costs and liabilities in respect of securities and other property held for the Member and its clients at the subsidiary's location.

3. *Acceptable Counterparties – with respect to security positions maintained as a book entry of securities issued by the Acceptable Counterparty and for which the Acceptable Counterparty is unconditionally responsible.*

4. *Banks and Trust Companies otherwise classified as Acceptable Counterparties – with respect to securities for which they act as transfer agent and for which custody services are not being provided (in such case, a written custody agreement is not required).*

5. *Mutual Funds of their Agents – with respect to security positions maintained as book entry of securities issued by the mutual fund and for which the mutual fund is unconditionally responsible.*

6. *Regulated entities.*

7. *Foreign institutions and securities dealers that satisfy the following criteria:*

   (a) the paid-up capital and surplus according to its most recent audited balance sheet is in excess of Cdn. $150 million as evidenced by the audited financial statements of such entity;

   (b) in respect of which a foreign custodian certificate has been completed and signed in the prescribed form by the Member's board of directors or authorized committee thereof;

   provided that:

   (c) a formal application in respect of each such foreign location is made by the Member to the relevant joint regulatory authority in the form of a letter enclosing the financial statements and certificate described above; and

   (d) the Member reviews each such foreign location annually and files a foreign custodian certificate with the appropriate joint regulatory authority annually.

   And such other locations which have been approved as acceptable securities locations by the Joint Regulatory Body having prime jurisdiction over the Member.

b. Please describe any requirements concerning the custody agreement between intermediary and custodian. In particular, may the custodian be permitted to place a lien, charge or other encumbrance on Client Assets? If so, please explain.

As per IIROC Rule 2000.1 Segregation Requirements – Acceptable external locations, securities held beyond the physical possession of the Dealer Member may be segregated and held in trust for customers of a Dealer Member, or segregated and held by or for a Dealer Member, as the case may be , in acceptable securities locations, provided that the written terms upon which such securities are deposited and held beyond the physical possession of the Dealer Member include provisions to the effect that

(a) No use or disposition of the securities shall be made without the prior written consent of the Dealer Member;

(b) Certificates representing the securities can be delivered to the Dealer Member promptly on demand or, where certificates are not available and the securities are represented by book entry at the location, the securities can be transferred either from the location or to another person at the location promptly on demand; and

(c) The securities are held in segregation for the Dealer Member or its customers free and clear of any charge, lien, claim or encumbrance of any kind in favour of the depository or institution holding such securities.

6. Under what circumstances, if any, is an Investment Firm required to disclose to clients information related to the protection of the client's assets? What is the nature of such required disclosures? How do any such required disclosures apply to Client Assets held in another jurisdiction?

Dealer members must provide a monthly customer statement showing securities held in segregation. This applies whether the client is domestic or foreign.

Dealer members are required to disclose on customer statements and confirmations that they are members of CPIF.

7. Under what conditions, if any, may clients choose to waive any of the Client Asset protection requirements applicable in your jurisdiction (also known as "opting out")? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

No opt out possible.

8. Under what circumstances, if any, is an Investment Firm required to notify the regulators, or the market generally, of material changes in their financial position or ability to continue to carry on business? What is the nature of such required disclosures?

All dealer members provide a regulatory financial report showing on their capital adequacy on a monthly basis and audited regulatory report on an annual basis. The annual report also requires a special compliance procedure report by the

auditors testing for compliance in respect to regulatory segregation of customer asset rules.

Dealer members must maintain risk adjusted capital greater than zero at all time. Also, the dealer members need to advise IIROC as soon as they become aware that they are designated in early warning as defined in IIROC Rule 30. The dealer member must deliver immediately to IIROC a letter describing the circumstances which gave rise to the early warning designation, an outline of the proposal to rectify the problems identified and an acknowledgement that the dealer member applies the restrictions imposed on them by IIROC.

There is no requirement to inform the marketplace unless there is a breach of capital adequacy rules in which case the market is notified after a disciplinary notice is published.

9. For an Investment Firm whose financial situation is seen to have deteriorated (*e.g.*, capital has fallen below certain thresholds), what actions, if any, may the firm's regulators take to protect Client Assets?

IIROC has established early warning thresholds. If such thresholds are triggered – the firm is restricted from certain business activities and frequency of regulatory reporting increases. The restrictions are elevated based on the severity of the thresholds triggered. If a firm becomes capital deficient they must immediately correct the situation within 2 business days or result in suspension of membership which would lead to insolvency proceedings.

Post-Insolvency

10. Please describe the process by which an Investment Firm enters the status of "insolvent" or "bankrupt" or the equivalent. For example, is a petition filed by the firm's regulator or some other administrative agency, by creditors of the firm, or otherwise? Is a decree entered by a court? Is this process different from the process applicable to entities that are not Investment Firms?

Any dealer member which fails to meet IIROC capital adequacy requirements is suspended. IIROC issues a public notice announcing the suspension and the fact that privileges of membership, including dealing with the investing public are withdrawn.

Where IIROC suspends a Member, the provincial commissions where the dealer is registered must also suspend the registration. Usually, upon request from the Administrative Officer the commissions will permit liquidating trades in customer accounts.

Pursuant to an agreement between IIROC and the Canadian Investor Protection Fund (CIPF) which is a fund created to provide customer protection for financial losses incurred from the insolvency of any IIROC dealer member, IIROC must notify CIPF immediately of any situations that ***could*** *result in CIPF having to compensate customers*

IRROC will advise CIPF of its suggested plan of action.

Where no payment from CIPF anticipated

If both IIROC and CIPF are satisfied that client assets can be transferred to another IIROC Member without payment from CIPF, and there is a Member that will accept the accounts, then IIROC will oversee this process without any assistance from CIPF.

In this event CIPF's procedures require it to place advertisements in national and local newspapers, similar to the following:

On <<date>>, the Investment Industry Regulatory Organization of Canada announced that it had suspended the membership of <<Dealer member>>). <<Dealer Member>> has ceased dealing with the public and customer accounts were transferred to <<dealer member 2>> on <<date>>.

The Canadian Investor Protection Fund/Fonds canadien de protection des épargnants ("CIPF") understands that <<dealer member>> has ceased business but does not have complete information as to its financial status. However, customers with accounts at <<dealer member>> who have suffered or may suffer financial loss solely as a result of <<dealer member>> being or becoming insolvent may be eligible for coverage for such losses by CIPF to prescribed limits. Such losses must result from the failure of <<dealer member>> to return or account for securities, cash balances, commodities, futures contracts, segregated insurance funds or certain other property acquired or held by <<dealer member>> in an account for customers. Losses that do not result from the insolvency of <<dealer member>> such as losses arising from changing market values of securities, unsuitable investments or the default of an issuer of securities are not eligible for CIPF coverage.

Where payment from CIPF anticipated

Where it appears that CIPF will be required to advance monies, IIROC will suspend the Dealer Member and CIPF will ask the Court to appoint a trustee in bankruptcy in accordance with Part XII of the Canadian Bankruptcy and Insovlency Act.

Part XII is bankruptcy legislation that can only be used for Canadian Securities Firms. CIPF is specifically mentioned as a body that can petition a securities firm into bankruptcy. CIPF may request the Commissions permit liquidating trades in customer accounts.

11. Please describe the process by which the Administrative Officer (as defined above), if any, is selected. What qualifications, if any, must an Administrative Officer have? Who selects the Administrative Officer?

If required, CIPF request the court appoint a trustee in bankruptcy from one of the major accounting firms in Canada. The trustee will then, under the direction of CIPF, petition the court for bankruptcy proceedings against the dealer member The key objective is to transfer client assets as quickly as possible so the selection is based on the following criteria:

- *The ability of the trustee to deal with the size and complexity of the bankrupt Dealer Member.*
- *The trustee must be licensed in Canada to act as a trustee*
- *CIPF must satisfy itself that the trustee is free from conflicts with the Dealer Member.*

- *Experience with Part XII of the Bankruptcy Act and knowledge of the Canadian Investment Industry.*

12. What are the duties of the Administrative Officer?

a. What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?

CIPF maintains staff to assist the trustee. The primary objective is to move customer assets as quickly as possible. To do this it must determine the resources it must advance, in accordance with its policies, to transfer customer assets. CIPF has developed an insolvency procedures manual that prospective trustees must agree to follow.

Part XII contains specific procedures for administering a bankrupt securities firm which includes a requirement that the trustee consult with CIPF on the administration of the bankruptcy and permits CIPF to designate an inspector. The Act also sets out how losses will be allocated to customers and what assets can be used to satisfy such losses before CIPF's coverage is required. For example, where there is a shortfall in customer assets, the dealer member's inventory will be used to satisfy those losses before CIPF is required to advance funds.

b. Under what standard (*e.g.*, strict liability, negligence), if any, is the Administrative Officer, pursuant to the Regime in your jurisdiction, subject to personal liability for failure to properly perform his or its duties?

Generally trustees are not liable for any act unless it is a result of gross negligence or willful misconduct.

13. What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?

a. Does the regulator continue to supervise the Investment Firm?

No – CIPF assumes full responsibility in the dissolution of the dealer member.

b. How, if at all, is the regulator involved in the process of returning Client Assets?

Not involved – the process is fully assumed by CIPF.

14. Does the Regime in your jurisdiction facilitate or encourage the transfer of Client Assets from an Investment Firm which has become bankrupt or insolvent to a solvent Investment Firm?

Yes – the first order of business is to find another IIROC Dealer Member prepared to assume the book of customer business and transfer the customer assets. This process is assumed by CIPF and trustee.

a. What steps, if any, are prerequisite to accomplishing such a transfer? In general, how long does it take to accomplish those steps?

See answer to question 10 where a trustee is not appointed.

Transfer of customer accounts is top priority. The speed depends on many factors

- *The state of the books and records*
- *The availability of another Dealer Member to take the accounts – trustee may have a responsibility to maximize estate assets and may need to auction accounts*
- *The compatibility of the receiving dealer members system with the bankrupt's. If they are compatible a "bulk transfer " can be done – if not accounts may have to be transferred "one by one". Compatibility of systems is a factor considered in deciding which Dealer Member the accounts will be transferred to.*

b. What factors, if any, affect the time period required to accomplish such a transfer?

As above. If assets are available to be distributed to customers, as set out in the Bankruptcy Act, are not sufficient to satisfy all customer claims, creating a shortfall, the shortfall, under Canadian bankruptcy law, is allocated over all customers in proportion to their client net equity. The customer would then be compensated by CIPF in accordance with CIPF's coverage policy. This allocation reduces the probability that any customer will have a loss that exceeds CIPF's coverage.

CIPF speeds up the transfer process by settling the agreed on losses directly with the trustee rather with each customer. What this means is that

- *CIPF determines the difference between the assets available to settle customer claims and the assets required to settle customer claims is known*
- *The difference is adjusted for claims not eligible for CIPF coverage, for example, directors of the bankrupt company, those causing the insolvency – all of which are set out in the coverage policy*
- *CIPF provides funding of the adjusted difference to the trustee. That funding, with assets recovered from the estate, permit the trustee to transfer client accounts in full. The customer would not necessarily know that CIPF has provided funding.*

15. To what extent are clients at risk of, or protected from, having to return Client Assets (or the value thereof) that were distributed to the client prior to the insolvency proceeding?

Canadian bankruptcy law permits the trustee to recover preferential payments made prior to bankruptcy. However, to the extent that assets to which a customer was entitled were withdrawn prior to insolvency – without complications of conflict of interest or inside information – there should be little risk to customers of having to return the assets. These assets would be covered by CIPF in any event.

There is a $1 million coverage limit for losses in a customer's General Account and each Separate Accounts (see below). This includes losses of securities, commodity and futures contracts, segregated insurance funds and cash and excludes losses in market value.

General Accounts

Regular accounts of a customer are combined to determine the assets of the customer's general account. For example, the interest of a customer in an account of a personal holding company, or that is held on a joint or shared ownership basis, shall be treated as part of the General Account of a customer.

Separate Accounts

Each account of a customer held in the capacity or circumstance set out below shall be considered a Separate Account of the customer. Unless otherwise indicated below, each Separate Account held by a customer in the same capacity or circumstance shall be combined or aggregated so as to constitute a single Separate Account.

Are considered Separate Accounts:

- *Registered Retirement Plans*
- *Registered Education Savings Plans*
- *Testamentary Trusts*
- *Inter-vivos Trusts and Trusts imposed by law*
- *Guardians, Custodians, Conservators, Committees, etc.*
- *Personal holding Corporations: Accounts of corporations controlled by a customer provided that the beneficial ownership of a majority of the equity capital of the corporation is held by persons other than the customer, as might be the case in a corporation created pursuant to an estate freeze.*
- *Partnerships: Accounts of partnerships controlled by a customer provided that the beneficial ownership of a majority of the equity interests in the partnership is held by persons other than the customer.*
- *Unincorporated Associations or Organizations: Accounts of unincorporated associations or organizations controlled by a customer provided that the beneficial ownership in a majority of the assets of the association or organization is held by persons other than the customer.*

16. To what extent, if at all, does the Regime in your jurisdiction provide compensation to clients from other sources (for example, an investor protection or similar fund) for loss of Client Assets? Please discuss the scope of protections, conditions on such protection, and the limits of compensation (*e.g.*, maximum compensation per client).

As discussed above, the role of CIPF is to administer the insolvency proceedings of the dealer member and provide protection for customer asset losses up to $1 million per customer.

17. Are there circumstances in which clients are treated differently based on permissions they have granted pre-bankruptcy. E.g., if any re-hypothecation has been entered into (or a 'right-to-use' exercised), please explain the client's position under the Insolvency Regime in such event.

Certain customers are excluded from CIPF coverage, but are still entitled to distribution from the trustee – ie CIPF does not top up any shortfall.

Customers not covered are:

i) a Member of a sponsoring SRO of CIPF or any other dealer registrant such as a securities dealer, mutual fund dealer, limited market dealer or futures commission merchant, or a foreign securities dealer registered with a Canadian securities regulatory authority or foreign equivalent;

ii) an institution, securities dealer or other person, and its customers, dealing with a Member of an SRO on an omnibus basis (being an account in which the transactions of two or more persons are combined without the disclosure to the Member of the identity of the persons);

iii) a clearing corporation;

iv) any person who owns in aggregate five percent or more of the capital of the insolvent Member consisting of equity securities of any class and/or subordinated debt of the Member;

v) a general partner or director of the insolvent Member;

vi) a limited partner with a participation of five percent or more in the net assets or net profits of the insolvent Member;

vii) a person with the power to exercise a controlling influence over the management or policies of the insolvent Member;

viii) a person who caused or materially contributed to the insolvency of the Member;

ix) a person who did not deal at arm's length with the insolvent Member or with a person who is excluded as a customer, or

x) a customer of a foreign approved participant of an SRO which is not considered by the Board of Directors to be a Member of an SRO. Such

participants include foreign dealers or other organizations regulated in recognized jurisdictions, without a place of business in Canada, and who do not deal with customers in Canada except as permitted by applicable Canadian securities legislation.

In addition. Customers are not covered for financing transaction with the Dealer Member

18. Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?

"Where the laws and circumstances prevailing in a foreign jurisdiction may restrict the transfer of securities from the jurisdiction and the Member is unable to arrange for the holding of client securities in the jurisdiction at an acceptable securities location, the Member may hold such securities at a location in that jurisdiction if (a) the Member has entered into a written custodial agreement with the location as required hereunder and (b) the client has consented to the arrangement, acknowledged the risks and waived any claims it may have against the Member, in a form approved by the Joint Regulatory Authority. Such a consent and waiver must be obtained on a transaction by transaction basis."
In any event – this does not affect CIPF coverage – the Member would be required to provide capital.

19. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?

No Clients are not treated differently. The bankruptcy acts creates a customer pool of assets that is distributed to all customers. The pool includes all cash, securities whether belonging to customers or the firm and whether segregated or not segregated and various other assets. Customers share in that pool based on their client net equity so there is no tracing of lost property to specific clients.

20. If there is a shortfall, *i.e.*, if claims by clients exceed resources dedicated to paying such claims (whether from Client Assets, investor protection fund, or otherwise), how are Client Assets distributed? *E.g.*, is there a pro rata distribution of Client Assets, are there priorities between classes of clients, is there a priority distribution ahead of the distribution of the general estate/distribution to unsecured creditors?
Canadian bankruptcy rules create two pools of assets for distribution – a customer and general. The customer pool includes all customer assets and more (e.g. inventory, cash) and is used to pay customers,(and the trustee if general fund not able to do so). Any shortfall in customer pool is allocated to all customers based on their client net equity and is compensated by CIPF in accordance with its policies.

21. Please explain how claims of clients are ranked in the insolvency process relative to those of other creditors. Does your insolvency regime rank domestic creditors above foreign creditors?

The bankruptcy act only distinguishes between customers and deferred customers. Deferred customers are generally those that contributed to the insolvency and must be found by the court to be deferred. Other than that, there is no distinction between customers for distribution of the customer pool. If the there is a shortfall in the pool however, CIPF does have customers whose shortfall it does not cover. These include directors of the insolvent corporation, omnibus accounts. A full list is found in our coverage policy.

III. Pertinent references

Please provide, for any statutes, regulations, or other authorities or texts that are referred to in your response, electronic copies (in English translation, if available), or URL links to available copies. How might a person outside your jurisdiction most readily get access to such items? Are there treatises that would be useful for obtaining a general understanding of client asset protection in your jurisdiction?

See IIROC Rule Book

IIROC Rule 17.1 – Dealer member minimum capital requirement

IIROC rule 17.3A – Dealer member segregation of customer assets requirement

Rule 30 – Early Warning System

IIROC Rule 2000 – Segregation Requirements

Rule 2600 - Internal Control Policy Statement 5 and 6 - Safeguarding of customer assets

IIROC Form 1 – Notes to general instructions (definition of acceptable securities location)

IIROC Form 1 – Audit Report on Compliance for Segregation of Securities

IIROC Rule 41 – Canadian Investor Protection Fund

CIPF-IIROC Industry Agreement (non-public document)

See CIPF web site - www.cipf.ca

Part XII of the Bankruptcy and Insolvency Act Part XII of the Bankruptcy and Insolvency Act

China

Answers to Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets

1 Please provide a brief overview setting forth the defining characteristics of your jurisdiction's approach to protecting Client Assets.

In general, our Regime requires as follows: clients' trading settlement funds shall be kept in full at the third party depository by securities companies; securities are kept at central clearing companies; entrusted assets are kept at an independent custodian to ensure the safety of client assets by segregating client assets from operating risks of the company.

Specifically, *the Securities Law* and *Regulations on Supervision and Administration of Securities Companies* provide that a securities company undertaking securities brokerage business shall deposit clients' trading settlement funds with a designated commercial bank, which shall manage such funds in a separate account opened in the name of the client. The client, the securities company and the designated commercial bank shall sign a custodial contract, stipulating that the securities company deposits client's trading settlement funds in a special account opened in the commercial bank, purpose of the funds and transfer method. Based on the provisions, the securities company will clear and settle transactions on behalf of the client. The designated commercial bank supervises the funds transfer, and establishes a funds detail account to record fund changes; the securities company and the designated commercial bank shall reconcile the general ledger and sub-ledger, and ward off abusive use of funds.

For the securities, Article 158 of *the Securities Law* provides that registration and clearance of securities shall be done in a centralized and unified manner nationwide. Article166 stipulates that to entrust a securities company with the processing of securities trading, an investor shall apply for opening a securities account. A securities registrar and clearance institution shall, in accordance with relevant regulations, open

a securities account for the investor in the investor's own name.

For the entrusted assets, Article 58 of *the Regulation on Supervision and Administration of Securities Companies* provides that a securities company undertaking securities asset management business shall transfer client entrusted assets for custodial purpose to the designated commercial bank or to such other asset custodial agency as recognized by the securities regulatory authority under the State Council.

Pre-Insolvency

2. Does the regime in your jurisdiction require an Investment Firm to hold special authorization (*i.e.,* a specific form of license or registration) to be permitted to hold Client Assets?

Article 122 of *the Securities Law* requires that the establishment of a securities company shall be subject to examination and approval by the securities regulatory authority under the State Council. Securities companies engaging in brokerage businesses shall be subject to the examination and approval of the CSRC.

a. If special authorization is required, what requirements (both initial and ongoing) are an Investment Firm required to comply with to hold such authorization?

Basic requirements for securities companies to engage in brokerage business are as follows:

Article 124 of *the Securities Law* provides the following conditions for the establishment of a securities company:

(1) It has the articles of association which are in conformity with the provisions of laws or administrative regulations;

(2) Its major shareholders possess sustainable profitability and enduring trustworthiness and have no record of major illegal activities for the three immediately preceding years, and the net assets of each of them are not less than 200

million yuan;

(3) Its registered capital is in conformity with the provisions of this Law;

(4) Its directors, supervisors and senior managers should be qualified for those posts, and its employees should have the qualification licenses for securities business;

(5) It has complete systems for risk management and internal control;

(6) It has up-to-standard operating premises and business facilities; and

(7) Such other conditions as may be so stipulated by laws or administrative regulations or by the securities regulatory authority under the State Council and so approved by the State Council.

Article 127 provides that a securities company engaging in brokerage businessshould meet the minimum registered capital of 50 million yuan.

Securities companies should comply with *the Regulation on Supervision and Administration of Securities Companies* and other regulatory rules set by the CSRC on an ongoing basis.

3. Does the Regime in your jurisdiction require that Client Assets be maintained separately from the assets of an Investment Firm? If so, please provide a description of the process by which segregation is accomplished, and of the applicable requirements. Specifically:

a.Must the Client Assets of one client be maintained separately from those of other clients?

Yes. Both the securities companies and the commercial bank shall set up a detailed account resepectively for each and every client, to record the changes of funds and supervise the usage and safety of the funds.

i. Are Investment Firms allowed to hold Omnibus Accounts?

Yes. Securities companies may hold clients' funds in an omnibus account opened with the commercial bank.

ii. What measures are used to protect the Client Assets of each client from losses due to the activities of other clients?

Article 139 of *the Securities Law* provides the clients' funds for trade settlement and their securities shall not be sealed up, frozen, withheld or alienated, or subjected to compulsory enforcement, except for the purposes of satisfying the debts of the clients themselves or under such other circumstances as provided for by law. In practice, the securities company and the commercial bank set up a detailed account for client respectively, to facilitate the tracking and management of funds. A client is authorized to use the amount of funds recorded in his/her detailed account.

b. Please describe any requirement that an Investment Firm must reconcile the Client Asset account. For example:

i. How do you calculate the amount of Client Assets that a firm is required to hold in one or more accounts segregated for the benefit of clients?

The securities company and the commercial bank shall reconcile the aggregate of the client's detail account with the omnibus account of client funds at the securities company on each trading day.

A) Are required Client Assets fungible between or within asset classes, or is the Investment Firm required to hold, *e.g.*, the specific assets deposited by the client?

A securities company deposits the funds of client of brokerage business in an omnibus account for the client.

B) How is the reconciliation conducted? (*e.g.*, on an aggregate basis, or a client-by-client basis)

The securities company and the commercial bank shall reconcile the detail accounts between themselves. Besides, they will reconcile the aggregate in detail accounts with the aggregate in the omnibus account for the client funds opened by the securities company.

C) If a client has a debit balance (*i.e.*, the client owes the Investment Firm), is such balance deducted in determining the amount the Investment Firm is required to hold?

The balance will not be deducted.

ii Timing issues:

A) How often is reconciliation required (*e.g.*, daily, weekly, monthly).

The securities company and the commercial bank conduct reconciliation on a daily basis. Additionally, investor protection fund companies are working on establishing an independent daily reconciliation system.

B) When is such reconciliation required (*e.g.*, noon of the following business day, the tenth business day of the following month).

End of each business day and the noon of the following business day.

C) Is the Investment Firm required to make good any deficiency from their own funds? If so, in what period? Is any payment by the Investment Firm thereby deemed to be Client Money?

When money in the detail account is not enough for payables in client's securities transactions, and the client fails to replenish the account as required, then the securities company shall make good the deficiency from their own funds. The securities company can claim the payment from the client later.

iii. Is an Investment Firm permitted or encouraged to maintain any of their own assets in a Client Asset account (*e.g.*, as a "buffer")? If so, are any such assets so transferred then deemed to be Client Assets? Is there a requirement to remove any excess assets?

An Investment Firm is not permitted to do so.

c. Can the Investment Firm use Client Assets of one client for meeting obligations of another client? If so, how?

It is not allowed.

d. Are there any restrictions on the ability of the Investment Firm (or other party holding Client Assets) to invest, encumber, rehypothecate, stock-lend, or otherwise deal with, the Client Assets? If so, please describe.

According to Article 60 of the *Regulation on Supervision and Administration of Securities Company*, a securities company is banned from investing Client Assets. In Article 61, it provides securities companies shall not provide financing or guarantee with the assets of securities brokerage clients.

5. If the Regime in your jurisdiction permits or requires Client Assets to be held by third party custodians:

Based on the provision of Article 58 of *the Regulation on Supervision and Administration of Securities Company*, a securities company undertaking securities asset management business shall transfer client entrusted assets for custodial purpose to the designated commercial bank or to such other asset custodial agency as recognized by the securities regulatory authority under the State Council.

The custodial agency shall hold the responsibility of safekeeping the entrusted assets, receiving and paying of funds, and supervising the investment behavior of the securities company pursuant to the rules of the securities regulator under the State Council as well as the provisions in the securities asset management contract.

6. Under what circumstances, if any, is an Investment Firm required to disclose to clients information related to the protection of the client's assets? What is the nature of such required disclosures? How do any such required disclosures apply to Client Assets held in another jurisdiction?

Clients could check the balance and changes of funds in their detail accounts from the securities company and the commercial bank.

7. Under what conditions, if any, may clients choose to waive any of the Client Asset protection requirements applicable in your jurisdiction (also known as

"opting out")? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

Not applicable

8. Under what circumstances, if any, is an Investment Firm required to notify the regulators or the market generally, of material changes in their financial position or ability to continue to carry on business? What is the nature of such required disclosures?

Securities companies are required to submit annual reports to the CSRC within four months as of the last day of each accounting year, and monthly reports within seven business days as of the end of the previous month. Where events take place that materially affect or may affect the operations, financial positions, risk control indicators or the safety of client assets, securities companies shall submit a provisional report to the CSRC, explaining the causes, status quo, possible consequences and planned responses to this event in question. Securities companies should also report on other relevant matters based on the rules of the CSRC.

9. For an Investment Firm whose financial situation is seen to have deteriorated (e.g., capital has fallen below certain thresholds), what actions, if any, may the firm's regulators take to protect Client Assets?

Article 150 of *the Securities Law* states, where the net capital level or other risk control thresholds of a securities company is not in conformity with the specified level or thresholds, the securities regulatory authority under the State Council shall order the company to rectify within a specified time limit; if the company fails to do so by the time limit, or its behavior severely threatens its steady operation or jeopardizes the lawful rights and interests of its clients, the securities regulatory authority under the State Council may take the following measures against the company as the case may be:

(1) to impose restrictions on the business activities of the company, order it to suspend part of its businesses, or to withhold approval with respect to its application for new businesses;

(2) to withhold approval with respect to its application for increasing or acquiring business branches;

(3) to impose restrictions on the profit distribution of the company, or on the compensation payments or benefit availabilities to its directors, supervisors or senior managers;

(4) to impose restrictions on the alienation of the property of the company, or the creation of other rights on its property;

(5) to order the company to replace its directors, supervisors or senior managers, or to impose restrictions on their rights;

(6) to order the controlling shareholders to divest their interests in the company or to impose restrictions on the exercise of the shareholder rights of relevant shareholders; or

(7) to revoke the relevant business permits.

Upon completion of rectification, the securities company shall submit a report to the securities regulatory authority under the State Council who shall go through the procedure of check and acceptance thereupon. Where the risk control thresholds are met, the relevant measures taken against the company under the provisions of the preceding paragraph shall be removed within three days after completion of check and acceptance.

Post-Insolvency

10. Please describe the process by which an Investment Firm enters the status of "insolvent" or "bankrupt" or the equivalent.

Where a securities company is engaged in some abusive practices, significant risks emerge or the company is insolvent, the CSRC can revoke the company's license. The CSRC then could entrust a professional institution to set up a task force that undertakes the administrative clearing of the company, and entrust a qualified securities company to be the custodian of its brokerage business. When the administrative clearing is completed, the task force files bankruptcy with the court who determines the company is in judicial bankruptcy procedure. The major difference between bankruptcy of securities companies and that of ordinary companies lies in the administrative clearing. The leader of the task force acts as the legal representative of the company during this period.

Article 153 of *the Securities Law* provides where a securities company conducts business against law or incurs tremendous risks, thus severely undermining the order of the securities markets or jeopardizing the interests of investors, the securities regulatory authority under the State Council may take such regulatory measures as ordering the company to suspend business operation for rectification, putting the company under the trusteeship of, or having it taken over by, a designated institution, or terminating the company.

Article 19 of the *Regulations on Handling of Risks of Securities Companies* specifies the securities regulatory authority under the State Council may directly dissolve a securities company if all the following circumstances apply to such securities company:

(1)there exist in the securities company particularly serious illegal operation and huge operating risks;

(2)the securities company is unable to pay debts when due, and its assets are not sufficient to pay off all its debts or it obviously lacks the ability to pay off debts; and

(3)the Securities Investor Protection Fund needs to be used.

Article 20 specifies where a securities company is still unable to meet the normal operation requirements within the prescribed time limit after being ordered to suspend

business for rectification, put into custody, taken over or subjected to administrative restructuring and, moreover, falls under one of the circumstances prescribed in Article 19 (2) or (3) of these Regulations, the securities regulatory authority under the State Council shall dissolve the company.

Article 21 provides that to dissolve a securities company, the securities regulatory authority under the State Council shall make a decision of dissolution and, in accordance with the prescribed procedures, select professional agencies such as law firms and accounting firms to set up a task force to conduct administrative clearing of the securities company.

Article 22 provides that the head of the administrative clearing task force shall exercise the functions and powers of the legal representative of the securities company in question in this period.

Article 23 states during the period of administrative clearing, the clients-related business of a dissolved securities company, such as the securities brokerage business, shall be put into the custody of another securities company or other professional agency selected by the securities regulatory authority under the State Council in accordance with the prescribed procedures.

11. Please describe the process by which the Administrative Officer (as defined above), if any, is selected. What qualifications, if any, must an Administrative Officer have? Who selects the Administrative Officer?

The CSRC reviews the applicants. Only those qualified securities companies, law firms and accounting firms can be added into the candidate list. Where risk disposal is required at a securities company, the CSRC will invite related professionals to set up a review group on the basis of public tendering, to vote the custodian and clearing institution. Factors to be considered during the review include the candidate's compliance records, business performance and scope (the custodian shall dispatch a custody team comprised of a manager, a financial staff and a computer expert into the securities company). Administrative Officers to handle risks in the securities company

can be another securities company with good risk control and strong financial strengths, or a law firm that has securities –related business or hands-on experience in clearing, or an asset management company or any other qualified institutions recognized by the CSRC.

12. What are the duties of the Administrative Officer?

a. What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?

When the task force of administrative clearing is established and the custodian is selected, the CSRC will start necessary training for those in charge of this matter. Contents of the training include relevant policies, laws and regulations and an overview of the targeted securities company.

b. Under what standard (*e.g.*, strict liability, negligence), if any, is the Administrative Officer, pursuant to the Regime in your jurisdiction, subject to personal liability for failure to properly perform his or its duties?

Under *the Regulations on Handling of Risks of Securities Companies,* the administrative clearing task force shall perform the following duties:

1. managing the property, seals, account books, documents and other materials of the securities company;

2. straightening out accounts, checking up on the assets and liabilities of the securities company, and registering any claims that conform to the provisions of the State;

3. assisting in screening, confirming and purchasing the claims that conform to the provisions of the State;

4.assisting the Securities Investor Protection Fund authority in making up the clients' transaction settlement funds;

5. making arrangement for the clients based on their free will;

6. transferring securities-related assets;

7. and any other duties as required by the securities regulatory authority under the State Council.

And the custody group shall perform the following duties:

1. ensuring the normal and proper operation of the securities brokerage business of the securities company in custody and, when necessary, advancing the working capital and clients' transaction settlement funds in accordance with the relevant provisions;

2. taking effective measures to maintain the safety of clients' assets during the period of custody;

3. examining the risks existing in the securities company, reporting any emergency that arises in business operation to the securities regulatory authority under the State Council in a timely manner, and proposing solutions to such emergency; and

4. any other functions and duties as required by the securities regulatory authority under the State Council.

c. Examination of the administrative officer

Under *the Rules for an Administrative Officer to Participate in Handling of Risks in Securities Companies,* the Office of Risk Disposal at the CSRC is responsible for examination of the administrative officer. Elements to be examined include: performance in maintaining operational order and social stability; asset checking and collection and safekeeping; clearing up the accounts; punishment measures; work efficiency; providing accurate data in timely manner; expenditures; just practices, response from and impact on the society; cooperation with regulators, local governments and regional offices of the CSRC. The Office of Risk Disposal will record the outcomes of the examination into the administrative officer's credit document, release an appraisement on the institution or the individual and report this

matter to relevant departments. For those who fail to deliver its duties, or commit errors that hinder risk disposal, the CSRC will ban them from engaging in such business in the future. Yet, for those perform well, the CSRC will support their other business in the capital markets.

13. What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?

When a securities company's license is revoked and the company is under insolvency proceedings, it is the court that takes charge of the process pursuant to *Law on Enterprise Bankruptcy*, and the CSRC will not supervise the process. When necessary, the CSRC can coordinate with the court on administrative clearing and the handover to judicial insolvency procedure.

Together with relevant departments, the CSRC has mapped out policies for purchasing the credit right and client securities trading settlement funds at the dissolved company, clarifying the standards, scope and procedures for purchase and compensation. When dissolved, the securities company will have its individual credits purchased and the shortfalls in client securities trading settlement funds met by the task force according to the policies during the administrative clearing process. Credits that are not covered by the policies will be liquidated pursuant to the *Law on Enterprise Bankruptcy* in insolvency proceedings. The CSRC does not intervene in that.

14. Transfer of Client Assets

Assets of brokerage business clients and brokerage business assets of non-brokerage business clients may be transferred to receiving companies for securities-related assets, or other solvent securities companies. Clients can also transfer their assets to other securities companies at will. The rest of clients outside of the brokerage business bracket will have their assets arranged by the asset receiving company after securities assets at the dissolved company being transferred.

Under *the Regulations on Handling of Risks of Securities Companies,* the task force of

administrative clearing should make arrangement for the clients based on their free will.

15. to what extent are clients at risk of, or protected from, having to return Client Assets (or the value thereof) that were distributed to the client prior to the insolvency proceeding?

Not applicable. (Individual credits and client's securities trading settlement funds are in exception).

16. To what extent, if at all, does the Regime in your jurisdiction provide compensation to clients from other sources (for example, an investor protection or similar fund) for loss of Client Assets? Please discuss the scope of protections, conditions on such protection, and the limits of compensation (e.g., maximum compensation per client).

Under *Opinions on Purchase of Individual Credits and the Securities Trading Settlement Fund at Dissolved Securities Companies*, and *Supplements to the Notice of Purchase of Individual Credits and the Securities Trading Settlement Fund at Dissolved Securities Companies*, credits at a dissolved securities company shall be purchased, and shortfalls in clients' securities trading settlement funds shall be met by the state. And the SIPF (Securities Investor Protection Fund) shall appropriate financial resources for the purchase.

a. Purchase of Securities Trading Settlement Fund

i Scope and purchase standards

By definition, securities trading settlement funds include the deposits by clients of brokerage business with securities companies to ensure full settlements, payments from sales of marketable securities (deducting commission fees and costs for legitimate purpose), stock dividends, cash dividends, bond interest, and interest of above mentioned funds.

Securities trading settlement funds should be purchased in full.

b. Purchase of Individual Credits

i Scope

Individual credits here mainly refer to properties that individuals entrust securities companies to run; marketable securities (e.g. treasury bonds, equities, and some other types of bonds) that are owned and deposited by individuals into the related accounts of securities companies but misappropriated by financial institutions, which thus constitutes de facto credits to those financial institutions.

ii Standards

For credits before (and on) September 30, 2004, the principals shall be purchased based on the following standards:

a) Credits with an aggregated amount of less than (including) 100,000 RMB of one individual (the owner of one particular set of ID number, hereafter) shall be purchased in full.

b) The part of Credits above the line of 100,000 RMB of one individual shall be purchased at 10% discount.

For credits from September 30, 2004 to January 31, 2006, the standards are as follows:

a) Credits with an aggregated amount of less than (including) 100,000 RMB of one individual shall be purchased in full.

b) The part of credits within the range of 100,000 RMB (not included) - 200,000 RMB of one individual shall be purchased at 10% discount.

c) The part of credits within the range of 200,000 RMB (not included) - 500,000 RMB of one individual shall be purchased at 20% discount.

d) The part of credits within the range of 500,000 RMB (not included) - 1000,000 RMB of one individual shall be purchased at 30% discount.

e) The part of credits within the range of 1000,000 RMB (not included) - 2000,000 RMB of one individual shall be purchased at 40% discount.

f) The part of credits within the range of 2000,000 RMB (not included) - 3000,000 RMB of one individual shall be purchased at 50% discount.

g) The part of credits above the line of 3000,000 RMB of one individual shall not be purchased.

17. Are there circumstances in which clients are treated differently based on permissions they have granted pre-bankruptcy?

No.

19. What happens if the Investment Firm fails to comply with Client Asset protection requirements?

As specified in *the Regulations on Handling of Risks of Securities Companies*, the securities regulatory authority under the State Council may put into custody a securities company's clients-related business such as securities brokerage business when it misappropriates clients' assets and is unable to make up the funds misappropriated; and may, in case of serious circumstances, take over the securities company.

Where the securities regulatory authority under the State Council decides to put into custody the clients-related business of a securities company, such as the securities brokerage business, it shall, in accordance with the prescribed procedures, select securities companies or other professional agencies to form a custody group to exercise the managerial power over the clients-related business such as the securities brokerage business.

Where the securities regulatory authority under the State Council decides to take over a securities company, it shall, in accordance with the prescribed procedures, establish a takeover group composed of professionals to exercise the managerial power of the securities company. The head of the takeover group shall exercise the functions and

powers of the legal representative of the securities company, whereas the shareholders' meeting, the shareholders' general meeting, the board of directors, the board of supervisors, managers and deputy managers of such securities company shall cease to perform their functions and duties.

Where a securities company meets the requirements for normal business operation within the prescribed time limit after being put into custody or taken over, it may resume normal operations upon the approval of the securities regulatory authority under the State Council.

Where a securities company is still unable to meet the normal business operation requirements within the prescribed time limit after being put into custody or taken over, but is able to pay its debts when due, the securities regulatory authority under the State Council shall revoke its securities business license in accordance with law. When its business license being revoked, a securities company shall cease securities business and arrange for transferring its clients to other securities companies based on their free will. In the process of such arrangement, all parties concerned must take necessary measures to ensure securities transaction.

Where a securities company is still unable to meet the normal business operation requirements within the prescribed time limit after being ordered to suspend business for rectification, put into custody, taken over or subjected to administrative restructuring, and is unable to pay debts when due, and its assets are not sufficient to pay off all its debts or it obviously lacks the repayment ability, and needs to use the Securities Investor Protection Fund, the securities regulatory authority under the State Council may directly wind up this securities company.

20. If there is a shortfall, i.e., if claims by clients exceed resources dedicated to paying such claims (whether from Client Assets, investor protection fund, or otherwise), how are Client Assets distributed?

Except the securities trading settlement funds and individual credits in the purchase scope, other credits incurred from the disputes between clients and securities

companies will be liquidated through insolvency proceedings in accordance with relevant rules in *Law on Enterprises Bankruptcy*. There is not any prioritized rank nor preferred distribution.

21. Please explain how claims of clients are ranked in the insolvency process relative to those of other creditors. Does your insolvency regime rank domestic creditors above foreign creditors?

Credits in insolvency process are treated as ordinary credits and shall be liquidated regardless of the origin of creditors. There isn't any prioritized rank.

France

Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets

I. Background

This questionnaire seeks information to aid in understanding the responding jurisdictions' techniques for protecting Client Assets in the event of the insolvency and/or winding up of an Investment Firm, and for promptly transferring such assets to a solvent Investment Firm or distributing them to the client. It is not intended to require information concerning the general legal framework for insolvency, except to the limited extent necessary to understand how rules for the protection of Client Assets fit within that framework.

Definitions.

(1) **"Administrative Officer"** refers to the person or entity who is appointed, whether by a court, regulator, creditors, the Investment Firm itself, or otherwise, to assume control of or power over a bankrupt or insolvent Investment Firm. This term includes administrators, debtors in possession, receivers, liquidators, trustees, and similar titles.

(2) **"Client Assets"** refers collectively to Positions, Securities, and Client Money:

- "**Positions"** are contractual rights and obligations arising from transactions entered into by an investment firm on behalf of its clients, including mark to market accruals arising from the change in value of futures, options and/or other derivatives positions;

- "**Securities"** are defined to incorporate both securities and derivatives, as those terms are defined or understood in the responding jurisdiction; and

- "**Client Money"** refers to funds owed to or held on behalf of clients by an investment firm, and may include margin collateral associated with client positions (both existing and potential), income relating to an investment such as dividends or interest, proceeds of the liquidation of client securities and/or positions, and funds in excess of required margin.

(3) **"Investment Firm"** means an intermediary that holds Client Assets and is engaged in the business of managing client accounts, which could include, without limitation: executing orders on behalf of others, dealing in or distributing Securities (including carrying derivatives positions). In jurisdictions where banks are broadly permitted to engage in such a business, this term includes banks to the extent they are providing such services.

(4) **"Omnibus Account"** means an Investment Firm's account with a third party in which Client Assets are maintained separate from the firm's assets, but are held in the aggregate instead of in accounts designated for individual clients.

(5) **"Regime"** refers to statutes, regulations, rules of exchanges, clearing organizations and other self-regulatory bodies, or other legally binding requirements.

II. Survey Questions *Where appropriate, please provide citations to statutes, regulations, or other authorities supporting your answers below.*

Context

1. Please provide a brief overview setting forth the defining characteristics of your jurisdiction's approach to protecting Client Assets.

The protection of client assets in France results mainly from:

- Provisions set in the European directive 2004/39 on Markets in financial Instruments (Mifid) and its implementing directive (European directive 2006/73/EC of 10 August 2006), which have been transposed in the Monetary and Financial code by the Order of 2 July 2007 as well as in the CRBF and Autorité des marches financiers (AMF) regulations.

  The high level principles set by MiFID (MiFID articles 13.7 and 13.8) aim at requiring investment service providers[1], when holding assets belonging to clients, to make adequate arrangements so as to safeguard the clients' rights. In addition, when outsourcing critical or important operational functions (and safekeeping is one) investment service providers must comply with articles 14 and 15 of the implementing directive of MiFID transposed in the AMF General Regulation (GR).

  In addition, it should be noted that, in France, portfolio management firms as defined by article L. 532-9 of the Financial and Monetary code are prohibited from holding client assets.

- Specific regulations in France regarding custody-account holding contained in the Monetary and Financial code and the AMF GR. Although safekeeping and administration of financial instruments for the account of clients, including custodianship and related services, which is an ancillary service of MiFID, is not subject to a specific license, as MiFID prevents this, this service can only be provided by certain entities and is subject to certain regulations set by the AMF.

- Specific and very protective rules set by the AMF GR (see below answer to question c) 2) among which:

  - The obligation for custodians to return any financial instruments held in bookentry form on their books contained in the AMF GR. This is also the case when the custodian has recourse to subcustodians. This is an "obligation de résultat".

  - The prohibition to make use of instruments other than what the accountholder instructs. This ensures that the custody account holder must ensure that the securities of one client are not used to settle the trades of another client, a process know as "lending from the bow" or unauthorized securities lending. There are also rules to prevent this. In particular, as per art. 322-18 of AMF GR: An ordinary individual financial instrument account shall not be in debit on the settlement date of any instrument sold therefrom. The custody account-keeper shall establish procedures to:

[1] Please note that in French law, investment firms and credit institutions authorized to provide investment services are called "investment service providers".

1° identify any trade or disposal that could lead to a debit balance on the financial instrument account at the settlement date;

2° preventing the occurrence of such debit balance.

See also specific investor protection rules related to securities holding in article 322-32 to 322-35 (these are described below page 8 of the questionnaire).

- The pivotal role of the central securities depository. Indeed, it records in a specific account in its books the entirety of the financial instruments making up each issue accepted for the depository's transactions and verifies that the total amount of each issue accepted for its operations and recorded in this specific account is equal to the sum of the financial instruments recorded on the current accounts of its members (custodians).

- Provisions resulting from the directive on compensation schemes which have been transposed in the Monetary and Financial code. Compensation schemes aim at compensating investors in the event that their financial instruments become unavailable.

The sharing of responsibilities among the Banking Commission and the AMF is described below in the answer to the various questions. In summary, the AMF is in charge of the protection of clients' assets in so far as they are financial instruments, whereas the Banking Commission is in charge of the protection of clients funds.

In answering the remaining questions:

(1) Please provide details, as appropriate, where the Regime in your jurisdiction applies different treatment or results based on differences in:

a. Categories of Client Assets;

The *Autorité de Contrôle Prudentiel* (ACP) is charged with monitoring investment firms' observance - other than portfolio management companies mentioned in Article L. 532-9 of the said Code- of laws and regulations relating to the segregation of funds held only on behalf of their customers. The regime is based on the Order of 2 July 2007 which applies to the investment firms mentioned in article L. 531-4 of the Monetary and Financial Code, other than portfolio management companies mentioned in Article L. 532-9 of the said Code, which may hold funds for their customers incidentally to their principal activity.

The remit of the AMF relates to rules relating to the protection of clients' financial instruments. Its GR contains:

- Rules implementing the MiFID provisions in this field, i.e. implementing measures of MiFID art. 13-7 that is transposed in the Monetary and Financial Code: articles 16, 17, 19 and 32 of the implementing directive for what relates to financial instruments. All these rules are included in the organisational rules applicable to investment service providers other than portfolio management firms. See articles 313-13 to 313-17 and article 314-39 of AMF GR.
- Rules applicable to custody account-keeping as an ancillary service, which form a separate set of rules: See Title II, Chapter II, of AMF GR – articles 322-1 and following. These are applicable to securities, not to futures or options.

b. Models of trading (e.g., exchange-traded versus over-the-counter).

There are no differences in the rules explained in the present document based on the model of trading although the existence of a clearing house is a key element of the security of the market.

*c. Categories of clients (*e.g., *retail versus sophisticated)*

The Order of 2 July 2007 which transposed MiFID applies to:

- "professional customer": a customer who possesses the experience, knowledge and skills to make his own investment decisions and adequately evaluate the risks incurred (article L. 533-16 of the Monetary and Financial Code). These customers can require to be treated in the same way as "non-professional customers" and the investment firms can accept to provide them with a higher level of protection (in accordance with the modalities set by the AMF GR);

- "non-professional customer": a customer other than a professional customer.

There are a few specific provisions in the AMF GR that apply to investment service providers differently according to the nature of their client (professional or non professional). These provisions aim at ensuring additional protection to non professional clients or waiving some obligations when professional clients are concerned in certain circumstances. They are the followings (see art. 313-16 and 313-17):

- Investment services providers may not use a third party to hold their clients' financial instruments if that third party is located in a State that is not party to the European Economic Area agreement that does not regulate the holding of financial instruments on behalf of another person, unless one of the following conditions is met:
  1° The nature of the financial instruments or of the investment services connected with those instruments requires them to be deposited with a third party in the State that is not party to the European Economic Area agreement.
  2° If the financial instruments are held on behalf of a professional client, that client makes a written request to the investment services provider to have them held with a third party in the State that is not party to the European Economic Area agreement.

- The agreement by which the client allows the investment service provider to use the client's financial instruments must be made in writing (see art. 313-17).

- In addition, when securities are held abroad for the account of a professional investor, the custodian may agree with him that responsibilities are shared (art. 322-41).

When the custody account-keeper appoints an agent or engages a third party as described in articles 322-39 and 322-40, it conducts an assessment of the resources and procedures employed and the risks incurred. This assessment is available for review by the AMF.
The liability of the custody account-keeper to the holder of a financial-instrument account is not affected by the appointment of another custody account-keeper as agent or by the engagement of a third party to provide technical resources.
However, when a custody account-keeper holds financial instruments issued under foreign law in custody for the account of a qualified investor as defined by applicable law and regulations, the custody account-keeper may agree to share liability with that investor.

(2) You are requested to provide details of the Regime in your jurisdiction. You are additionally invited to provide information explaining how that Regime is applied in practice, through, e.g.*, informal arrangements between governmental entities.*

Protection of funds:

The funds of clients that an investment firm holds must be deposited in an institution within a specific account. Credit institutions are not subject to the principle of segregation due to the nature of their activities which is receiving funds of clients, recorded as liabilities.

The branches whose head office is located in another Member State are subject to the regulatory requirements relating to the information to be provided to clients (title IV of the Order of 2 July 2007).

Investment firms have to reconcile regularly between their accounts and the register of the custodian. They are also required to report to the ACP on a quarterly basis and provide clients with all the relevant information.

There is no informal arrangement between governmental entities.

Protection of financial instruments:

Pursuant to MiFID article 13.7 transposed at article L533-10, 6, investment firms must, 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.

This principle is further detailed in the implementing directive of MiIFD (European directive 2006/73/EC of 10 August 2006) transposed in the AMF GR (articles 313-13 to 313-17 and article 314-39), as follows:

Article 313-13
Investment services providers must comply with the following obligations to safeguard their clients' rights in relation to the financial instruments belonging to the clients:
1° 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 other clients, and from their own financial instruments.
2° They must maintain their records and accounts in a way that ensures their accuracy, and in particular, their correspondence to the financial instruments held by clients.
3° They must conduct periodic reconciliations between their internal accounts and records and those of the third parties with whom the clients' financial instruments are held.
4° They must take the necessary steps to ensure that any client financial instruments deposited with a third party can be identified separately from the financial instruments belonging to the investment services provider by means of differently titled accounts on the books of the third party or other equivalent measures that achieve the same level of protection;
5° They must introduce adequate organisational arrangements to minimise the risk of loss or diminution of clients' assets or of rights in connection with those financial instruments

resulting from misuse of the financial instruments, fraud, poor administration, incorrect record-keeping or negligence.

Articles 313-14 to 313-16 relate to sub-depositing and provide for the following:

Investment services providers using a third party to hold their clients' financial instruments must exercise all due skill, care and diligence in the selection, appointment and periodic review of the third party and of the arrangements made by said party for the holding of those financial instruments. They must take into account the expertise and market reputation of the third party, as well as any legal or regulatory requirements or market practices related to the holding of those financial instruments that could adversely affect clients' rights.

If investment services providers use a third party to hold their clients' financial instruments and that third party is located in another country that has specific regulations and supervision regarding the holding of financial instruments on behalf of another person, then those investment services providers must choose a third party that is subject to the specific regulations and supervision and do so in accordance with the provisions contained in the above paragraph.

Investment services providers may not use a third party to hold their clients' financial instruments if that third party is located in a State that is not party to the European Economic Area agreement that does not regulate the holding of financial instruments on behalf of another person, unless one of the following conditions is met:
1° The nature of the financial instruments or of the investment services connected with those instruments requires them to be deposited with a third party in the State that is not party to the European Economic Area agreement.
2° If the financial instruments are held on behalf of a professional client, that client makes a written request to the investment services provider to have them held with a third party in the State that is not party to the European Economic Area agreement.

Article 313-17 relates to the use of clients' financial instruments (see below for more detail).

Moreover, in accordance to article 314-39 of AMF GR that transposes article 32 of MiFID implementing directive, investment service providers must comply with information requirements concerning the safeguarding of client financial instruments.
Investment services providers holding financial instruments must provide their clients with such of the following information as is relevant:

1° The investment services provider shall inform the retail client of the fact that the financial instruments or funds of that client may be held by a third party on behalf of the investment services provider and of the responsibility of the investment services provider for any acts or omissions of the third party and the consequences for the client of the insolvency of the third party.
2° Where financial instruments of the retail client may, if permitted by applicable law, be held in an omnibus account by a third party, the investment services provider shall inform the client of this fact and shall provide a prominent warning of the resulting risks.
3° Where it is not possible under applicable law for a retail client's financial instruments held with a third party to be separately identifiable from the proprietary financial instruments of

that third party or of the investment services provider, the latter shall provide a prominent warning of the resulting risks.
4° The investment services provider shall inform the client in cases where accounts that contain financial instruments or funds belonging to that client are or will be subject to the law of a jurisdiction other than that of a State party to the European Economic Area agreement and shall indicate how the rights of the client relating to those financial instruments or funds may differ accordingly.
5° The investment services provider shall inform the client about the existence and the terms of any security interest or lien which the provider has or may have over the client's financial instruments or funds, or any right of set-off it holds in relation to those instruments. Where applicable, it shall also inform the client of the fact that a depository may have a security interest or right of set-off in relation to those instruments.
6° An investment services provider, before entering into securities financing transactions in relation to financial instruments held by it on behalf of a retail client, or before otherwise using such financial instruments for its own account or the account of another client, shall in good time before the use of those instruments provide the retail client, in a durable medium, with clear, full and accurate information on the obligations and responsibilities of the investment services provider with respect to the use of those financial instruments, including the terms for their restitution, and on the risks involved.

As regards the regulation of custodians, the AMF GR's main principles are the following (see art. 322-4 and following):

- **Custodians must safeguard the financial instruments in its custody.** It is important to note that under French law, the holder of the financial instruments owns them. This is in contrast to certain countries where he is considered as a « creditor » (créancier) of the custodian.

- Custodians must ensure that **no use is made of those instruments other that what the accountholder instructs.** This ensures among other things that the custody account holder or bank must ensure that the securities of one client are not used to settle the trades of another client, as process known as « lending from the box » or unauthorized securities lending.

- **Custodians must return any financial instruments held in their books (unless, with professional clients, when an agreement has taken place in order to share responsibilities – see art. 322-41).** This requirement is particular to the French market; it means that the custody agent is obliged to return any securities in book entry form that his clients have entrusted him with. This obligation is also applicable to any party whom he may appoint (outsource to) (see art. 322-39). In addition, this implies that excepted in case of fraud, the client of a custodian who has failed will immediately retrieve his financial instruments.

One should also note the following investor protection rules art. 322-32 to 322-35 of AMF GR):

Delivery of financial instruments subsequent to a transaction made by an authorised service provider for its own account, whether or not in relation to transactions made by its customers, is subject to systematic checking of availability from the service provider's own account so that no use is made of financial instruments recorded in the name of third parties. If sufficient

financial instruments are not available in that account, the custody account-keeper must resort to borrowing the instruments in question.

Whenever the custody account-keeper resorts to borrowing financial instruments as provided for in article 322-32, it ensures that the financial instruments in question are received not later than the day on which those instruments are to be withdrawn from the available asset account for the purpose of making the delivery mentioned in that Article. When the borrowed financial instruments are to be returned, the custody account-keeper ensures that it holds a sufficient quantity of financial instruments in its own account before doing so.

Any movement of financial instruments in custody that is not completed within the time limits set by the market rules or the rules of payment and settlement systems is detected immediately by the information system and brought to the attention of the relevant department in order to bring the situation into compliance with requirements.

Where an expected delivery of financial instruments is not received by the scheduled date, the custody accountkeeper contacts the counterparty as soon as possible to claim the financial instruments in question. Concomitantly, the missing quantity of financial instruments in custody is reconstituted either by borrowing or, if need be, by purchase, according to the terms and conditions set forth in the market rules or the rules of the payment and settlement system in question or according to the contract provisions agreed with the account holder.

In addition, an ordinary individual financial instrument account must not be in debit on the settlement date of any instrument sold therefrom (AMF GR art. 322-18)

The custody account-keeper must establish procedures to:
1° identify any trade or disposal that could lead to a debit balance on the financial instrument account at the settlement date ;
2° preventing the occurrence of such debit balance.

There are also provisions regarding internal and external segregation:

Art 322-4 of AMF GR provides that “Subject to the accounting provisions set forth in Article 322-17, the custody account-keeper ensures that the assets of its customers, including those of any collective investment scheme for which it is custodian, are segregated from its own assets on the books of any central securities depositories of which it is a member. When the custody account-keeper uses the services of an agent, as provided for in Article 322-39, it ensures that the same segregation is made on the books of the agent.

See also art 322-17: The custody account-keeper describes its accounting organisation in an appropriate document. For the purpose of ascertaining and monitoring the rights of account holders, financial instrument accounts are kept according to the rules of double-entry book-keeping. The terminology of these accounts and the operating rules applicable to them are specified in an AMF instruction. For purposes of control, this terminology classifies financial instruments belonging to collective investment schemes, to other clients and to the custody account-keeper itself into distinct categories.

Custodians are also subject to specific obligations in terms of resources and procedures (see art. 322-8 and following), among which **accounting procedures are particularly important** and include the following principles:

- the service provider must maintain a double-entry accounting system;
- movements in cash and securities must be booked at the same time;
- a financial instrument account must not be in debit on the settlement date;
- application to the outsourcing of custody account-keeping of the rules provided for on outsourcing.

Custodians must also comply with requirements that relate to matters such as human resources, information systems, customer protection and compliance and internal control system. They must also at all times be able to show that these requirements are being met.

The protection afforded to clients by rules applicable to custodians is reinforced by the fact that the central securities depository records in a specific account in its books the entirety of the financial instruments making up each issue accepted for the depository's transactions **and verifies** that the total amount of each issue accepted for its operations and recorded in this specific account is equal to the sum of the financial instruments recorded on the current accounts of its members (custodians).

Pre-Insolvency

2. Does the regime in your jurisdiction require an Investment Firm to hold special authorization (*i.e.*, a specific form of license or registration) to be permitted to hold Client Assets?

No. There is no special authorization but only certain entities listed in article L. 542-1 of the Financial and monetary code may act as custodians or administrators of financial instruments. These are:
1. Legal entities for the financial instruments they issue through public offerings;
2. Credit institutions established in France;
3. Investment firms established in France;
4. Legal entities whose members or partners are indefinitely and jointly liable for their debts and commitments, provided that such members or partners are institutions or companies referred to in 2 and 3 which are authorised to provide administration or custody for financial instruments;
5. Legal entities established in France having as their primary or sole purpose the custody or administration of financial instruments;
6. The institutions referred to in Article L. 518-1 (i.e. the Treasur, the Bank of France);
7. As provided for in the GR of the AMF, credit institutions, investment firms and legal entities having as their primary or sole purpose the custody or administration of financial instruments which are not established in France.

The persons referred to in 1 are subject, in regard to their financial instrument custody or administration activities, to the control and sanctions of the AMF. The persons referred to in 2 to 5 are subject, in regard to their financial instrument custody or administration activities, to the laws and regulations, the rules of supervision and the sanctions laid down for investment service providers by the Financial and monetary code. Persons referred to in 2 and

3 are subject, in regard to their financial instrument custody or administration activities, to an authorisation issued in connection with their approval. Persons referred to in 5 are subject to the rules of approval laid down for investment firms by the Financial and monetary code. Persons referred to in 7 must be subject in their State of origin to rules governing the custody or administration of financial instruments and supervision equivalent to those applied in France. The AMF exercises, in relation to such persons, the powers of supervision and sanction stipulated for investment service providers in the Financial and monetary code, taking the supervision carried out by the proper authorities of each State into account.

From a general point of view, in order to provide investment services, the investment service providers must obtain authorisation by the Credit institutions and Investment Companies Committee (CECEI). Prior to granting approval to an investment firm, the CECEI verifies that (article L. 532-2 of the Monetary and Financial Code):

- Its registered office and its principal administrative establishment are in France;
- It has, in view of the nature of the service it wishes to provide, sufficient initial capital as determined by the Minister for the Economy as well as suitable and sufficient financial resources;
- It has indicated the identities of its direct or indirect shareholders, natural persons or legal entities, who have a qualified equity holding, as well as the amount of their holdings; the Committee assesses the status of those shareholders in regard to the necessity of guaranteeing sound and prudent management of the investment firm.
- Its policy is determined by at least two persons possessing the necessary respectability and competence and adequate experience for that function;
- It has a legal form suitable for the business of an investment firm;
- It has an activities schedule for each of the services it intends to offer which specifies the manner in which it envisages providing the investment services concerned and indicates the type of transactions envisaged and its organisational structure.

The Committee may attach to the approval granted special conditions intended to maintain the balance of the company's financial structure. It may also make the awarding of approval subject to compliance with undertakings given by the applicant firm. The committee may refuse to grant approval if performance of the supervisory function in relation to the applicant firm is likely to be impeded either by the existence of links of capital or direct or indirect control between the company and natural persons or legal entities, or by the existence of laws or regulations of a State outside the European Economic Area which one or more of those legal entities or natural persons are governed by.

The investment firm must meet the conditions of its approval at all times.

Note however that the holding (or not) of funds by an investment firm is a characteristic to be mentioned in the program of activities (included in the accreditation package) which is examined by the AMF (for opinion to the CECEI) and the CECEI during the procedure of authorization.

In addition, investment firms holding funds for their customers are required to comply with the Order of 2 July 2007 relating to the segregation of customers' funds.

a. If special authorization is required, what requirements (both initial and ongoing) is an Investment Firm required to comply with to hold such authorization?

(See the previous answer)

In addition, there is a specific minimum requirement regarding minimum capital set at 3.8 million euros (Regulation CRBF n° 96-15).

b. If special authorization is not required, how, if at all, is this activity supervised by a regulator?

Yes: the CB supervises the compliance of investment firms with the regulatory framework relating to the segregation of funds held for the customers (i.e. Order of 2 July 2007). In this respect, the investment firms are required to make sure that their auditors report at least once a year to the to the ACP on the compliance of the measures taken with respect the regulatory requirements. If, pursuant to a foreign regulation similar to the one set forth in the Order of 2 July 2007, certain funds held for customers must be segregated specifically, verification of the requirements of the Order shall be extended to include verification of such specific provisions.

The General Secretariat of the ACP supervises, on a quarterly and sub-consolidated basis, (i) the amounts of customers' funds to be segregated by investment firms, and (ii) the eligible assets held by investment firms and deposited with custodians.

The ACP may object to the inclusion of certain assets or the exclusion of certain liabilities when implementing the provisions of the Order if it considers that such assets or liabilities do not satisfactory meet the conditions contained in the regulations or that their inclusion or exclusion is liable to distort assessment of the effective capacity to repay customers' funds.

The ACP may, under exceptional circumstances, allow an investment firm subject to the Order of 2 July 2007 time to bring its situation into compliance with the regulatory provisions.

The AMF also supervises compliance by investment service providers and custodians of all laws and regulations applicable to them and summarized in this survey.

Article L. 621-7 of the Financial and Monetary Codes defines the AMF regulatory powers with regards to investment service providers and the conditions in which they comply with their obligations (see IV of article L. 621-7), as well as with regards to the custody and administration of financial instruments (see VI of article L. 621-7°.

The AMF has the power to conduct controls (see article L. 621-9) in these entities to check that they comply with their obligations and to take sanctions if they do not (see article L. 621-15, II)

3. Does the Regime in your jurisdiction require that Client Assets be maintained separately from the assets of an Investment Firm? If so, please provide a description of the process by which segregation is accomplished, and of the applicable requirements. Specifically:

a. Must the Client Assets of one client be maintained separately from those of other clients?

As regards the funds of investment firms' customers: No.

As regards financial instruments, yes: see above articles 322-17 and 322-4 of the AMF GR. In addition, as per art. 313-13 of AMF GR, investment service providers 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 other clients, and from their own financial instruments.

When the custody account-keeper uses the services of an agent, as provided for in article 322-39, it must ensure that the same segregation is made on the books of the agent.

Administered registered financial instruments must be held in book entry form with the issuer in the name of the owner, in accordance with the information provided by the custody account-keeper that administers the instruments.

i. Are Investment Firms allowed to hold Omnibus Accounts?

There is no specific regulatory requirement on this issue regarding funds.

From a general point of view, note that in accordance with the article 3, title II of the Order of 2 July 2007, investment firms are required to deposit all of the funds of their clients on one or more accounts opened specially for this purpose, separately identified from any other account used to hold funds belonging to the investment firm, with one or more of the following institutions:

– central bank;

– credit institution authorised in a Member State of the European Community or another Member State of the European Economic Area;

– bank authorised in a third country;

– "qualifying money market fund".

Investment firms subject to the Order of 2 July 2007 should at any moment be able to produce a justification of their compliance with this obligation.

With regards to financial instruments, the principles regarding accounts are determined by the AMF GR:
1° with regards to relations with customers and their accounts (see article 322-4 ad following). In particular, the operating principles for customer accounts in financial instruments are set forth in the agreement between the custody account-keeper and the account holder.
This agreement identifies the respective rights and obligations of the parties. It specifies the manner in which the account-holder is provided with statements showing the nature and number of financial instruments held in the account.

2° with regards to the investment service provider's accounting procedures which ensure the safe accounting and safeguarding of the clients assets in financial instruments : see articles 322-1 and following.

ii. What measures are used to protect the Client Assets of each client from losses due to the activities of other clients?

As regards funds, the existing measure to prevent this risk is embedded in the segregation rule requiring not netting the accounts receivable from customers (the losses of a customer will render its account debtor) with accounts payable (see response to question 3. b. i. C).

As pointed out in the answer to the question 2 b), the ACP may also object to the inclusion of certain assets or the exclusion of certain liabilities.

With regards to financial instruments, the custody account-keeper must in all circumstances do its utmost to safeguard the financial instruments in its custody and, to this end, ensure that all financial instruments and movements affecting them are booked in strict accordance with applicable rules and procedures. He may not make any use of the financial instruments and attached rights in its custody, nor transfer title thereto, without the express consent of the holder. It must organize its internal procedures to ensure that any movement affecting the financial instruments it holds in custody on behalf of third parties is justified by a properly recorded transaction in a third-party account (see AMF GR, art 322-4). It must also ensures that, barring any legal or regulatory provision to the contrary, any movement of financial instruments affecting the account of an account holder is carried out only on the instruction of that account holder, his representative, or, in certain cases such as inheritances, an authorised third party (see AMF GR, art 322-6). There are also the prohibitions and rules to prevent "lending from the box" as explained above (see 2° of art. 322-4 and art 322-32 to 322-35 of AMF GR).

b. Please describe any requirement that an Investment Firm must reconcile the Client Asset account. For example:

i. How do you calculate the amount of Client Assets that a firm is required to hold in one or more accounts segregated for the benefit of clients?

As regards the funds of investment firms' customers, the amount to be segregated shall be calculated by adding together the following items (see articles 4, I & II "segregation rule", Order of 2 July 2007):

– the credit balance of customers' cash accounts;

– sums deposited with the investment firm subject to this Order by customers, in order to cover and guarantee transactions related to the provision of investment services and all other sums used to carry out these transactions or resulting from these transactions;

– among all accounts tracking current transactions linked to the accounts or sums, sums due to customers but not yet credited to their accounts and, for transactions where delivery versus payment is.

The following sums shall be deducted from that amount: sums credited to customer accounts or to accounts tracking their current transactions and transactions awaiting collection by the investment firm.

As for securities, there is also a requirement that investment service providers conduct periodic reconciliations between their internal accounts and records and those of the third parties with whom the clients' financial instruments are held (art. 313-13 of AMF GR). In addition, the accounting system for financial instruments must implement procedures for ongoing verification of the accuracy of available asset account balances, with the aid of documentation of the corresponding assets provided by the central depository, the custody account-keepers having custody of the financial instruments, and the legal persons that issued them by means of a public offer of securities. Any discrepancy must be substantiated. (AMF GR Art 322-30).

A) Are required Client Assets fungible between or within asset classes, or is the Investment Firm required to hold, *e.g.*, the specific assets deposited by the client?

There is no such a requirement.

B) How is the reconciliation conducted (*e.g.*¸ on an aggregate basis, or a client-by-client basis)?

As far as customers' funds are concerned, investment firms are required to conduct reconciliation on an aggregated basis, in accordance with article 3 of the Order of 2 July 2007. Moreover, the article 5 of the Order provides that investment firms "must regularly reconcile their accounts and internal registers with those of third parties with whom those assets are held". Beyond the approximation which is made on an aggregated basis, the regulatory framework request investment firms to have an audit trail up to the customer account (internal registers).

C) If a client has a debit balance (*i.e.*, the client owes the Investment Firm), is such balance deducted in determining the amount the Investment Firm is required to hold?

No: The accounts receivable (debit balance) of the customer can not be deducted from the credits. Sums already reflected in the books of the investment firms and submitted by customers can not be deducted from the customers' funds to segregate on the grounds that they are owed by customers to the investments firms (e.g. funds used in hedging operations with delayed deferred settlement service).

ii Timing issues:

A) How often is reconciliation required (*e.g.*, daily, weekly, monthly).

Regarding funds, reconciliation is required to be conducted regularly (e.g. on a daily basis).

B) When is such reconciliation required (*e.g.*, noon of the following business day, the tenth business day of the following month).

There are no regulatory requirements on this issue. Note, however, that the date of reconciliation to provide the ACP is the last day of the Quarter.

C) Is the Investment Firm required to make good any deficiency from their own funds? If so, in what period? Is any payment by the Investment Firm thereby deemed to be Client Money?

The funds deposited in an investment firm by clients are not part of the assets of the investment firm. Should securities be missing (in case of a fraudulent use by the depositary for instance), the depositor is covered by the Securities Deposit Guarantee Fund.

iii. Is an Investment Firm permitted or encouraged to maintain any of their own assets in a Client Asset account (*e.g.*, as a "buffer")? If so, are any such assets so transferred then deemed to be Client Assets? Is there a requirement to remove any excess assets?

No.

Answer to question b) with regards to financial instruments: see above, AMF GR 313-13.

As further detailed by articles 322-17 to 322-31:

For the purpose of ascertaining and monitoring the rights of account holders, financial instrument accounts must be kept according to the rules of double-entry book-keeping. The terminology of these accounts and the operating rules applicable to them are specified in an AMF instruction. For purposes of control, this terminology classifies financial instruments belonging to collective investment schemes, to other clients and to the custody account-keeper itself into distinct categories.

An ordinary individual financial instrument account must not be in debit on the settlement date of any instrument sold therefrom. The custody account-keeper must establish procedures to:
1° identify any trade or disposal that could lead to a debit balance on the financial instrument account at the settlement date;
2° preventing the occurrence of such debit balance.

Transactions are recorded on the books of account as soon as the custody account-keeper has knowledge of them.

When transactions remain to be confirmed between the custody account-keeper and its counterparties, the corresponding commitments are recorded in off-book entries if they do not give rise to entries on the books of account.

Accounting provides all information needed to manage the settlement of transactions.

Every book entry is justified either by
1° a written document, or by
2° unalterable electronic data.

In respect of holders of accounts in administered registered financial instruments, the authorised intermediary serving as custody account-keeper is at all times able to show that the book entries for such holdings correspond exactly to those on the books of the issuing entity. A daily record is kept of changes in registered owner that have not been transmitted to the central depository within the required time limit and are still to be transmitted.

Processing procedures are organised in such a way as to ensure complete entry, reliability and safeguarding of basic data, in particular data relating to account holders, financial instruments held in custody, counterparties and corporate actions and events affecting such instruments.

The processing system is able to produce the following documents for each of the financial instruments held in custody:
1° record of movements in the financial instruments;
2° record of financial instrument accounts opened under all classes of the chart of accounts.

These records are retained for the period required by applicable regulations

The custody account-keeper establishes an audit trail linking the cash and securities entries corresponding to a given transaction, by means of either common references or rules of administration.

The accounting system for financial instruments is designed to provide evidence of the overall balance in each financial instrument on the basis of the balances in each holder's account and the balances on transactions in progress (balance audit trail) and to allow reconstruction of each balance from the detailed transactions that gave rise to it (book entry audit trail). Such justifications may be performed on a daily basis.

The accounting system for financial instruments is organised to enable verification of the accuracy of the processing procedures.
For each financial instrument, the following are checked daily:
1° Equality between the total of all credit entries to accounts and the total of all debit entries;
2° Balance between accounts with credit balances and accounts with debit balances.
The accounting system for financial instruments is also organised to enable verification of the data by means of appropriate procedures.

The accounting system for financial instruments implements procedures for ongoing verification of the accuracy of available asset account balances, with the aid of documentation of the corresponding assets provided by the central depository, the custody account-keepers having custody of the financial instruments, and the legal persons that issued them by means of a public offer of securities. Any discrepancy is substantiated.

The date on which receipt or delivery of financial instruments is normally expected is recorded. The recorded date takes into account the specific characteristics of cross-border transactions.
For all of the financial instruments concerned, a report on net fails in financial instruments and in cash is provided daily to the department with operating responsibility for counterparty payment and settlement transactions.
For the purposes of this Article, net fails include:
1° Transactions that have not been agreed within the scheduled time period.
2° Pending deliveries and payments relating to transactions that have been "agreed" with the counterparties but have not been completed within the scheduled time period.
The report on net fails is broken down by counterparty, and each line of the report shows the originally scheduled settlement date.
Confirmation by the counterparties of identified net fails in financial instruments or in cash is sought on a regular basis.

c. Can the Investment Firm use Client Assets of one client for meeting obligations of another client? If so, how?

No as far as funds are concerned.

As far as financial instruments are concerned and as explained above, there are rules that prevent this since custodians may not make any use of the financial instruments and attached rights in its custody, nor transfer title thereto, without the express consent of the holder. In addition, the custody account-keeper must organize its internal procedures to ensure that any movement affecting the financial instruments it holds in custody on behalf of third parties is justified by a properly recorded transaction in a third-party account.

d. Are there any restrictions on the ability of the Investment Firm (or other party holding Client Assets) to invest, encumber, rehypothecate, stock-lend, or otherwise deal with, the Client Assets? If so, please describe.

As regards the funds held by investment firms for their customers, investment firms, or other party holding client assets (with the exception of "qualifying money market fund"), are not allowed to invest, encumber, rehypothecate, stock-lend, or otherwise deal with the client assets.

"Qualifying money market funds" are required, in order to achieve their primary objective (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), to exclusively invest in high-quality money market instruments with a maturity or residual maturity of no more than 397 days, or for which regular yield adjustments in accordance with the annual maturity is 60 days. It may also achieve this objective by additionally investing in deposits with credit institutions.

The ACP (see article 9 of Order of 2 July 2007) may object to the inclusion of certain assets or the exclusion of certain liabilities when implementing the provisions of this Order if it considers that such assets or liabilities do not satisfactorily meet the conditions contained in the regulations or that their inclusion or exclusion is liable to distort assessment of the effective capacity to repay customers' funds.

The conditions in which an investment service provider may use its client's financial instruments are set by the AMF GR (art. 313-17 as well as art. 322-4 2°).
Art 313-17:

I. - Investment services providers may not enter into arrangements for securities financing in respect of financial instruments held by them on behalf of a client or otherwise use such financial instruments for their own account for the account of one of their other clients, unless the client has given his prior express consent for the use of the instruments on specified terms, as evidenced, in the case of a retail client, by his signature or an equivalent alternative mechanism.
The use of that client's financial instruments must be restricted to the specified terms to which the client has consented.
II. - Investment services providers may not enter into arrangements for securities financing transactions in respect of financial instruments held by them on behalf of a client in an omnibus account maintained by a third party, or otherwise use financial instruments held in such an account for their own account or for the account of another client unless at least one of the following conditions is met:
1° Each client whose financial instruments are held on an omnibus account must have given consent in accordance with I.
2° The investment services provider must have systems and controls to ensure that only financial instruments belonging to clients who have given prior consent in accordance with I are so used.
The investment services providers' records shall include data on the client on whose instructions the financial instruments have been used and on the number of financial

instruments used belonging to each client who has given his consent, so as to enable the allocation of any loss of financial instruments

Art 322-4:
2° The custody account-keeper may not make any use of the financial instruments and attached rights in its custody,nor transfer title thereto, without the express consent of the holder. The custody account-keeper organises its internal procedures to ensure that any movement affecting the financial instruments it holds in custody on behalf of third parties is justified by a properly recorded transaction in a third-party account.

e. What are the requirements, if any, for clearinghouses or other central counterparties to maintain the separate identification of collateral posted by the Investment Firm for its Client Positions?

No specific requirements for clearinghouses. However, the investment firm will be required to open specific account for the clearing of transactions of the customers. The clearing house will then calculate a separate margin call separate between the own account and third party account.

a. 4Are Investment Firms permitted to transfer to, or hold Client Assets in, another jurisdiction? If so, does the Regime in your jurisdiction require Investment Firms topreserve the separate identification of:Client Assets transferred to or located in other jurisdictions?

Yes. In this respect, the article 5 of the Order of 2 July 2007 requires that, when sums are deposited with a credit institution authorized by a Member State of the European Community or another Member State of the European Economic Area or a bank authorized in a third country, they may be paid into sight or time accounts. The account name shall mention the appropriation of the sums deposited in compliance with the provisions of the Order of 2 July 2007. Investment firms must also regularly reconcile their accounts and internal registers with those of third parties with whom these assets are held. That supposes the Regime has to be the same in another jurisdiction concerning holding of clients' funds. Moreover, the investment firms have to distinguish, in their quarterly reports provided to the ACP, between the funds deposited with (i) credit institutions which have been authorized in a member State of the European Community or the European Economic Area, (ii) banks authorized in a third country and (iii) funds in a "qualifying money market fund".

With regards to financial instruments, yes. In that case, this is governed by article 313-15 and 313-16 of AMF GR (see above):

The separate identification is governed by the general rules regarding the identification of client's assets (see above answers).

In addition, article 322-45 sets the following rules with regards the safety of assets held in another jurisdiction:
The security of financial instruments held in custody outside France, for the account of customers and through the medium of an agent as referred to in Article 322-39, is ensured by

a signed agreement between the custody accountkeeper and the agent. This agreement specifies or provides for, inter alia:
1° The terms and conditions under which account(s) will be kept in the name of the custody account-keeper on the books of the agent;
2° The obligation of the agent to provide as quickly as possible all information relating to movements on the account(s) of the custody account-keeper, as well as periodic reports on the financial instruments on deposit;
3° Implementation of the requirement mentioned in the seventh paragraph of Article 322-4 (segregation);
4° Observance of local practices.

In addition, the Banking Commission considers that this is outsourcing and therefore that the corresponding regulation applies.

b. Client Assets that have been transferred to the Investment Firm from other jurisdictions and that have been identified as Client Assets in those jurisdictions If so, please provide details of those requirements.

The Order of 2 July 2007 requires that, if pursuant to a foreign regulation similar to the one set forth in this Order, certain funds held for customers must be segregated specifically, verification of the requirements of the Order shall be extended to include verification of such specific provisions.
For financial instruments, the separate identification is governed by the general rules regarding the identification of client's assets (see above answers).

4. If the Regime in your jurisdiction permits or requires Client Assets to be held by third party custodians:

a. Please describe the requirements, if any, concerning the qualifications of such custodians e.g., licensing, creditworthiness. May the Client Assets be kept with an affiliate of the Investment Firm?

Investment firms are required to deposit all of the funds of their clients with one or more or the following institutions: central bank, credit institutions authorized in a member State of the European Community or another Member State of the European Economic Area, bank authorized in a third country and "qualifying money market fund".

Note that a "qualifying money market fund" means a collective investment undertaking as defined or subject to supervision, and, if applicable, authorised by an authority under the national law of a Member State of the European Community or another Member State of the European Economic Area, and that meets the following conditions:

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

ii. to achieve its primary investment objective, it must invest exclusively in high-quality money market instruments with a maturity or residual maturity of no more than 397 days, or for which regular yield adjustments in accordance with the annual maturity are made, and for which the average weighted maturity is 60 days. It may also achieve this objective by additionally investing in deposits with credit institutions;

iii. it must provide liquidity through same say or next day settlement. A money market instrument shall be considered to be of high quality if it has been awarded the highest credit rating by all competent rating agencies that have rated the instrument. An instrument that has not been rated by a competent agency shall not be considered to be of high quality.

The Order of 2 July 2007 also requires that in the event that the funds of the investment firm's clients are not deposited with a central bank, the investment firm must exercise extreme care, diligence and competence when selecting, appointing and conducting a periodical assessment of the credit institution, authorized bank in a third country or money market fund where these funds are deposited and of the provisions governing the holding of these funds. The investment firm must take into account the expertise and the reputation of these institutions and money market funds on the market, as well as any legal or regulatory requirement or market practice linked to the holding of clients' funds, which might have an adverse impact on clients' rights. Clients have the right to be opposed to their funds being invested in a qualifying money market fund.

For financial instruments, articles 313-14 to 313-16 (see above) as well as articles 322-39 and following relate to sub-depositing and provide for the following:

In addition, the custody account-keeper may appoint another entity as its agent for performing all or part of the tasks related to its custodial activity. When the custody account-keeper appointing an agent is not an issuing entity, such agent must be another custody account-keeper.
A custodial agency agreement is drawn up between the two parties (principal and agent). This agency agreement specifies, inter alia:
1° The tasks entrusted to the agent;
2° The respective responsibilities of the principal and the agent;
3° The procedures to be implemented by the principal to ensure oversight of the operations carried out by the agent.
Where an agent is responsible for keeping the client accounts of the principal on an individual basis, that agent shall ensure that the principal is following the procedures established pursuant to the second sub-paragraph of Article 322-18. If the agent finds that these procedures have not been implemented, it shall not proceed with settlement.
However, if the agent is unable to prevent completion of settlement because of technical factors relating to the operation of the settlement system, it shall ensure that no financial instrument belonging to clients is used for such purpose without the express agreement of those clients as called for in point 2° of Article 322-4.

The custody account-keeper may, simultaneously with a custodial agency agreement or independently of such agreement, engage a third party to provide it with technical resources.

When the custody account-keeper appoints an agent or engages a third party as described in above, it conducts an assessment of the resources and procedures employed and the risks incurred. This assessment is available for review by the AMF.
The liability of the custody account-keeper to the holder of a financial-instrument account is not affected by the appointment of another custody account-keeper as agent or by the engagement of a third party to provide technical resources.

However, when a custody account-keeper holds financial instruments issued under foreign law in custody for the account of a qualified investor as defined by applicable law and regulations, the custody account-keeper may agree to share liability with that investor.

b. Please describe any requirements concerning the custody agreement between intermediary and custodian. In particular, may the custodian be permitted to place a lien, charge or other encumbrance on Client Assets? If so, please explain.

Pursuant to article 322-42 of the AMF GR, relations between the custody account-keeper and the service providers assuming the functions of broker-dealer or clearer for the same investor are governed by conventions or contracts that specify the obligations of each party, so that any disputes over settlement or adjustment of securities transactions can be resolved as efficiently as possible.

5. Under what circumstances, if any, is an Investment Firm required to disclose to clients information related to the protection of the client's assets? What is the nature of such required disclosures? How do any such required disclosures apply to Client Assets held in another jurisdiction?

In accordance with title IV (information of existing or potential clients), investment firms are required to communicate to their "non-professional" clients (see above definition) or potential clients the following information on the maintenance of funds:

a)

- when funds are invested in a qualifying money market fund, the possibility of them being held by a third party in the name of the investment firm as well as the responsibility carried by the latter, according to the national law of the country under consideration, for any action or omission of the third party, or its possible insolvency and its consequences for the client;
- in the other cases, the holding of these funds by a third party in the name of the investment firm as well as the responsibility carried by the latter, according to the national law of the country under consideration, for any action or omission of the third party, or its possible insolvency and its consequences for the client;

b) The cases in which the accounts mentioned are or will be governed by a law other than the national law of a Member State of the European Community or another Member State of the European Economic Area, by specifying to what extent the rights of the client are affected;

c) The existence or conditions of any security interest or lien that the investment firm has or could have over the funds of the client, or of any right of set-off it holds in relation to these funds. If necessary, the investment firms shall inform the client that a depository may have a security interest or lien, or a right of set-off in relation to these funds.

The investment firms are also required to communicate to their professional clients or potential clients the information under b) and c).

The investment firms shall provide the clients for whom they hold funds with a statement of these funds at least once a year on a durable medium, unless the same information is available in another periodical information notice, notably the statement of financial instruments set out in the AMF GR. The statement of the client's funds should contain the following information:

- Details on all the funds held by the investment firm for the client at the end of the period covered by the statement;
- The extent to which any temporary sales of securities have been carried out;
- The quantification of any advantage falling to the client that results from his participation in any temporary sales of securities, and the grounds on which this advantage falls to him.

Moreover, in accordance to article 314-39 of AMF GR that transposes article 32 of MiFID implementing directive, investment service providers must comply with information requirements concerning the safeguarding of client financial instruments (see above).

6. Under what conditions, if any, may clients choose to waive any of the Client Asset protection requirements applicable in your jurisdiction (also known as "opting out")? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

With regards to funds, there is no "opting out" in France. The Order of 2 July 2007 sets a single regime applicable to all clients.

With regards to financial instruments, as mentioned above, when a custody account-keeper holds financial instruments issued under foreign law in custody for the account of a professional investor, the custody account-keeper may agree to share liability with that investor (art 322-41 GR AMF).

7. Under what circumstances, if any, is an Investment Firm required to notify the regulators, or the market generally, of material changes in their financial position or ability to continue to carry on business? What is the nature of such required disclosures?

Such information is provided to the ACP in the framework of accounting reports and internal control reports. In this respect, the investment firms are required to report on a quarterly basis, quantitative information relating to (i) the amounts of funds to be segregated and (ii) the eligible assets deposited with one or more depositors.

8. For an Investment Firm whose financial situation is seen to have deteriorated *(e.g.*¸ capital has fallen below certain thresholds), what actions, if any, may the firm's regulators take to protect Client Assets?

The principle is that the clients funds held by an investment firm are not part of the assets of the investment firm. They are not concerned by the insolvency procedure or actions to be undertaken by the ACP with respect to the financial situation of the investment firm.

Post-Insolvency

9. Please describe the process by which an Investment Firm enters the status of "insolvent" or "bankrupt" or the equivalent. For example, is a petition filed by the firm's regulator or some other administrative agency, by creditors of the firm, or otherwise? Is a decree entered by a court? Is this process different from the process applicable to entities that are not Investment Firms?

In accordance with the article L.613-18 of the Monetary and Financial Code, the appointment of a provisional administrator is made either at the request of the management, if it is no longer able to exercise its functions normally, or at the initiative of the ACP, if the management of the institution can no longer be carried out in normal conditions, or if a sanction has been imposed. Note that the definition of insolvency applicable to non banking institution is the "unability to pay its accrued liabilities with its available assets" (Article L. 631-1 of the French Commercial Code).

Except in cases where reorganization or liquidation proceedings are initiated, the ACP, after determining that securities are unavailable because a member institution is unable to return securities held for reasons that may be related to its financial situation and that it appears unlikely that the securities will be returned soon, shall, after seeking the opinion of the AMF, ask the deposit guarantee fund to intervene under the terms of the first paragraph of Article L. 322-2 of the Monetary and Financial Code and shall notify the member institution that it has been struck off (see article 7, Title III of Regulation n°99-14 relating to the guarantee of securities held on the behalf of the intermediaries).

10. Please describe the process by which the Administrative Officer (as defined above), if any, is selected. What qualifications, if any, must an Administrative Officer have? Who selects the Administrative Officer?

See answer 10. Note also that the provisional administrators are appointed by taking into account the same considerations as those used by the *Comité des Etablissements de Crédit et Entreprises d'Investissement* (CECEI*)* when assessing the fit and properness of the senior managers appointed by the investment firm.

11. What are the duties of the Administrative Officer?

The provisional administrators have the full powers (transferred from the senior managers in the wake of their appointment) relating to the legal entity's administration, management and representation.

The obligation of the provisional administrators is also to provide solicited information to the judge, the ACP and the Prosecutor. They are also in the obligation of consulting the debtors, auditors and the representative of creditors so as to help the recovery of the investment firm.

a. What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?

The provisional administrators have to comply with their judicial mission (assistance, supervision, administration) and the legal and contractual obligations as managers at the head of the firm (see answer to question 12).

b. Under what standard (*e.g.*, strict liability, negligence), if any, is the Administrative Officer, pursuant to the Regime in your jurisdiction, subject to personal liability for failure to properly perform his or its duties?

Under the administrators' own liability, the applicable regime is that of a strict liability due to misconduct incompatible with their duties.

12. What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?

The ACP does not intervene directly in the insolvency proceedings.

Note however that the judicial reorganisation and liquidation procedures cannot be initiated in relation to an investment firm until the ACP's opinion has been obtained (article 613-27 of the Monetary and Financial Code). In the event of judicial liquidation proceedings being instituted or ordered, the ACP appoints a liquidator who draws up an inventory of the assets and gives effect to the liquidation and the redundancies (article 613-29 of the Monetary and Financial Code).

a. Does the regulator continue to supervise the Investment Firm?

Yes, the investment firm is required to comply with the Regulations and Laws that the ACP and AMF supervise.

b. How, if at all, is the regulator involved in the process of returning Client Assets?

Yes, indirectly (see previous answers).

13. **Does the Regime in your jurisdiction facilitate or encourage the transfer of Client Assets from an Investment Firm which has become bankrupt or insolvent to a solvent Investment Firm?**

No, but there is work undertaken on that issue.

a. What steps, if any, are prerequisite to accomplishing such a transfer? In general, how long does it take to accomplish those steps?

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b. What factors, if any, affect the time period required to accomplish such a transfer?

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14. To what extent are clients at risk of, or protected from, having to return Client Assets (or the value thereof) that were distributed to the client prior to the insolvency proceeding?

The distribution of prior debts to clients before the beginning of a collective bargaining is prohibited. In principle, this distribution is to be null and void. So, the clients aren't no protected from having to return clients assets.

15. To what extent, if at all, does the Regime in your jurisdiction provide compensation to clients from other sources (for example, an investor protection or similar fund) for loss of Client Assets? Please discuss the scope of protections, conditions on such protection, and the limits of compensation (*e.g.*, maximum compensation per client).

Pursuant to article 11 of MiFID transposed in Financial and Monetary Code by the Order of July 2007, investment firms (art. L532-2, 6) and portfolio management firms authorized by the AMF (L532-9, 6) must be a member of an investor-compensation scheme as provided by the European directive 97/9/EC of 3 March 1997 on investor-compensation schemes.. The purpose of this mechanism is to compensate investors in the event of their financial instruments or their cash deposits being unavailable when they are linked to an investment service, to clearing or to financial instrument custody.

The claims of investors guaranteed are those relating to any financial instrument[2] held on an investor's behalf that the member institution is required to return under the legal and contractual conditions that apply, especially with regard to clearing. The securities include cash deposits*[3] with a member institution that is not a credit institution, including deposits made to guarantee or cover positions taken on a market in financial instruments, when such

[2] Financial instruments are defined by the financial and monetary code (see article L211-1). In summary, they are financial "securities" and financial contracts (i.e. financial futures). Financial securities are equity securities issued by corporations, debt instruments, unit trust units or shares, with the exception of bills of exchange and certificates of deposit.

[3] with the exception of cash deposits in a currency other than those of States party to the agreement on the European Economic Area, with the exception of the CFP franc.

deposits relate to an investment service or to the clearing or custody of financial instruments provided by such institution.

The limit on compensation per investor is 70,000 euros. It applies to all of the same investor's assets with the same guarantee scheme member institution, irrespective of the number of accounts, their location on the territory of the French Republic or in the European Economic Area (subject to certain conditions).

Note that securities deposited by credit institutions, investment firms, insurance undertakings, collective investment organizations, pension organizations and funds are excluded from the guarantee (for more details, please refer to Regulation n°99-14).

16. Are there circumstances in which clients are treated differently based on permissions they have granted pre-bankruptcy. *E.g.*, if any re-hypothecation has been entered into (or a 'right-to-use' exercised), please explain the client's position under the Insolvency Regime in such event.

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17. Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?

Clients are not supposed to be affected by their permission previously given to allow their client assets to be held in another jurisdiction. In principle; investment firms have been required to exercise "extreme care, diligence and competence when selecting, appointing and conducting a periodical assessment of the credit institution, authorized bank in a third country or money market fund where these funds are deposited and of the provisions governing the holding of these funds.". In addition, the obligation to return the securities applies also in the case of outsourcing (except if an agreement has taken place when the client is a professional client).

18. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?

If investment firms fail to comply with client funds' protection requirements, the depositors are covered by the Securities Deposit Guarantee Fund.

19. If there is a shortfall, *i.e.*, if claims by clients exceed resources dedicated to paying such claims (whether from Client Assets, investor protection fund, or otherwise), how are Client Assets distributed? *E.g.*, is there a pro rata distribution of Client Assets, are there priorities between classes of clients, is there a priority distribution ahead of the distribution of the general estate/distribution to unsecured creditors?

In accordance with the article L. 211-6 of the Monetary and Financial Code, in the event of a judicial reorganisation or liquidation procedure being initiated against the book-keeping

institution, the receiver or the liquidator, acting jointly with the provisional administrator or liquidator, if any, appointed by the ACP, shall verify, for each financial instrument individually, that the number of securities held in a current account with a central custodian or with another intermediary on behalf of the defaulting intermediary, regardless of the nature of the accounts opened with them, is sufficient to enable the intermediary to meet its obligations towards the holders of the rights in the financial instruments registered in its books. In the event of the number of securities held being insufficient, an allocation of securities shall be made among the holders of the rights in proportion to the securities made available, financial instrument by financial instrument; their owners may arrange to have them credited to an account kept by another intermediary or by the issuing legal entity.

20. Please explain how claims of clients are ranked in the insolvency process relative to those of other creditors. Does your insolvency regime rank domestic creditors above foreign creditors?

See answer to question 20.

III. Pertinent references

Please provide, for any statutes, regulations, or other authorities or texts that are referred to in your response, electronic copies (in English translation, if available), or URL links to available copies. How might a person outside your jurisdiction most readily get access to such items? Are there treatises that would be useful for obtaining a general understanding of client asset protection in your jurisdiction?

Order of 3 July 2007 relating to the segregation of funds of investment firms' customers:

http://inbdf/gb/supervi/telechar/regle_bafi/20070702_order3.pdf

Regulation n°99-14 of 23 September 1999, relating to the guarantee of securities held on the behalf of investors by credit institutions and investment firms, intermediaries authorized by the *Conseil des Marchés Financiers* and members of clearing houses having their registered office on the territory of the French Republic

http://inbdf/gb/supervi/telechar/regle_bafi/Regulation_99_14.pdf

AMF GR, title III: **http://www.amf-france.org/documents/general/7553_1.pdf**

Financial and monetary code: http://www.legifrance.gouv.fr/affichCode.do?cidTexte=LEGITEXT000006072026&dateTexte=20091111 (please note that this is the link to the French version as the English version is not up to date).

Germany

Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets

I. Background

This questionnaire seeks information to aid in understanding the responding jurisdictions' techniques for protecting Client Assets in the event of the insolvency and/or winding up of an Investment Firm, and for promptly transferring such assets to a solvent Investment Firm or distributing them to the client. It is not intended to require information concerning the general legal framework for insolvency, except to the limited extent necessary to understand how rules for the protection of Client Assets fit within that framework.

Definitions.

(1) **"Administrative Officer"** refers to the person or entity who is appointed, whether by a court, regulator, creditors, the Investment Firm itself, or otherwise, to assume control of or power over a bankrupt or insolvent Investment Firm. This term includes administrators, debtors in possession, receivers, liquidators, trustees, and similar titles.

(2) **"Client Assets"** refers collectively to Positions, Securities, and Client Money:

- "**Positions"** are contractual rights and obligations arising from transactions entered into by an investment firm on behalf of its clients, including mark to market accruals arising from the change in value of futures, options and/or other derivatives positions;

- "**Securities"** are defined to incorporate both securities and derivatives, as those terms are defined or understood in the responding jurisdiction; and

- "**Client Money"** refers to funds owed to or held on behalf of clients by an investment firm, and may include margin collateral associated with client positions (both existing and potential), income relating to an investment such as dividends or interest, proceeds of the liquidation of client securities and/or positions, and funds in excess of required margin.

(3) **"Investment Firm"** means an intermediary that holds Client Assets and is engaged in the business of managing client accounts, which could include, without limitation: executing orders on behalf of others, dealing in or distributing Securities (including carrying derivatives positions). In jurisdictions where banks are broadly permitted to engage in such a business, this term includes banks to the extent they are providing such services.

(4) **"Omnibus Account"** means an Investment Firm's account with a third party in which Client Assets are maintained separate from the firm's assets, but are held in the aggregate instead of in accounts designated for individual clients.

(5) **"Regime"** refers to statutes, regulations, rules of exchanges, clearing organizations and other self-regulatory bodies, or other legally binding requirements.

II. Survey Questions *Where appropriate, please provide citations to statutes, regulations, or other authorities supporting your answers below.*

Context

1. Please provide a brief overview setting forth the defining characteristics of your jurisdiction's approach to protecting Client Assets.

The Safe Custody Act (Depotgesetz – DepotG) contains provisions to protect investors who entrust tradable securities to a credit institute for safekeeping. In order to protect investors and their securities the DepotG provides for different forms of safekeeping (e.g., collective deposit and individual safekeeping). Furthermore, in addition to the right to separation the DepotG provides for further mechanisms to protect investors against the risks of third party safekeeping (e.g. section 4 DepotG – restricted claim of rights to pledge or retention).

The DepotG applies to shares, parts in mining companies , interest and dividend coupons and talons, debentures to bearer or transferable by endorsement, and other transferable securities except banknotes and paper money, section 1 (1) DepotG.

The DepotG distinguishes between different types of securities safekeeping accounts: The Depot A (Eigendepot) contains the own securities of the depositing credit institute and the securities of the clients which are liable without limitation as pledge for the third party custodian's receivables to him (sections 12 (4) and 13 DepotG) plus the securities owned by the intermediate depositary pursuant to sections 19-21 DepotG. The Depot B (Fremddepot) contains securities which are deposited by a credit institute or which are purchased for that credit institute and are unmortgaged kept safe for the client of the intermediate depositary with the third party custodian. The Depot C (Pfanddepot) contains the securities which the intermediate depositary has pledged to the third party custodian in accordance with an authorization pursuant to section 12 (2) DepotG. The Depot D (Sonderpfanddepot) contains securities which are pledged to the third party custodian under specification of the corresponding client number by an intermediate depositary pursuant to section 12 (3) DepotG. A Depot D is to be kept for each individual client.

Securities can be traded anywhere (e.g., exchange-traded or over-the-counter). Regarding the safekeeping of securities there are no differences between both models of trading.

The German Banking Act (Kreditwesengesetz – KWG) contains regulations for all credit institutions and financial services institutions (an investment firm as defined above is always considered a credit institution or financial services institution according to the KWG). The KWG contains regulations for the capital requirements for such firms as well as the licensing requirements and the organizational requirements for such firms.

In answering the remaining questions:

(1) Please provide details, as appropriate, where the Regime in your jurisdiction applies different treatment or results based on differences in:

a. Categories of Client Assets;

b. Models of trading (e.g., exchange-traded versus over-the-counter).

*c. Categories of clients (*e.g.*, retail versus sophisticated)*

(2) You are requested to provide details of the Regime in your jurisdiction. You are additionally invited to provide information explaining how that Regime is applied in practice, through, e.g.*, informal arrangements between governmental entities.*

Pre-Insolvency

2. Does the regime in your jurisdiction require an Investment Firm to hold special authorization (*i.e.*, a specific form of license or registration) to be permitted to hold Client Assets?

   a. If special authorization is required, what requirements (both initial and ongoing) is an Investment Firm required to comply with to hold such authorization?

   Anyone wishing to provide banking transactions or financial services in Germany commercially or on a scale which requires a commercially organized business undertaking, generally requires a license from the BaFin , section 32 (1) KWG. The safe custody business is a banking transaction pursuant to section 1 (1) sentence 2 no. 5 of the KWG. The safe custody business comprises the safekeeping and managing of securities for others.

   Initial and ongoing requirements:

   The BaFin may grant authorization only if the following mandatory conditions are met. The resources needed for business operations, in particular sufficient initial capital, must be available in Germany, section 33 1 sentence 1 no. 1 of the KWG. The institution must have trustworthy senior managers who have the necessary professional qualifications and work for it not merely in an honorary capacity, section 33 (1) sentence 1 nos. 2, 4 and 5 of the KWG. The financial services institution's head office must be domiciled in Germany, section 33 (1) sentence 1 no. 6 of the KWG. The ongoing requirements correspond to the initial requirements.

   b. If special authorization is not required, how, if at all, is this activity supervised by a regulator?

   Not applicable.

3. Does the Regime in your jurisdiction require that Client Assets be maintained separately from the assets of an Investment Firm? If so, please provide a description of the process by which segregation is accomplished, and of the applicable requirements.

   The Regime in the German jurisdiction requires generally that client securities must be maintained separately from the assets of an investment firm.

Concerning client money, in the case of investment firms being universal banks, client money will in most cases be deposits. These are not required to be held separately from the own assets of the institution; however, German regulations then apply a different deposit guarantee scheme (see question 15 below); as well, universal banks are regulated and supervised much more stringently.

Specifically:

a. Must the Client Assets of one client be maintained separately from those of other clients?

   i. Are Investment Firms allowed to hold Omnibus Accounts?

      The deposit business within the meaning of section 1 (1) sentence 2 no. 5 KWG can be provided in different forms. Generally, the securities are entrusted to a bank for central depository of securities (collective deposit) unless the depositor has required the individual safekeeping.

      In the case of collective deposit, the depositary may keep safe securities unseparated from its own assets of the same kind or of such of third parties or entrust those to a third party for collective depositing only when the depositor has given express and written consent, section 5 (1) sentence 2 DepotG. The depositary may entrust the securities to a third party, in the majority of cases a bank for central depository of securities, for collective depositing. In case of individual safekeeping, the depositary must keep safe securities separately from other assets and under an externally recognizable designation of the depositor, section 2 DepotG.

      In the scope of the DepotG investment firms are not allowed to hold omnibus accounts. Securities of one client can not be affected by activities of other clients.

   ii. What measures are used to protect the Client Assets of each client from losses due to the activities of other clients?

   See answer to a.i.

b. Please describe any requirement that an Investment Firm must reconcile the Client Asset account. For example:

   i. How do you calculate the amount of Client Assets that a firm is required to hold in one or more accounts segregated for the benefit of clients?

      A) Are required Client Assets fungible between or within asset classes, or is the Investment Firm required to hold, *e.g.*, the specific assets deposited by the client?

      The depositary is required to hold the specific securities deposited by the clients. But: Section 15 (1) allows for a special safekeeping. Depositor and depositary may agree that the ownership shall directly pass to the depositary or a third party and the depositary is only obligated to return securities of the

same type. In such a case the depositor loses the protection granted by the DepotG (e.g., right to separation). Section 10 allows another special safekeeping (Deposit with the Right to Change). The depositary is entitled to return securities of the same type in exchange for the deposited securities.

B) How is the reconciliation conducted (*e.g.*¸ on an aggregate basis, or a client-by-client basis)?

The depositary is required to issue a securities account statement. The Depot-Bek. [1] contains in no. 11 requirements regarding the reconciliation of the Deposit Account. Pursuant to no. 11 (2) Depot-Bek. the securities account statements must include the following information: securities entrusted to the credit institute individually with their nominal amount or number, the exact name of the security type including the information about the characteristics and form of safekeeping. The clients must be able to understand how they own their securities. These requirements also apply to contractual claims (e.g., purchase and delivery of securities).

The securities account statement has to be accepted by the depositor. Exceptionally, an acceptation is not necessary if certain functions (e.g., depositing, executing of client orders) are separated exactly of each other.

C) If a client has a debit balance (*i.e.*, the client owes the Investment Firm), is such balance deducted in determining the amount the Investment Firm is required to hold?

In the scope of the DepotG there are no specific requirements regarding this issue. Investment firms have included in their general terms and conditions a stipulation stating that the client grants the investment firm a lien on valuables of any kind (e.g., shares in a collective deposit) which, in the course of banking business, may come into the possession or power of disposition of the investment firm through acts of the client or of third parties for account of the client.

ii Timing issues:

A) How often is reconciliation required (*e.g.*, daily, weekly, monthly).

As far as Investment firms are banks, the Safe Custody Act requires these as custodians to reconcile their books and records with the requisite requirements without delay; segregation requirements for securities tradings firms are also to be met without delay, see section 34a (1) sentence 1

[1] Official Requirements regarding Safe Custody Business, hereinafter referred to as the Depot-Bek., (Amtliche Anforderungen an das Depotgeschaft - Bekanntmachung über die Anforderungen an die Ordnungsmäßigkeit des Depotgeschäfts und der Erfüllung von Wertpapierlieferungsverpflichtungen vom 21.12.1998).

Securities Trading Act. The depositary is required to issue a securities account statement at least once a year. The securities account statements are created and sent to the clients normally in the first month of the year.

B) When is such reconciliation required (*e.g.*, noon of the following business day, the tenth business day of the following month).

The depositary is required to issue a securities account statement at least once a year. The securities account statements are created and sent to the clients normally in the first month of the year.

C) Is the Investment Firm required to make good any deficiency from their own funds? If so, in what period? Is any payment by the Investment Firm thereby deemed to be Client Money?

Depositaries are not required to make good any deficiency from their own funds.

iii. Is an Investment Firm permitted or encouraged to maintain any of their own assets in a Client Asset account (*e.g.*, as a "buffer")? If so, are any such assets so transferred then deemed to be Client Assets? Is there a requirement to remove any excess assets?

Within the scope of the DepotG there is no rule which investment firms permit or encourage to maintain any of their own assets in Client Asset account (e.g., as a "buffer"). In the case of collective deposit, the depositary may keep safe securities unseparated from its own assets of the same kind or of such of third parties when the depositor has given express and written consent, section 5 (1) sentence 2 DepotG.

c. Can the Investment Firm use Client Assets of one client for meeting obligations of another client? If so, how?

In the scope of the DepotG: The investment firm can not use client positions or securities of one client for meeting obligations of other clients.

However, if the investment firm is a universal bank and client money is deemed a deposit, it may use the deposits to fulfil its contractual obligations to other parties. The deposit is however part of a different deposit protection scheme (see question 15 below); as well, prudential supervision of universal banks is a lot more stringent.

d. Are there any restrictions on the ability of the Investment Firm (or other party holding Client Assets) to invest, encumber, rehypothecate, stock-lend, or otherwise deal with, the Client Assets? If so, please describe.

Investments firms are only allowed to use financial instruments which are held for clients under the regulations of the DepotG for own account or for account of another clients under exactly defined requirements which have been accepted by the clients. The DepotG provides an extensive protection in case of the insolvency of the safekeeper or illegal disposes (section 32 and 34

DepotG). This protection does not interfere if investment firms accept securities in connection with their activities.

The depositary may pledge securities or shares in a collective deposit only by virtue of an authorization and only in connection with a granting of credit to the depositor and only to another depositaries, section 12 (1) sentence 1 DepotG. The authorization must be given expressly an in writing for the several depositing transaction. This authorization must not be included in the terms and conditions of the depositary. The authorization must not refer to other documents. A depositary with authorization to pledge securities or shares in a collective deposit may pass the authorization as given on to another person, section 12 (5) DepotG.

By way of exception of section 12 DepotG, the depositary may pledge securities and shares in collective deposit by virtue of an express and written authorization as collateral for his liabilities arising transactions at a stock exchange which is subject to a legal supervision to that stock exchange, or to the institution to which that stock exchange is attached, or to the organisation which with legal rights empowered by that stock exchange and restricted in its business to the settlement of transactions under the supervision of that stock exchange, provided that as there are liabilities of the depositor with the depositary resulting from a transac-tion of the depositor and the depositary which is substantially identical, section 12a sentence 1 DepotG.

The depositary is required to ensure with the pledgee that the securities or shares in a collective deposit pledged in connection with the pledgee's liabilities in accordance with section 12a (1) DepotG may only be forfeited up to the amount of the liabilities of the depositor to the depositary in accordance with section 12a (1) DepotG.

The depositary is liable for a default by the pledge as it is for its own default; this liability may not be restricted by agreement, section 12a (2) sentence 2 DepotG.

e. What are the requirements, if any, for clearinghouses or other central counterparties to maintain the separate identification of collateral posted by the Investment Firm for its Client Positions?

There are no legal requirements for clearing houses or other central counterparties to maintain the separate identification of collateral posted by an investment firm for its client positions. Eurex Clearing AG requires clearing members to transfer proprietary funds for both client and proprietary positions. Under its clearing conditions clearing members have to ask clients to transfer collateral equivalent to the one transferred by the clearing member to Eurex, but no segregation of assets is required at the clearing member level. Any margin segregation requirements at that level are determined by the laws applicable to the the relevant clearing member and its arrangements with its clients. Germany has implemented MiFID (directive 2004/39/EG) and therefore requires investment firms by law to segregate client money as well as client assets. The legal obligation to segregate does not apply to most German clearing members, however, since most of them are deposit-taking credit institutions which are exempt from the segregation requirement.

4. Are Investment Firms permitted to transfer to, or hold Client Assets in, another jurisdiction? If so, does the Regime in your jurisdiction require Investment Firms to preserve the separate identification of:

a. Client Assets transferred to or located in other jurisdictions?

b. Client Assets that have been transferred to the Investment Firm from other jurisdictions and that have been identified as Client Assets in those jurisdictions?

If so, please provide details of those requirements.

Investment firms are permitted to transfer to, or hold Client Assets in, another jurisdiction.

Section 5 (4) DepotG

Collective security-deposit banks may deposit transferable securities for collective deposit with a foreign depositary in the course of the mutual keeping of accounts entered into for an establishment of international securities-giro-transactions, provided that: 1.) the foreign depositary carries out in its state of residence the functions of a collective security-deposit bank and is subject to a public supervision or an equivalent supervision protecting the investor, 2.) the depositary obtains in relation to the collective deposit by such a depositary a legal status equivalent to that provided by Safe Custody Act (DepotG), 3.) no prohibition of the state of residence of such depositary inhibits the claim by the collective-security deposit bank against the depositary of delivery of transferable securities and 4.) the transferable securities are fungible and admitted for collective deposit by the collective-security deposit bank in the course of their mutual keeping of accounts.

In the scope of the DepotG there are no specific requirements which require investment firms to preserve the separate identification of client assets transferred to or located in other jurisdictions or client assets that have been transferred to the investment firm from other jurisdictions and that have been identified as client assets in those jurisdictions.

5. If the Regime in your jurisdiction permits or requires Client Assets to be held by third party custodians:

a. Please describe the requirements, if any, concerning the qualifications of such custodians e.g., licensing, creditworthiness. May the Client Assets be kept with an affiliate of the Investment Firm?

The depositary is entitled to deposit securities under its name with an-other depositary, section 3 (1) sentence 1 DepotG. Pursuant to no. 3 (1) sentence 1 of the Official Requirements concerning the Safe Custody Business credit institutions are only entitled to deposit securities with another credit institutions. The qualifications of the third party custodian are equivalent to the qualifications of the (intermediate) depositary.

Securities may be kept with an affiliate of the investment firm, section 3 (1) sentence 2 DepotG.

b. Please describe any requirements concerning the custody agreement between intermediary and custodian. In particular, may the custodian be permitted to place a lien, charge or other encumbrance on Client Assets? If so, please explain.

The safekeeping has to be made under the name of the intermediate depositary. Accordingly, the escrow (custody) agreement is closed between intermediate depositary and third party custodian.

The (intermediate) depositary may pledge securities or shares in a collective deposit only by virtue of an authorization and only in connection with a granting of credit to the depositor and only to another depositaries, section 12 (1) sentence 1 DepotG. A (intermediate) depositary with authorization to pledge securities or shares in a collective deposit may pass the authorization as given on to another depositary (third party custodian), section 12 (5) DepotG.

6. Under what circumstances, if any, is an Investment Firm required to disclose to clients information related to the protection of the client's assets? What is the nature of such required disclosures? How do any such required disclosures apply to Client Assets held in another jurisdiction?

The "Communication of information" is laid down in no. 16 of the Special Conditions for Dealings in Securities. If information concerning the customer's securities is published in the "Wertpapier-Mitteilungen" (information system) or if the bank is provided with such information by the issuer or by its foreign depository/intermediate depository, the bank is required to inform the customer thereof, to the extent that such information may materially affect the customer's legal position and notification of the customer is necessary in order to safeguard the customer's interests, no. 16 of the Special Conditions for Dealings in Securities.

The Special Conditions for Dealings in Securities have the character of general terms and conditions. Accordingly, the nature of that information is "contractual".

If an Investment Firm has the licence to provide deposit business, financial commission business or issuing business or if the institution provides financial services as investment and acquisition agent or as financial portfolio manager or if it trades for own account, then it is obligated to inform the non-institutional investors about its membership in an investor protection system respectively deposit guarantee scheme by its published price list. Furthermore the firm has to inform non-institutional customers about the relevant protection scheme and coverage level before starting a business relationship (§ 23a German Banking Act – KWG; see also the definition in question 15 below for relevant customers).

7. Under what conditions, if any, may clients choose to waive any of the Client Asset protection requirements applicable in your jurisdiction (also known as "opting out")? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

The requirements of the DepotG can not be waived by an agreement, they are not optional; nor can the requirements of the EAEG be waived by any agreement (concerning eligible clients see question 15 below).

8. Under what circumstances, if any, is an Investment Firm required to notify the regulators, or the market generally, of material changes in their financial position or ability to continue to carry on business? What is the nature of such required disclosures?

Investment firms must notify BaFin of a fall in the initial capital below the minimum capital requirements as well as of a loss amounting to 25% of the liable capital according to section 24 (1) KWG. BaFin must also be notified immediately in case of insolvency or overindebtment of a firm pursuant to section 46b (1) KWG.

9. For an Investment Firm whose financial situation is seen to have deteriorated *(e.g.*, capital has fallen below certain thresholds), what actions, if any, may the firm's regulators take to protect Client Assets?
In case of a fall in the initial capital below the minimum capital requirements BaFin may revoke the firm's license to provide banking business or investment services (section 35 (2) KWG). In case the firm's own funds fail to satisfy the requirements of the KWG for adequate own funds, BaFin may prohibit or limit the withdrawals by the proprietors or partners, the distribution of profits and the granting of loans, section 45 KWG. In case of danger concerning the discharge of an institution's obligations to its creditors, and especially the safety of the assets entrusted to it, BaFin may take temporary measures to avert the danger, such as the issuance of instructions on the management of the institution's business, the prohibition of the taking of deposits or funds or securities of customers and the granting of loans, prohibition other activities or appointment of supervisors (section 46 KWG). In case of danger of a collapse of a bank because of insolvency and when such a collapse is expected to have serious negative impact on other financial market actors or the financial market, the regulator may transfer client assets from the insolvent bank to a solvent bank within the rules of a restructuring regime.

Post-Insolvency

10. Please describe the process by which an Investment Firm enters the status of "insolvent" or "bankrupt" or the equivalent. For example, is a petition filed by the firm's regulator or some other administrative agency, by creditors of the firm, or otherwise? Is a decree entered by a court? Is this process different from the process applicable to entities that are not Investment Firms?

If an investment firm becomes insolvent or overindebted, the managers must report this fact without delay to BaFin. BaFin will then file a petition for the initiation of insolvency proceedings over the instituion's assets at the competent district court if it has reason to be believe that the firm is indeed insolvent or overindebted. This is regulated in section 46b (1) KWG. The competent court will then issue a decision whether formal insolvency proceedings are commenced. Other entities which are not licensed by BaFin are obliged to file a petition for the initiation of insolvency proceedings before the competent court themselves if they become insolvent or overindebted.

11. Please describe the process by which the Administrative Officer (as defined above), if any, is selected. What qualifications, if any, must an Administrative Officer have? Who selects the Administrative Officer?

The Administrative Officer is selected by the competent court. The officer must be independent and possess adequate experience.

What are the duties of the Administrative Officer?

a. What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?

The duties of the Administrative Officer are set out in the German Insolvency Code (Insolvenzordnung – InsO).

b. Under what standard (*e.g.*, strict liability, negligence), if any, is the Administrative Officer, pursuant to the Regime in your jurisdiction, subject to personal liability for failure to properly perform his or its duties?

The Administrative Officer is subject to personal liability for all breaches of his duties for which he is culpable. He is culpable, if he/she does not act with the diligence of a scrupulous insolvency administrator. When employing former employees of the debtor, the officer is solely responsible for the oversight and decisions of major importance unless these persons are evidently unsuited (section 60 InsO).

12. What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?

See answer to question 10. Pursuant to section 5 (1) Deposit Guarantee and Investor Compensation Act, BaFin then determines if the insolvency constitutes a compensation event under the Act.

a. Does the regulator continue to supervise the Investment Firm?

Yes.

b. How, if at all, is the regulator involved in the process of returning Client Assets?

In principle, BaFin is not involved in this process. However, pursuant to section 5 (1) Deposit Guarantee and Investor Compensation Act, BaFin determines if the insolvency constitutes a compensation event under the Act.

What is more, the Administrative Officer, as part of insolvency procedure, regularly also ensures that the insolvent Investment firm´s licenced business is wound up. BaFin may demand reports on the winding up, which generally also includes reporting on the return of Client Assets.

13. Does the Regime in your jurisdiction facilitate or encourage the transfer of Client Assets from an Investment Firm which has become bankrupt or insolvent to a solvent Investment Firm?

The Regime generally focuses on returning Client Money and client Securities to clients. Similarly, Client Positions are liquidated and valued. However, under the provisions of the Restructuring Act, client assets may be transferred from an

insolvent bank to a solvent bank. It covers the cases of such a transfer with and without client consent.

a. What steps, if any, are prerequisite to accomplishing such a transfer? In general, how long does it take to accomplish those steps?

b. What factors, if any, affect the time period required to accomplish such a transfer?

14. To what extent are clients at risk of, or protected from, having to return Client Assets (or the value thereof) that were distributed to the client prior to the insolvency proceeding?

When settling a securities transaction in Germany, the Bank is required, if the securities are eligible for collective safe custody with the German central depository (Clearstream Banking AG), to provide the customer with co-ownership of these collective securities deposits (section 6 [1] DepotG). In case of insolvency of the depositary, the depositor is entitled to claim segregation and the return of the securities. The securities are not a part of the insolvency assets (section 47 Insolvency Code).

If securities are not eligible for collective safe custody, the customer shall be provided with sole ownership of the securities. The Bank is required to keep these securities for the physically segregated from its own holdings and from those of third parties (section 2 [1] DepotG). In case of insolvency of the depositary, the depositor is also entitled to claim segregation.

15. To what extent, if at all, does the Regime in your jurisdiction provide compensation to clients from other sources (for example, an investor protection or similar fund) for loss of Client Assets? Please discuss the scope of protections, conditions on such protection, and the limits of compensation (*e.g.*, maximum compensation per client).

Deposit Guarantee and Investor Compensation Act (Einlagensicherungs- und Anlegerentschädigungsgesetz - EAEG)

If compensation is payable, the creditor of an institution has a right to compensation as provided in section 4 EAEG from the compensation scheme to which the institution has been assigned.

Client money, if defined as a deposit, is covered up to an amount of 50.000 € per customer and bank. If client money is defined as "liabilities arising from investment business[2]" there is a lower coverage level. These "liabilities" are only covered at 90% up to a limit of 20.000 € (section 4 Deposit Guarantee and Investor Compensation Act – EAEG). A compensation is provided in connection with investment business particularly if, contrary to its duties, an institution is unable to return securities owned by the costumer and held in custody on his behalf.

[2] "liabilities arising from investment business" shall mean an institution`s obligations to repay funds owed or belonging to investors from investment transactions and which are held for their account in connection with investment business.

All private persons and small business companies as creditors of an institution are protected by EAEG. Financial institutions, insurance enterprises, investment companies, medium and big sized enterprises, Federal, State or Regional Government/Authorities and managers/general partners of the institution and their relatives are excluded from compensation.

Apart from schemes provided by law (e.g. the Deposit Guarantee and Investor Compensation Act) there are optional schemes (e.g. the Deposit Protection Fund of German Banks). This Fund has been established as a dependent special fund within the Association of German Banks. The purpose of the Fund is to give assistance, in the interest of depositors, in the event of imminent or actual financial difficulties of banks, particularly when the suspension of payments is imminent, in order to prevent the impairment of the public confidence in private banks.

A regulatory power to enforce intervention or payments by the Fund does not exist. The Fund only provides compensation with the By-laws if and insofar as creditors are compensated by another protection scheme or by a compensation scheme as provided for under the Deposit Guarantee and Investor Compensation Act.

16. Are there circumstances in which clients are treated differently based on permissions they have granted pre-bankruptcy. *E.g.*, if any re-hypothecation has been entered into (or a 'right-to-use' exercised), please explain the client's position under the Insolvency Regime in such event.

The treatment depends on whether or not the client agreed, prior to the insolvency proceedings, 1) to transfer full or partial title of its Securities to either the Investment Firm or the third-party depository or 2) gave the Investment Firm or the third-party depository other rights in rem. If Client Securities have been (re)hypothecated to the Investment Firm´s lienors, and these have liquidated the hypothecated securities, a settlement procedure pursuant to section 33 Safe Deposit Act ensues, with the goal of equably distributing certain separate funds pursuant to Section 33 (2) Safe Deposit Act.

For further details regarding possible differences due to pre-insolvency permissions, see Question 20 below.

17. Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?

The German compensation schemes are not applicable if assets are held by firms domiciled outside Germany or the European Union.

18. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?

German investment firms automatically become member of one of the legal compensation schemes when they are licensed to provide banking business or financial services.

19. If there is a shortfall, *i.e.*, if claims by clients exceed resources dedicated to paying such claims (whether from Client Assets, investor protection fund, or otherwise), how are Client Assets distributed? *E.g.*, is there a pro rata distribution

of Client Assets, are there priorities between classes of clients, is there a priority distribution ahead of the distribution of the general estate/distribution to unsecured creditors?

If claims by clients should exceed resources of the Investor Compensation Fund the German Compensation Scheme can demand additional contributions from its member firms. In case of further need the Fund also can take out a loan. Also a mixed variant composed of taking out a loan by the Fund and collecting additional premiums from member institutions is possible. The Fund itself decides about possible pro rata compensation and the order of disbursement.

Concerning claims against the Investment Firm itself, the distribution of the firm´s assets follow general insolvency regulations (for details of the applicable laws, which do not fall under BaFin´s remit, see question 20 below).

20. Please explain how claims of clients are ranked in the insolvency process relative to those of other creditors. Does your insolvency regime rank domestic creditors above foreign creditors?

In the insolvency process, the claims of clients are ranked above those of other creditors, section 32 DepotG.

The following claims will be settled in preference to claims of all other insolvency creditors out of a segregated mass. Preferred are claims of:

1. principals to whom the ownership or co-ownership of securities has not been transferred to at the moment of commencement of insolvency proceedings although their obligations under the securities' transaction towards the commission agent have been fully settled; that also applies where the commission agent has not purchased the securities at the moment of commencement of the insolvency proceedings yet;

2. depositors, pledgers and principals whose ownership or co-ownership has been infringed illegally by the depositary, pledge or commission agent or their employees provided the former have fully settled their obligations towards the insolvent out of the securities' transaction;

3. the creditors under nos. 1. and 2. where the non-settled amount of their obligations mentioned above does not exceed at the moment of commencement of the insolvency proceedings 10 per cent of the value of the delivery claim of securities and if following a demand by the insolvency administrator they have completely settled such obligations.

That also applies in the case of insolvency of a dealer acting of his own account from whom securities were bought an in a insolvency of a com-mission agent who executes the order to buy or exchange securities acting on his own account.

The German Insolvency Regime does not rank domestic creditors above foreign creditors.

III. Pertinent references

Please provide, for any statutes, regulations, or other authorities or texts that are referred to in your response, electronic copies (in English translation, if available), or URL

links to available copies. How might a person outside your jurisdiction most readily get access to such items? Are there treatises that would be useful for obtaining a general understanding of client asset protection in your jurisdiction?

Translations of the DepotG, the KWG and the Deposit Guarantee and Investor Compensation Act (EAEG) are attached. As they all have recently been amended, I would like to give notice that these are not translations of the most current versions of these regulations as these are not yet available in English. They should however suffice to provide a broad overview over the applicable German regulations.

A 2004 version of the Insolvency Code may be found here:
http://www.iuscomp.org/gla/statutes/statutes.htm

Hong Kong

Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets

I. Background

This questionnaire seeks information to aid in understanding the responding jurisdictions' techniques for protecting Client Assets in the event of the insolvency and/or winding up of an Investment Firm, and for promptly transferring such assets to a solvent Investment Firm or distributing them to the client. It is not intended to require information concerning the general legal framework for insolvency, except to the limited extent necessary to understand how rules for the protection of Client Assets fit within that framework.

Definitions.

(1) **"Administrative Officer"** refers to the person or entity who is appointed, whether by a court, regulator, creditors, the Investment Firm itself, or otherwise, to assume control of or power over a bankrupt or insolvent Investment Firm. This term includes administrators, debtors in possession, receivers, liquidators, trustees, and similar titles.

(2) **"Client Assets"** refers collectively to Positions+, Securities, and Client Money:

- "**Positions"** are contractual rights and obligations arising from transactions entered into by an investment firm on behalf of its clients, including mark to market accruals arising from the change in value of futures, options and/or other derivatives positions;

- "**Securities"** are defined to incorporate both securities and derivatives, as those terms are defined or understood in the responding jurisdiction; and

- "**Client Money"** refers to funds owed to or held on behalf of clients by an investment firm, and may include margin collateral associated with client positions (both existing and potential), income relating to an investment such as dividends or interest, proceeds of the liquidation of client securities and/or positions, and funds in excess of required margin.

(3) **"Investment Firm"** means an intermediary that holds Client Assets and is engaged in the business of managing client accounts, which could include, without limitation: executing orders on behalf of others, dealing in or distributing Securities (including carrying derivatives positions). In jurisdictions where banks are broadly permitted to engage in such a business, this term includes banks to the extent they are providing such services.

(4) **"Omnibus Account"** means an Investment Firm's account with a third party in which Client Assets are maintained separate from the firm's assets, but are held in the aggregate instead of in accounts designated for individual clients.

(5) **"Regime"** refers to statutes, regulations, rules of exchanges, clearing organizations and other self-regulatory bodies, or other legally binding requirements.

II. Survey Questions *Where appropriate, please provide citations to statutes, regulations, or other authorities supporting your answers below.*

Context

1. Please provide a brief overview setting forth the defining characteristics of your jurisdiction's approach to protecting Client Assets.

   Our code of conduct for Investment Firms require them to ensure client assets are adequately safeguarded and properly accounted for. The Securities and Futures (Client Money) Rules ("Client Money Rules") and the Securities and Futures (Client Securities) Rules ("Client Securities Rules") further require client money and client securities received or held in Hong Kong by Investment Firms to be properly segregated in designated trust accounts maintained by the Investment Firms. These Rules permit Investment Firms to deliver client money and client securities for settling the client's outstanding trades or meeting the client's obligations to the Investment Firm. With a specific or standing authorization by the client, Investment Firms may deal with client money and client securities according to the client's instruction, subject to certain restrictions set out in the aforesaid Rules.

In answering the remaining questions:

(1) Please provide details, as appropriate, where the Regime in your jurisdiction applies different treatment or results based on differences in:

a. Categories of Client Assets;

b. Models of trading (e.g., exchange-traded versus over-the-counter).

*c. Categories of clients (*e.g.*, retail versus sophisticated)*

(2) You are requested to provide details of the Regime in your jurisdiction. You are additionally invited to provide information explaining how that Regime is applied in practice, through, e.g.*, informal arrangements between governmental entities.*

Pre-Insolvency

2. Does the regime in your jurisdiction require an Investment Firm to hold special authorization (*i.e.*, a specific form of license or registration) to be permitted to hold Client Assets?

   Investment Firms are permitted to hold client assets unless the SFC requires otherwise, for example, by imposing a condition on its licence prohibiting it from holding client assets.

   a. If special authorization is required, what requirements (both initial and ongoing) is an Investment Firm required to comply with to hold such authorization?

      Not applicable.

b. If special authorization is not required, how, if at all, is this activity supervised by a regulator?

The SFC supervises Investment Firms which hold client assets mainly through the following regulatory requirements and measures:

- the Client Money Rules and the Client Securities Rules stipulate statutory requirements on the manners in which client money and client securities may be held / handled by Investment Firms;
- the code of conduct and guidance notes issued by the SFC supplement the law with practical guidelines for Investment Firms holding / handling client assets;
- the law[1] requires Investment Firms to appoint auditors to conduct annual audit and review of controls and compliance of the Investment Firms and submit their reports to the SFC;
- the SFC may appoint auditors under sections 159 or 160 of the Securities and Futures Ordinance ("SFO") to examine the books and records of Investment Firms if non-compliance of the legal requirements in respect of client money and client securities is suspected;
- the SFC is given wide powers under the SFO to supervise Investment Firms' activities (including conducting onsite inspection of Investment Firms' books and records) and investigate into misconducts and offences.

3. Does the Regime in your jurisdiction require that Client Assets be maintained separately from the assets of an Investment Firm? If so, please provide a description of the process by which segregation is accomplished, and of the applicable requirements. Specifically:

Yes, the Client Money Rules and Client Securities Rules require client assets which are received or held in Hong Kong to be maintained separately from the own assets of Investment Firms.

In respect of client money received or held in Hong Kong, Investment Firms are required to establish and maintain in Hong Kong segregated accounts with banks[2] for deposit of such money within one business day of receipt. In case non-client money is held in a segregated account, the Investment Firm is required to withdraw the non-client money from the segregated account within one business day of becoming so aware.

In respect of client securities or securities collateral received from clients, an Investment Firm shall ensure that, as soon as reasonably practicable, such securities are registered in the name of the relevant client or deposited in safe custody in a segregated account established and maintained in Hong Kong with

(i) a bank;

[1] Sections 153 and 156 of the Securities and Futures Ordinance ("SFO") and the Securities and Futures (Accounts and Audit) Rules

[2] "Bank" means an "authorized institution" as defined in section 2 of the Banking Ordinance of Hong Kong.

(ii) an approved custodian (currently, only the Hong Kong Securities Clearing Company Limited is approved custodian); or

(iii) another Investment Firm licensed for dealing in securities.

Securities collateral received by an Investment Firm may also be registered in the name of the Investment Firm, or deposited in an account in the name of the Investment Firm with a bank, an approved custodian, or another Investment Firm licensed for dealing in securities.

a. Must the Client Assets of one client be maintained separately from those of other clients?

No.

i. Are Investment Firms allowed to hold Omnibus Accounts?

Yes, Investment Firms are allowed to hold client assets in Omnibus Accounts.

ii. What measures are used to protect the Client Assets of each client from losses due to the activities of other clients?

Under the Client Money Rules and Client Securities Rules, Investment Firms are generally not permitted to use a client's money and client securities for settling obligations of another client. Investment Firms are further required under the code of conduct and guidance notes to institute adequate controls to safeguard client assets and ensure client assets are properly accounted for.

b. Please describe any requirement that an Investment Firm must reconcile the Client Asset account. For example:

i. How do you calculate the amount of Client Assets that a firm is required to hold in one or more accounts segregated for the benefit of clients?

The amount of Client Assets that a firm is required to segregate should be calculated on a client-by-client basis.

A) Are required Client Assets fungible between or within asset classes, or is the Investment Firm required to hold, *e.g.*, the specific assets deposited by the client?

An Investment Firm is required to hold assets of the same type and description as those deposited by the client.

B) How is the reconciliation conducted (*e.g.*, on an aggregate basis, or a client-by-client basis)?

Investment Firms are required to reconcile their client asset records with custodians' statements / bank statements. The reconciliation can be done on an aggregate basis.

C) If a client has a debit balance (*i.e.*, the client owes the Investment Firm), is such balance deducted in determining the amount the Investment Firm is required to hold?

Investment Firms are not required to segregate client money held by it for settling the client's outstanding trade or indebtedness to the firm. If the client money is for meeting settlement or margin obligations to the Investment Firm that would fall due within 2 business days or is for repaying an existing indebtedness due to the firm (such as margin loan), the segregation requirement does not apply to the client money so received or held.

An Investment Firm can offset credit and debit balances for the same client. It cannot offset credit and debit balances across different clients.

ii Timing issues:

A) How often is reconciliation required (*e.g.*, daily, weekly, monthly).

Investment Firms should perform the reconciliation on a daily basis.

B) When is such reconciliation required (*e.g.*, noon of the following business day, the tenth business day of the following month).

An Investment Firm must make sure that Client Assets are properly segregated from proprietary assets within one (1) day after receipt. Therefore, an Investment Firm must complete the reconciliation for the day of receipt (e.g., Day X) before the end of the next day (e.g., Day X+1).

C) Is the Investment Firm required to make good any deficiency from their own funds? If so, in what period? Is any payment by the Investment Firm thereby deemed to be Client Money?

If the firm identifies any deficiency in the amount of client money or client securities that should be held in a segregated account, it should make good the deficiency as soon as possible and the payment or securities deposited into the segregated account will be deemed client money or client securities (as the case may be).

iii. Is an Investment Firm permitted or encouraged to maintain any of their own assets in a Client Asset account (*e.g.*, as a "buffer")? If so, are any such assets so transferred then deemed to be Client Assets? Is there a requirement to remove any excess assets?

No, Investment Firms are not permitted to maintain a "buffer" by depositing its own money / securities into a segregated account.

Section 10 of the Client Money Rules requires an Investment Firm which becomes aware that it is holding an amount of non-client money in a segregated account to pay that amount of money out of the segregated account within one business day of becoming so aware.

c. Can the Investment Firm use Client Assets of one client for meeting obligations of another client? If so, how?

No.

d. Are there any restrictions on the ability of the Investment Firm (or other party holding Client Assets) to invest, encumber, rehypothecate, stock-lend, or otherwise deal with, the Client Assets? If so, please describe.

Under sections 4 & 5 of the Client Money Rules, client money received or held by an Investment Firm may be paid in accordance with the client's specific, one-off direction in writing or the client's standing authority. However, an Investment Firm shall not pay client money in accordance with a client's standing authority if to do so would be unconscionable or such authority authorizes payment to an account in Hong Kong of the Investment Firm or its affiliated company which is not a segregated account. An Investment Firm is also forbidden to pay client money to any member of the staff of the firm or its affiliated company.

Under section 6 of the Client Securities Rules, an Investment Firm may deal with client securities or securities collateral received from a client in accordance with a specific, one-off written direction or standing authority given by the client. However, the Investment Firm is forbidden to deal with such securities in accordance with a client's standing authority if to do so

(i) would be unconscionable;

(ii) would result in transfer of such securities to any member of the staff of the firm or its affiliated company; or

(iii) except as permitted under sections 7 to 9 of the Client Securities Rules (please see details below), would result in transfer of such securities to an account in Hong Kong of the Investment Firm or its affiliated company other than a segregated account (in the case of securities collateral, also an account in the name of the Investment Firm) as specified in section 5 of the rules, or otherwise result in the Investment Firm or its affiliated company having the benefit or use of such securities.

Under sections 7 to 9 of the Client Securities Rules, with a client's standing authority,

(i) an Investment Firm licensed or registered for dealing in securities or licensed for securities margin financing may repledge securities collateral with a bank (in the case of Investment Firm licensed for securities margin financing, it may also repledge securities collateral with another Investment Firm which is licensed for dealing in securities) for financial accommodation provided to the Investment Firm, subject to a cap on the amount of securities collateral that can be repledged by the firm;

(ii) an Investment Firm licensed or registered for dealing in securities may deposit securities collateral with a recognized clearing house or another Investment Firm licensed or registered for dealing in securities

as collateral for the discharge and satisfaction of the Investment Firm's settlement obligations and liabilities;

(iii) an Investment Firm licensed or registered for dealing in futures contracts may deposit securities collateral with a recognized clearing house or another Investment Firm licensed or registered for dealing in futures contracts as collateral for the discharge and satisfaction of the Investment Firm's settlement obligations and liabilities;

(iv) an Investment Firm licensed or registered for dealing in securities may apply client securities or securities collateral pursuant to a securities borrowing and lending agreement.

e. What are the requirements, if any, for clearinghouses or other central counterparties to maintain the separate identification of collateral posted by the Investment Firm for its Client Positions?

The futures and options clearing houses in Hong Kong require their participants to maintain separate collateral accounts with the clearing houses for client positions and proprietary positions.

4. Are Investment Firms permitted to transfer to, or hold Client Assets in, another jurisdiction?

Transfers of client money / securities by an Investment Firm to another jurisdiction must be authorized in writing by the client unless the transfers are required for the purposes of meeting settlement or margin requirement on behalf of the client.

If so, does the Regime in your jurisdiction require Investment Firms to preserve the separate identification of:

a. Client Assets transferred to or located in other jurisdictions?

Investment Firms are required to ensure client assets are adequately safeguarded and keep proper records to account for all client assets received or held by them. Where client assets are transferred to or located in other jurisdictions, Investment Firms are required to segregate, as far as practicable, such client assets from their own assets.

b. Client Assets that have been transferred to the Investment Firm from other jurisdictions and that have been identified as Client Assets in those jurisdictions?

Investment Firms are required to segregate client money transferred from other jurisdictions to Hong Kong in segregated bank account. Regarding client securities transferred from other jurisdictions and fallen outside the scope of application of the Client Securities Rules[3], Investment Firms are required to segregate, as far as practicable, such securities from their own assets.

If so, please provide details of those requirements.

[3] The Client Securities Rules only apply to securities listed or traded on the Stock Exchange of Hong Kong Limited and interests in collective investment schemes authorized by the SFC.

5. If the Regime in your jurisdiction permits or requires Client Assets to be held by third party custodians:

   a. Please describe the requirements, if any, concerning the qualifications of such custodians e.g., licensing, creditworthiness. May the Client Assets be kept with an affiliate of the Investment Firm?

      Under section 4 of the Client Money Rules, Investment Firms are required to maintain segregated accounts for holding client money received or held in Hong Kong with banks.

      Under section 5 of the Client Securities Rules, Investment Firms are only permitted to maintain segregated accounts for holding client securities and securities collateral in Hong Kong with a bank, an approved custodian, or another Investment Firm licensed for dealing in securities.

      Under section 164 of the SFO, client assets of an Investment Firm may be received or held in Hong Kong by an associated entity[4] of the Investment Firm. An associated entity of an Investment Firm is required to comply with the Client Money Rules and the Client Securities Rules except where the associated entity is a bank, which is not subject to the Client Money Rules.

   b. Please describe any requirements concerning the custody agreement between intermediary and custodian. In particular, may the custodian be permitted to place a lien, charge or other encumbrance on Client Assets? If so, please explain.

      There is no regulatory requirement concerning the custody agreement between intermediary and custodian.

6. Under what circumstances, if any, is an Investment Firm required to disclose to clients information related to the protection of the client's assets? What is the nature of such required disclosures? How do any such required disclosures apply to Client Assets held in another jurisdiction?

   Where a client's assets are received or held overseas, Investment Firms are required under Paragraph 11.1(b) of the Code of Conduct, to provide additional risk disclosures to the client informing the client that such client assets may not enjoy the same protection as that conferred by the Client Money Rules and the Client Securities Rules on client assets held or received in Hong Kong.

   Investment firms that repledge clients' securities collateral to banks for financial accommodation are required to (i) provide to their securities margin clients a risk disclosure statement about the risk of providing an authority to the firm to repledge the client's securities collateral upon the provision and subsequent renewal of the authority; and (ii) disclose to their securities margin clients upon account opening and in the monthly client statements that the firm repledges clients' collateral. *(Per Schedule 1, Item 9 (a) to (c) in Schedule 5 to the Code of Conduct and section 11(3A)(d) of the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules)*

[4] An associated entities, as defined in Schedule 1 to the SFO, is a corporation that has a controlling-entity relationship with an Investment Firm and holds in Hong Kong clients assets of the Investment Firm.

7. Under what conditions, if any, may clients choose to waive any of the Client Asset protection requirements applicable in your jurisdiction (also known as "opting out")? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

Clients are not permitted to waive any of the Client Asset protection requirements. However, because an Investment Firm is permitted, with client consent, to re-hypothecate or otherwise use Client Securities, such Client Securities may become unavailable to the client upon the Investment Firm experiencing insolvency.

8. Under what circumstances, if any, is an Investment Firm required to notify the regulators, or the market generally, of material changes in their financial position or ability to continue to carry on business? What is the nature of such required disclosures?

Under section 146(1) of the SFO, an Investment Firm shall as soon as reasonably practicable notify the SFC by notice in writing if it becomes aware of its inability to meet the regulatory capital requirements stipulated in the Securities and Futures (Financial Resources) Rules ("FRR").

In addition, an Investment Firm is required under section 55 of the FRR to notify the SFC in writing as soon as reasonably practicable and in any event within one business day of becoming aware of specified circumstances, for example, its liquid capital falls below 120% of the minimum required level.

An Investment Firm is also required under Paragraph 12.5 of the Code of Conduct to notify the SFC immediately upon the happening of material events, such as insolvency or bankruptcy of the firm, the making of any receiving order or arrangement with creditors, suspension or revocation of any regulatory licence or approval in connection with the firm's business, material failure or defects in the firm's operation or systems etc.

9. For an Investment Firm whose financial situation is seen to have deteriorated *(e.g.*, capital has fallen below certain thresholds), what actions, if any, may the firm's regulators take to protect Client Assets?

Under section 146(5) of the SFO, where the SFC reasonably believes that an Investment Firm is unable to maintain, or to ascertain whether it maintains, regulatory capital in accordance with the minimum requirements set out in the FRR, the SFC may by notice in writing suspend the Investment Firm's licence or permit the Investment Firm to carry on any regulated activity for which it is licensed, subject to such conditions as may be imposed by the SFC. In addition, under sections 204 to 205 of the SFO, the SFC may, through the issuance of a restriction notice, restrict the firm's business and / or the firm's ability to deal with client assets and its own property. Furthermore, under sections 212 and 213 of the SFO, the SFC may petition for an Investment Firm to be wound up (details please see Answer 10 below), apply to court for appointment of administrator, and issuance of injunction or other orders.

Post-Insolvency

10. Please describe the process by which an Investment Firm enters the status of "insolvent" or "bankrupt" or the equivalent. For example, is a petition filed by the firm's regulator or some other administrative agency, by creditors of the firm, or otherwise? Is a decree entered by a court? Is this process different from the process applicable to entities that are not Investment Firms?

The Court of First Instance has jurisdiction to wind up any company formed and registered under the Companies Ordinance ("CO") (section 176 of the CO) and any unregistered company (section 326 of the CO). The winding up provisions and procedures of the CO apply to Investment Firms as they do to any other company that can be wound up under the CO.

There are three types of liquidation: compulsory winding-up, creditors' voluntary winding-up and members' winding-up.

Compulsory winding-up
The application for winding up of a company by the court may be made by a creditor, a shareholder, the company itself or relevant government officials (e.g. the Financial Secretary or the Registrar of Companies).

The SFC also has power under section 212 of the SFO to apply to the Court of First Instance to wind up any corporation (not just an Investment Firm) which the Court has jurisdiction to wind up. It must appear to the SFC that it is desirable in the public interest that the corporation should be wound up. The ground for such application is that it is "just and equitable" that the corporation be wound up. The winding-up procedures under the CO are applicable regardless of whether or not the company is an Investment Firm. Upon presentation of the petition, the SFC may also apply under section 193 of the CO for the appointment of provisional liquidators if the assets of the Investment Firm or the assets it controls appear to be at risk.

Once the petition is presented to the Court and served on the relevant parties, the petitioner must advertise a notice of the petition in the gazette and in one circulating English newspaper and one circulating Chinese newspaper. Prior to the hearing of the petition, the petitioner also has to obtain a certificate of procedural compliance from the High Court Registrar. If there is no opposition at the first hearing, a master in open court will grant a winding up order against the company with the Official Receiver to act as provisional liquidator. If the petition for winding–up is disputed, the hearing will be adjourned and fixed before a company judge for argument.

Creditors' voluntary winding-up
The directors of a company, realizing that there may be no real prospects of the company meeting the demands of creditors, call an extraordinary general meeting when members may resolve, by a special resolution, to wind up the company. The liquidation is deemed to have commenced upon passing of the special resolution.

Members' voluntary winding-up

The majority of the directors of a company may resolve at a meeting called for that purpose to have the company wound up and that one of them should make a statement in the form specified by the Companies Registry ("CR") and file the same with the CR under section 228A of the CO. Liquidation of the company is deemed to have commenced at the time of delivery of the statement to the CR.

11. Please describe the process by which the Administrative Officer (as defined above), if any, is selected. What qualifications, if any, must an Administrative Officer have? Who selects the Administrative Officer?

Compulsory winding-up
The Official Receiver ("OR") will act as liquidator *ex officio* from the time the winding-up order is made by the Court. The OR may summon separate meetings of the creditors and contributories of the company to appoint another individual as liquidator in its place. The Court may also appoint a liquidator at the time of making the winding up order.

Creditors' voluntary winding-up
The members and creditors of the company will provide nominations for the liquidator separately and in the event of any conflict the creditors' nomination will take precedence. The appointment of a liquidator will be sanctioned by a majority in value of those attending and voting at the creditors' meeting.

Members' voluntary winding-up
The liquidator is appointed by the members of the company. His/her appointment will be formalized by way of an ordinary resolution passed by the members at a general meeting at which the resolution to wind the company up is also passed.

In both types of voluntary winding-up, the Court has the power to appoint or replace a liquidator.

In cases where the SFC presents a petition under section 212 of the SFO and applies for the urgent appointment of provisional liquidators prior to the winding up hearing, the SFC will propose that the court appoint one or two nominated certified practicing accountants to act as provisional liquidators.

Qualification of Administrative Officer
There is no legal requirement for liquidators to be licensed or else approved, and they do not need to hold a particular professional qualification. Therefore, anyone may be appointed as a liquidator by providing such security as may be required by the OR. In practice, appointed liquidators and provisional liquidators tend to be insolvency practitioners such as accountants, solicitors or similar professionals. In compulsory liquidations, the OR operates 2 panels whereby insolvency work is contracted out to private sector insolvency practitioners. Panel members have to be suitably qualified (i.e. accountants or solicitors) and have a certain level of experience in insolvency work. The criteria are higher for the Panel which deals with the more complex and high value liquidations.

12. What are the duties of the Administrative Officer?

The Administrative Officer must conduct an investigation into the company's affairs with a view to uncovering and collecting in the company's assets, settling the validity and quantum of creditors' claims and identifying the reasons for the company's insolvency. He must then exercise his discretion in the administration of the assets of the company and distribute those assets amongst the company's creditors according to the ranking set out in the CO. The Administrative Officer is also obliged to assist the OR and any person who is entitled to inspect the books or papers of the company.

a. What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?

   The powers and duties of the Administrative Officer are contained in the CO and the Companies (Winding-Up) Rules set out procedural details for Administrative Officer. Though not mandatory, the Hong Kong Institute of Certified Public Accountants has issued coordinated Insolvency Guidance Notes which indicate best practice for insolvency practitioners and explain in detail their duties and responsibilities. There are various guides issued by the High Court of Hong Kong, such as Procedural Guide for Taxation / Determination of Bills of Provisional Liquidators or Liquidators by Masters and Procedural Guide for Taxation of Bills in Liquidation (other than bills of Provisional Liquidators or Liquidators) before Taxing Officers.

b. Under what standard (*e.g.*, strict liability, negligence), if any, is the Administrative Officer, pursuant to the Regime in your jurisdiction, subject to personal liability for failure to properly perform his or its duties?

   As regards compulsory liquidation by the court, a liquidator is under the supervision of the Court and the OR. Under section 205 of the CO, prior to the release of a liquidator, the court may make such order as it thinks just, charging the liquidator with the consequences of any act or default which he may have done or done contrary to his duty. The CO also provides that liquidators shall be liable to pay fines for failure to comply with certain provisions of the CO.

   A liquidator (i.e. an Administrative Officer) can be liable for negligence, default, breach of duty or breach of trust. However, under section 358 of the CO, if the liquidator has acted honestly and reasonably, and that, having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused for the negligence, default, breach of duty or breach of trust, the court may relieve him, either wholly or partly, from his liability on such terms as the court may think fit. As such, an Administrative Officer is not subject to strict liability.

13. What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?

a. Does the regulator continue to supervise the Investment Firm?

   Under section 195(1) of the SFO, when an Investment Firm goes into liquidation or is ordered to be wound up, the SFC is entitled to revoke or suspend its licence. However, this step is generally not taken until completion

of the insolvency proceeding or the return of Client Assets and until this stage the Investment Firm therefore remains under the SFC's supervision.

b. How, if at all, is the regulator involved in the process of returning Client Assets?

The SFC does not involve itself in the liquidation of the Investment Firm and the distribution of Client Assets. These processes will be undertaken by the liquidator. The SFC will maintain an oversight of the progress of these processes.

14. Does the Regime in your jurisdiction facilitate or encourage the transfer of Client Assets from an Investment Firm which has become bankrupt or insolvent to a solvent Investment Firm?

In general, the Administrator would arrange return of client assets to the respective clients according to their instructions. The SFC may facilitate such transfer by explicitly permitting such transfer in the restriction notice issued to the Investment Firm in financial distress.

a. What steps, if any, are prerequisite to accomplishing such a transfer? In general, how long does it take to accomplish those steps?

The insolvent Investment Firm would require the client's consent and the SFC's consent before making such transfer.

b. What factors, if any, affect the time period required to accomplish such a transfer?

The amount of time needed for accomplishing a transfer of client position or client assets to a solvent Investment Firm would depend on the circumstances of individual case, such as the time required for opening an account with the transferee investment firm by the client, the availability of the client to give consent to the transfer etc..

15. To what extent are clients at risk of, or protected from, having to return Client Assets (or the value thereof) that were distributed to the client prior to the insolvency proceeding?

There does not appear to be such a risk.

16. To what extent, if at all, does the Regime in your jurisdiction provide compensation to clients from other sources (for example, an investor protection or similar fund) for loss of Client Assets? Please discuss the scope of protections, conditions on such protection, and the limits of compensation (*e.g.*, maximum compensation per client).

An investor compensation fund is established for compensating investors for their losses in their investment in securities or futures contracts listed or traded in Hong Kong due to default committed by Investment Firms or their associated persons. It is based on a per-investor compensation limit of HK$150,000 for trading securities and futures contracts respectively. Only qualifying clients of an Investment Firm, which exclude institutional investors, are eligible to claim

compensation in line with the objective of the compensation fund to provide a safety net for retail investors. Details of the requirements are set out in the Securities and Futures (Investor Compensation – Compensation Limit) Rules and the Securities and Futures (Investor Compensation – Claims) Rules.

17. Are there circumstances in which clients are treated differently based on permissions they have granted pre-bankruptcy. *E.g.*, if any re-hypothecation has been entered into (or a 'right-to-use' exercised), please explain the client's position under the Insolvency Regime in such event.

Generally, there is no impact on the client's position, though the return of client assets that were re-hypothecated or lent to a third party may be subject to fulfillment by the Investment Firm of its liabilities to the third party.

18. Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?

Generally, there is no impact on the client's position, though the return of client assets held in another jurisdiction may be subject to the local requirements of that jurisdiction and the manner in which their assets are held. The Client Money Rules and Client Securities Rules do not apply to Client Assets held outside Hong Kong according to section 3 of the Client Money Rules and the Client Securities Rules.

19. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?

Client Asset protection requirements are set out in sections 4-11 of the Client Money Rules and sections 4-12 of the Client Securities Rules. If the SFC considers that it is desirable in the public interest/interest of the investing public, it may, pursuant to sections 204 and 205 of the SFO, issue a restriction notice in respect of the non-compliance. The restriction notice prohibits the Investment Firm carrying out any regulated activities and dealing with client assets and its own assets. In conjunction with a restriction notice, the SFC may also, pursuant to section 213(2)(d) of the SFO, apply to Court for the appointment of an administrator to administer the property of the Investment Firm and return Client Assets to clients. Further, under sections 12 and 13 of the Client Money Rules and the Client Securities Rules respectively, if an Investment Firm fails to comply with Client Asset protection requirements, it is liable on conviction to a fine of $10,000 to $1,000,000 and to imprisonment for 6 months to 7 years, depending on the seriousness of the offence. Further, the Investment Firm could be disciplined (e.g. licence revocation or suspension) for non-compliance. There is no distinction between different classes of clients in the application of the client asset protection requirements.

20. If there is a shortfall, *i.e.*, if claims by clients exceed resources dedicated to paying such claims (whether from Client Assets, investor protection fund, or otherwise), how are Client Assets distributed? *E.g.*, is there a pro rata distribution of Client Assets, are there priorities between classes of clients, is there a priority distribution ahead of the distribution of the general estate/distribution to unsecured creditors?

As regards whether clients take in priority to general creditors, see Answer 21 below.

If there is a shortfall of securities, there is a line of authorities[5] which has generally directed that the available securities be distributed pari passu among the clients who have a claim to them. Depending on the facts, a distinction may be drawn between cash clients and margin clients, the former having priority but clients in the same class sharing pari passu among themselves.[6] The same method is also used to allocate the available cash. However, in a case of misappropriation of Client Assets[7], the Court of First Instance indicated that where the records of the Investment Firm are sufficiently accurate to enable the Administrative Officer to identify which clients' securities have been taken, it would not be appropriate to follow the pari passu principle. Instead, the loss will fall on the identified clients.

21. Please explain how claims of clients are ranked in the insolvency process relative to those of other creditors. Does your insolvency regime rank domestic creditors above foreign creditors?

Under sections 4 and 5(1) of the Client Money Rules and Client Securities Rules respectively, the Investment Firm shall ensure that the Client Assets are deposited in safe custody in a segregated account which is designated as a trust account or client account. These assets so segregated by the Investment Firm do not form part of the assets of the Investment Firm and are not available for distribution to creditors upon insolvency of the Investment Firm. However, if there is a shortfall of Client Assets, clients who do not recover all their Client Assets will rank as unsecured creditors in the liquidation in respect of the shortfall. The Regime does not distinguish between domestic and foreign creditors of the Investment Firm.

III. Pertinent references

Please provide, for any statutes, regulations, or other authorities or texts that are referred to in your response, electronic copies (in English translation, if available), or URL links to available copies. How might a person outside your jurisdiction most readily get access to such items? Are there treatises that would be useful for obtaining a general understanding of client asset protection in your jurisdiction?

Securities and Futures Ordinance:

http://www.legislation.gov.hk/blis_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc*496*100*-568#568

Securities and Futures (Client Securities) Rules:

http://www.legislation.gov.hk/blis_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc*496*100*568.9#568.9

[5] C.A. Pacific Securities Limited (HCCW 36-37/98); Re Forluxe Securities Ltd (unreported, HCCW 310 &311/1998), Re Chark Fung Securities Co Ltd (unreported, HCCW 362/1998) and Re Tiffit (Hong Kong) Ltd ([2007] 1 HKLRD 267)
[6] C.A. Pacific, ibid.
[7] Re Great Honest Investment Company Ltd & Others (unreported HCMP 2251/2007 per Barma J)

Securities and Futures (Client Money) Rules:

http://www.legislation.gov.hk/blis_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc*496*100*568.10#568.10

Securities and Futures (Financial Resources) Rules:

http://www.legislation.gov.hk/blis_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc*496*100*568.15#568.15

Securities and Futures (Accounts and Audit) Rules:

http://www.legislation.gov.hk/blis_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc*496*100*568.17#568.17

Securities and Futures (Keeping of Records) Rules:

http://www.legislation.gov.hk/blis_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc*496*100*568.16#568.16

Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules:

http://www.legislation.gov.hk/blis_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc*496*100*568.18#568.18

Securities and Futures (Investor Compensation – Compensation Limit) Rules:

http://www.legislation.gov.hk/blis_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc*568.27*100*568.30#568.30

Securities and Futures (Investor Compensation – Claims) Rules:

http://www.legislation.gov.hk/blis_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc*496*100*-568.21#568.21

Banking Ordinance:

http://www.legislation.gov.hk/blis_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc*155*100*155#155

Companies Ordinance:

http://www.legislation.gov.hk/blis_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc*32*100*32.1#32.1

Companies (Winding-up) Rules:

http://www.legislation.gov.hk/blis_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc*1*100*-32.8#32.8

Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission:

http://www.sfc.hk/sfcRegulatoryHandbook/EN/displayFileServlet?docno=H598

Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission:

http://www.sfc.hk/sfcRegulatoryHandbook/EN/displayFileServlet?docno=H196

Suggested Control Techniques and Procedures for Enhancing a Firm's Ability to Comply with the Securities and Futures (Client Securities) Rules and the Securities and Futures (Client Money) Rules:

http://www.sfc.hk/sfcRegulatoryHandbook/EN/displayFileServlet?docno=H175

Insolvency Guidance Notes issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"):

http://app1.hkicpa.org.hk/ebook/index.php

India

Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets

I. Background

This questionnaire seeks information to aid in understanding the responding jurisdictions' techniques for protecting Client Assets in the event of the insolvency and/or winding up of an Investment Firm, and for promptly transferring such assets to a solvent Investment Firm or distributing them to the client. It is not intended to require information concerning the general legal framework for insolvency, except to the limited extent necessary to understand how rules for the protection of Client Assets fit within that framework.

Definitions.

(1) **"Administrative Officer"** refers to the person or entity who is appointed, whether by a court, regulator, creditors, the Investment Firm itself, or otherwise, to assume control of or power over a bankrupt or insolvent Investment Firm. This term includes administrators, debtors in possession, receivers, liquidators, trustees, and similar titles.

(2) **"Client Assets"** refers collectively to Positions, Securities, and Client Money:

- "**Positions"** are contractual rights and obligations arising from transactions entered into by an investment firm on behalf of its clients, including mark to market accruals arising from the change in value of futures, options and/or other derivatives positions;

- "**Securities"** are defined to incorporate both securities and derivatives, as those terms are defined or understood in the responding jurisdiction; and

- "**Client Money"** refers to funds owed to or held on behalf of clients by an investment firm, and may include margin collateral associated with client positions (both existing and potential), income relating to an investment such as dividends or interest, proceeds of the liquidation of client securities and/or positions, and funds in excess of required margin.

(3) **"Investment Firm"** means an intermediary that holds Client Assets and is engaged in the business of managing client accounts, which could include, without limitation: executing orders on behalf of others, dealing in or distributing Securities (including carrying derivatives positions). In jurisdictions where banks are broadly permitted to engage in such a business, this term includes banks to the extent they are providing such services.

(4) **"Omnibus Account"** means an Investment Firm's account with a third party in which Client Assets are maintained separate from the firm's assets, but are held in the aggregate instead of in accounts designated for individual clients.

(5) **"Regime"** refers to statutes, regulations, rules of exchanges, clearing organizations and other self-regulatory bodies, or other legally binding requirements.

Survey Questions

Where appropriate, please provide citations to statutes, regulations, or other authorities supporting your answers below.

Context

1. Please provide a brief overview setting forth the defining characteristics of your jurisdiction's approach to protecting Client Assets.

In answering the remaining questions:

(1) Please provide details, as appropriate, where the Regime in your jurisdiction applies different treatment or results based on differences in:

a. Categories of Client Assets;

b. Models of trading (e.g., exchange-traded versus over-the-counter).

*c. Categories of clients (*e.g.*, retail versus sophisticated)*

There is no difference in treatment based on client asset category

All the equity products are exchange traded and the stipulations given below are applicable to exchange traded products

(2) You are requested to provide details of the Regime in your jurisdiction. You are additionally invited to provide information explaining how that Regime is applied in practice, through, e.g.*, informal arrangements between governmental entities.*

Pre-Insolvency

2. Does the regime in your jurisdiction require an Investment Firm to hold special authorization (*i.e.*, a specific form of license or registration) to be permitted to hold Client Assets?

Yes

a. If special authorization is required, what requirements (both initial and ongoing) is an Investment Firm required to comply with to hold such authorization?

The investment firm has to fulfill various requirements for getting the certificate of registration from Securities and Exchange Board of India (SEBI). The firm is required to have specified net worth, key personnel, certification examination, infrastructure, relevant experience, and should be a fit and proper person. These requirements are to be complied with on continuous basis.

The investment firms have to comply with applicable provisions of the SEBI Act, 1992, regulations, circulars and guidelines issued by SEBI from time to time.

b. If special authorization is not required, how, if at all, is this activity supervised by a regulator?

NA

3. Does the Regime in your jurisdiction require that Client Assets be maintained separately from the assets of an Investment Firm?

Yes

If so, please provide a description of the process by which segregation is accomplished, and of the applicable requirements. Specifically:

a. Must the Client Assets of one client be maintained separately from those of other clients?

Yes

i. Are Investment Firms allowed to hold Omnibus Accounts?

Yes, the account should hold only the assets of the clients. However, the firm has to maintain securities register and have the client level accounting in the back office for all the assets of the clients

(Regulation 17 of SEBI (Stock Broker and Sub-Brokers) Regulations, 1992 and SEBI circular SMD/SED/CIR/93/23321 dated November 18, 1993)

ii. What measures are used to protect the Client Assets of each client from losses due to the activities of other clients?

SEBI circular SEBI/MIRSD/DPS-1/Cir-31/2004 dated August 26, 2004: The money/securities deposited by the client should be kept in a separate account distinct from the firm's own account or account of any other clients

SEBI circular MRD/DoP/SE/Cir- 11/2008 dated April 17, 2008: The investment firms should have adequate systems and procedures in place to ensure that client collateral is not misused and should also maintain records to ensure proper audit trail of use of client collaterals.

Thus, the assets of a client are not affected due to losses of other clients.

b. Please describe any requirement that an Investment Firm must reconcile the Client Asset account.

SEBI circular MIRSD/SE/CIR-19/2009 dated December 3, 2009: The client account is required to be reconciled on continuous basis at the choice of the clients and at least once in a quarter.

For example:

i. How do you calculate the amount of Client Assets that a firm is required to hold in one or more accounts segregated for the benefit of clients?

A) Are required Client Assets fungible between or within asset classes, or is the Investment Firm required to hold, *e.g.*, the specific assets deposited by the client?

The client assets are fungible between or within the asset classes

B) How is the reconciliation conducted (*e.g.*¸ on an aggregate basis, or a client-by-client basis)?

On client by client basis

C) If a client has a debit balance (*i.e.,* the client owes the Investment Firm), is such balance deducted in determining the amount the Investment Firm is required to hold?

Yes

ii Timing issues:

A) How often is reconciliation required (*e.g.*, daily, weekly, monthly).

B) When is such reconciliation required (*e.g.*, noon of the following business day, the tenth business day of the following month).

As mentioned in reply to Question 3(b), the reconciliation is done on a continuous basis.

C) Is the Investment Firm required to make good any deficiency from their own funds? If so, in what period? Is any payment by the Investment Firm thereby deemed to be Client Money?

The question is not clear. However, it may be mentioned that the clients would get their dues in full.

iii. Is an Investment Firm permitted or encouraged to maintain any of their own assets in a Client Asset account (*e.g.*, as a "buffer")? If so, are any such assets so transferred then deemed to be Client Assets? Is there a requirement to remove any excess assets?

No. The money/securities deposited by the client should be kept in a separate account distinct from the firm's own account or account of any other clients

c. Can the Investment Firm use Client Assets of one client for meeting obligations of another client?

No

If so, how?

SEBI circular MRD/DoP/SE/Cir- 11/2008 dated April 17, 2008: There should be adequate systems and procedures in place to ensure that client assets are not used for any purposes other than meeting the respective client's margin requirements / pay-in.

d. Are there any restrictions on the ability of the Investment Firm (or other party holding Client Assets) to invest, encumber, rehypothecate, stock-lend, or otherwise deal with, the Client Assets?

Yes

If so, please describe.

SEBI circular MRD/DoP/SE/Cir-11/2008 dated April 17, 2008: It is required to maintain records to ensure proper audit trail of use of client collateral. There should be adequate systems and procedures in place to ensure that client assets are not used for any purposes other than meeting the respective client's margin requirements / pay-in.

e. What are the requirements, if any, for clearinghouses or other central counterparties to maintain the separate identification of collateral posted by the Investment Firm for its Client Positions?

The clearinghouses/clearing corporations are required to maintain separate identification of client positions and margin at Investment Firm level. The investment firm is required to submit a list of client codes, names of the clients, client wise margin amount collected by it from the client and paid to the clearing member which in turn is paid to the Clearing House/Clearing Corporation. The investment firm is also required to submit to the clearing member the details of the margin amount due and paid by it to the Clearing House/Clearing Corporation for the purpose of meeting margin requirements.

The above reporting details are verified by clearing houses during the course of the inspection of the investment firm.

4. Are Investment Firms permitted to transfer to, or hold Client Assets in, another jurisdiction?

No

If so, does the Regime in your jurisdiction require Investment Firms to preserve the separate identification of:

a. Client Assets transferred to or located in other jurisdictions?

b. Client Assets that have been transferred to the Investment Firm from other jurisdictions and that have been identified as Client Assets in those jurisdictions?

If so, please provide details of those requirements.

5. If the Regime in your jurisdiction permits or requires Client Assets to be held by third party custodians:

Yes, In case of institutional clients

a. Please describe the requirements, if any, concerning the qualifications of such custodians e.g., licensing, creditworthiness. May the Client Assets be kept with an affiliate of the Investment Firm?

The custodians are required to obtain certificate of registration from SEBI in terms of SEBI (Custodian of Securities) Regulations, 1996. They are required to meet the eligibility criteria as specified in the regulations in terms of net worth, infrastructure, key personnel and fit and proper criteria.

b. Please describe any requirements concerning the custody agreement between intermediary and custodian. In particular, may the custodian be permitted to place a lien, charge or other encumbrance on Client Assets? If so, please explain.

Regulation 17 of SEBI (Custodian of securities) regulations, 1996: Every custodian of securities shall enter into an agreement with each client on whose behalf it is acting as custodian of securities and every such agreement shall provide for the following matters namely

- *the circumstances under which the custodian of securities will accept or release securities/monies from the custody account;*
- *the circumstances under which the custodian of securities will receive rights or entitlements on the securities of the client;*
- *the circumstances and the manner of registration of securities in respect of each client; and details of the insurance, if any, to be provided for by the custodian of securities.*

6. Under what circumstances, if any, is an Investment Firm required to disclose to clients information related to the protection of the client's assets? What is the nature of such required disclosures? How do any such required disclosures apply to Client Assets held in another jurisdiction?

Please refer to the reply to query 3(c) & (d) above

7. Under what conditions, if any, may clients choose to waive any of the Client Asset protection requirements applicable in your jurisdiction (also known as "opting out")? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

N.A.

8. Under what circumstances, if any, is an Investment Firm required to notify the regulators or the market generally, of material changes in their financial position or ability to continue to carry on business? What is the nature of such required disclosures?

Regulation 16 of the SEBI (stock Brokers and Sub-brokers) Regulations, 1992: The regulations prescribe the net worth requirement for obtaining the certificate of registration. Also on ongoing basis, the firm has to submit to the concerned stock exchange a half-yearly certificate from an auditor confirming the net worth. The Networth is closely monitored by the exchanges.

Regulation 18A of the SEBI (stock Brokers and Sub-brokers) Regulations: Every stock broker has to appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions, etc., issued by SEBI or the Central Government and for redressal of investors' grievances. The compliance officer is required to immediately and independently report to SEBI any non-compliance observed by him.

9. For an Investment Firm whose financial situation is seen to have deteriorated *(e.g.*, capital has fallen below certain thresholds), what actions, if any, may the firm's regulators take to protect Client Assets?

The ability of the firm to pay margins and maintain the capital cushions is closely monitored by the exchanges and suitable risk containment measures are taken as warranted. As mentioned earlier, the assets of clients are kept in a separate account and hence these would not be affected in case of fall in capital of the firm. However, in case it is required, the accounts held by one investment firm may be transferred to another firm. Also, necessary orders can be passed by SEBI to protect the interests of investors.

Post-Insolvency

Answers to all the questions pertaining to 'post-insolvency' are consolidated in a 'note' given below.

10. Please describe the process by which an Investment Firm enters the status of "insolvent" or "bankrupt" or the equivalent. For example, is a petition filed by the firm's regulator or some other administrative agency, by creditors of the firm, or otherwise? Is a decree entered by a court? Is this process different from the process applicable to entities that are not Investment Firms?

11. Please describe the process by which the Administrative Officer (as defined above), if any, is selected. What qualifications, if any, must an Administrative Officer have? Who selects the Administrative Officer?

12. What are the duties of the Administrative Officer?

    a. What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?

    b. Under what standard (*e.g.*, strict liability, negligence), if any, is the Administrative Officer, pursuant to the Regime in your jurisdiction, subject to personal liability for failure to properly perform his or its duties?

13. What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?

    a. Does the regulator continue to supervise the Investment Firm?

    b. How, if at all, is the regulator involved in the process of returning Client Assets?

14. Does the Regime in your jurisdiction facilitate or encourage the transfer of Client Assets from an Investment Firm which has become bankrupt or insolvent to a solvent Investment Firm?

    a. What steps, if any, are prerequisite to accomplishing such a transfer? In general, how long does it take to accomplish those steps?

b. What factors, if any, affect the time period required to accomplish such a transfer?

15. To what extent are clients at risk of, or protected from, having to return Client Assets (or the value thereof) that were distributed to the client prior to the insolvency proceeding?

16. To what extent, if at all, does the Regime in your jurisdiction provide compensation to clients from other sources (for example, an investor protection or similar fund) for loss of Client Assets? Please discuss the scope of protections, conditions on such protection, and the limits of compensation (*e.g.*, maximum compensation per client).

17. Are there circumstances in which clients are treated differently based on permissions they have granted pre-bankruptcy. *E.g.,* if any re-hypothecation has been entered into (or a 'right-to-use' exercised), please explain the client's position under the Insolvency Regime in such event.

18. Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?

19. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?

20. If there is a shortfall, *i.e.*, if claims by clients exceed resources dedicated to paying such claims (whether from Client Assets, investor protection fund, or otherwise), how are Client Assets distributed? *E.g.*, is there a pro rata distribution of Client Assets, are there priorities between classes of clients, is there a priority distribution ahead of the distribution of the general estate/distribution to unsecured creditors?

21. Please explain how claims of clients are ranked in the insolvency process relative to those of other creditors. Does your insolvency regime rank domestic creditors above foreign creditors?

Note

Declaration of default: Administrative supervision by the Stock Exchanges in India

A trading member may be declared a defaulter by the stock exchanges if among other things he is unable to fulfil his obligations. The procedure followed by the exchanges after declaration of the defaulter are enumerated in Chapter XII of the National Stock Exchange Bye-laws and Bye-laws 316, 326 & 400 of Bombay Stock Exchange){www.nseindia.com, www.bseindia.com}. The said procedure includes settling the claims of the clients from the assets of the firm and then out of Investor Protection Fund.

In case of certain eventualities, there are provisions in the SEBI Act and the regulations to protect the interest of the investors. SEBI can freeze the accounts of the investment firms and ensure that the assets of the clients are protected. SEBI can also seek the appointment of an Administrator to look into the affairs of the affected firm.

Further, the registration certificate of the investment firm is liable to be cancelled by SEBI in case it is declared defaulter by the stock exchange, declared insolvent and in case the order for winding up has been passed by the court.

There are also specific Acts which deal with Bankruptcy, Liquidation and insolvency issues viz. the Indian Companies Act, 1956, the Sick Industrial Companies (Special

Provisions) Act, 1985 ("SICA"), Recovery of Debts Due to Banks and Financial Institutions Act, 1993, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, the Indian Contract Act, 1872, the Indian Civil Procedure Code, 1908, Provincial Insolvency Act, 1920 and other substantive and procedural laws for recovery proceedings. As regards recovery of dues is concerned, Recovery of Debts Due to Banks and Financial Institutions Act, 1993, SRFAESI Act and CPC are the main laws under which recovery proceedings are initiated. *For all the acts refereed above pls refer http://www.vakilno1.com/bareacts*

III. Pertinent references

Please provide, for any statutes, regulations, or other authorities or texts that are referred to in your response, electronic copies (in English translation, if available), or URL links to available copies. How might a person outside your jurisdiction most readily get access to such items? Are there treatises that would be useful for obtaining a general understanding of client asset protection in your jurisdiction?

Italy

Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets

I. Background

This questionnaire seeks information to aid in understanding the responding jurisdictions' techniques for protecting Client Assets in the event of the insolvency and/or winding up of an Investment Firm, and for promptly transferring such assets to a solvent Investment Firm or distributing them to the client. It is not intended to require information concerning the general legal framework for insolvency, except to the limited extent necessary to understand how rules for the protection of Client Assets fit within that framework.

Definitions.

(1) **"Administrative Officer"** refers to the person or entity who is appointed, whether by a court, regulator, creditors, the Investment Firm itself, or otherwise, to assume control of or power over a bankrupt or insolvent Investment Firm. This term includes administrators, debtors in possession, receivers, liquidators, trustees, and similar titles.

(2) **"Client Assets"** refers collectively to Positions, Securities, and Client Money:

- "**Positions"** are contractual rights and obligations arising from transactions entered into by an investment firm on behalf of its clients, including mark to market accruals arising from the change in value of futures, options and/or other derivatives positions;

- "**Securities"** are defined to incorporate both securities and derivatives, as those terms are defined or understood in the responding jurisdiction; and

- "**Client Money"** refers to funds owed to or held on behalf of clients by an investment firm, and may include margin collateral associated with client positions (both existing and potential), income relating to an investment such as dividends or interest, proceeds of the liquidation of client securities and/or positions, and funds in excess of required margin.

(3) **"Investment Firm"** means an intermediary that holds Client Assets and is engaged in the business of managing client accounts, which could include, without limitation: executing orders on behalf of others, dealing in or distributing Securities (including carrying derivatives positions). In jurisdictions where banks are broadly permitted to engage in such a business, this term includes banks to the extent they are providing such services.

(4) **"Omnibus Account"** means an Investment Firm's account with a third party in which Client Assets are maintained separate from the firm's assets, but are held in the aggregate instead of in accounts designated for individual clients.

(5) **"Regime"** refers to statutes, regulations, rules of exchanges, clearing organizations and other self-regulatory bodies, or other legally binding requirements.

II. Survey Questions *Where appropriate, please provide citations to statutes, regulations, or other authorities supporting your answers below.*

Context

1. Please provide a brief overview setting forth the defining characteristics of your jurisdiction's approach to protecting Client Assets.

In answering the remaining questions:

(1) Please provide details, as appropriate, where the Regime in your jurisdiction applies different treatment or results based on differences in:

a. Categories of Client Assets;

b. Models of trading (e.g., exchange-traded versus over-the-counter).

*c. Categories of clients (*e.g.*, retail versus sophisticated)*

(2) You are requested to provide details of the Regime in your jurisdiction. You are additionally invited to provide information explaining how that Regime is applied in practice, through, e.g.*, informal arrangements between governmental entities.*

Investment Firms are required to hold client assets separately from their own assets and from the assets of other clients (see also response to question 3 below), pursuant to Article 22 of Legislative Decree no. 58/1998 (hereinafter, the "**Consolidated Law on Finance**").[1]

This regime triggers a so-called "true asset segregation", since for each client the financial instruments held by banks, and the financial instruments and funds held by Investment Firms other than banks shall be treated as separate assets: creditors of the Investment Firm or of other clients do not have any actions against such separate assets.

The provision has been further implemented by the Bank of Italy Regulation of October 29, 2007, specifying the rules applicable to the handling of Client Assets (hereinafter, the "**Bank of**

[1] Article 22 (unofficial translation) reads as follows: *"1. In providing investment and non-core services, the financial instruments and funds of individual customers held in whatever capacity by an investment firm, Italian management company, harmonized management company or financial intermediary entered in the register provided for in Article 107 of the Consolidated Law on Banking and the financial instruments of individual customers held in whatever capacity by a bank shall be separate assets for all intents and purposes from those of the intermediary and from those of other customers. Actions in respect of such assets may not be brought by creditors of the intermediary or on behalf of such creditors, nor by creditors of the custodian or the sub-custodian, if any, or on behalf of such creditors. Creditors of individual customers may bring actions up to the amount of the assets owned by such customers.*
2. Legal and court-ordered set-off shall not apply to accounts where financial instruments or funds are deposited with third parties and agreements may not be made for their set-off against claims of the custodian or the sub-custodian on the intermediary or the custodian.
3. Unless customers have agreed in writing, an investment firm, Italian management company, harmonized management company or financial intermediary entered in the register provided for in Article 107 of the Consolidated Law on Banking or a bank may not use, on its own behalf or on behalf of third parties, financial instruments belonging to customers which it holds in any capacity. Nor may an investment firm, Italian management company, harmonized management company or financial intermediary entered in the register provided for in Article 107 of the Consolidated Law on Banking use, on its own behalf or on behalf of third parties, liquid balances belonging to customers which it holds in any capacity."

Italy Regulation on Deposit and Sub-deposit"). This regime dictates requirements on proper book-keeping, use, deposit and sub-deposit (including rules on selection and monitoring of sub-custodians) of financial instruments and funds deposited by each client (see responses to questions below). Investment Firms shall satisfy stringent duties in the selection and monitoring of custodians and sub-custodian. The sub-custody of the Client Assets is without prejudice to the liability of the Investment Firm towards the clients.

Client Money shall be held only through duly authorized banks: Investment Firms other than banks are under a duty to deposit all Client Money, within 1 day of receipt, in a "third party" omnibus account to be opened with a bank or with the central bank. This third party account shall be separated from the accounts where the Investment Firm deposits his own assets (under Italian law, the receiving bank or central bank is named "**custodian**").

Investment Firms are also subject to recordkeeping obligations, and rules of conduct requiring them to adopt all measures to safeguard the right of customers on their assets, disclose relevant information to clients and prospective clients, and avoid preferential treatments of one client over another (see Article 21 of the Consolidated Law on Finance and relevant implementing provisions under Consob Regulation no. 16190 ("**Regulation on Intermediaries**") and Consob and the Bank of Italy Regulation of October 29, 2007 ("**Regulation on Internal Organization**")).

Managers of collective investment schemes, including hedge funds, shall deposit the assets of the CIS with a depository bank, pursuant to Articles 36(2) and 38 of the Consolidated Law on Finance. The appointment of the depositary bank shall be approved by the Bank of Italy, which shall verify that independency, experience, capital and organizational requirements provided for under the Section II, Chapter VII, Title V of the Bank of Italy Regulation of April 14, 2005 (the "**Regulation on Asset Management**") are met.

The commingling of Client Assets is criminally sanctioned pursuant to Article 168 of the Consolidated Law on Finance.

The administration of financial instruments by central depositories is also subject to stringent regulation. Central depositories, settlement services, guarantee systems, clearing houses and central counterparties are authorized and supervised by the Bank of Italy and Consob and regulated under the Consolidated Law on Finance and the Consob and Bank of Italy Regulation of February 22, 2008 (hereinafter, the "**Regulation on Central Depositories**").

Special provisions to ensure restitution of Client Assets are provided for in case the Investment Firm is declared insolvent or is otherwise put into special administration or compulsory administrative liquidation. These provisions are contemplated in Chapter 2 of the Consolidated Law on Finance and applied under the supervision and direction of the Bank of Italy.

Client Assets are protected through mandatory investor compensations schemes. According to Article 59 of the Consolidated Law on Finance, the Investment Firm is authorized only provided that it adheres to a duly recognized investor compensation scheme.

Pre-Insolvency

2. Does the regime in your jurisdiction require an Investment Firm to hold special authorization (*i.e.*, a specific form of license or registration) to be permitted to hold Client Assets?

Yes, Client Assets may be held only by Investment Firms duly authorized to the service of custody and administration of Client Assets (relevant requirements are set forth under Article 1 of the Bank of Italy Regulation on Deposit and Sub-deposit).

a. If special authorization is required, what requirements (both initial and ongoing) is an Investment Firm required to comply with to hold such authorization?

In order to be authorized to hold client assets, Investment Firms must satisfy higher capital requirements (minimum 1 million €) than those applicable to Investment Firms which do not hold client assets (minimum 385,000€) (see Article 1 of the Bank of Italy Regulation on Deposit and Sub-deposit).

Moreover, to be authorized as an Investment Firm, a company shall satisfy initial and ongoing requirements on governance, internal organization, internal compliance and controls, operational conducts, in accordance with the provisions implementing MiFID (i.e.: the Consolidated Law of Finance and relevant implementing Regulation on Intermediaries and Regulation on Internal Organization).

b. If special authorization is not required, how, if at all, is this activity supervised by a regulator? N/A

3. Does the Regime in your jurisdiction require that Client Assets be maintained separately from the assets of an Investment Firm?

Yes, pursuant to Article 22 of the Consolidated Law on Finance (see footnote 1) and relevant implementing Regulation issued by the Bank of Italy lastly on October 29, 2007.

If so, please provide a description of the process by which segregation is accomplished, and of the applicable requirements. Specifically:

a. Must the Client Assets of one client be maintained separately from those of other clients?

Yes, the Investment Firm must maintain each Client Assets separately from the other Client Assets. For each client, the Investment Firm must keep separate evidence of the assets on the basis of the type of service/activity provided and maintain evidence of the relevant (if any) custodians and sub-custodians.

For each transaction on Client Assets, the Investment Firm must keep record of the relevant execution date, contractual settlement date and actual settlement date. These records must be promptly updated on an ongoing basis, so as to ensure that in each moment there is clear and certain evidence of each client position (see Section II, par. 1, of the Bank of Italy Regulation on Deposit and Sub-deposit).

i. Are Investment Firms allowed to hold Omnibus Accounts?

No, Italian Investment Firms are not allowed to hold Omnibus Accounts, since the Client Assets shall be registered in each client's name. Moreover, according to Section II, par. 1, of the Bank of Italy Regulation on Deposit and Sub-deposit, Investment Firms may sub-deposit client assets in an omnibus accounts with a third party sub-custodian provided that one of the following requirements is satisfied:

- if the client is not a professional investor, he has authorized the sub-deposit in an omnibus account in written form;

- the Investment Firm undertakes measures to ensure that the Client Assets are used in accordance with the terms and conditions of the client agreement (this agreement must be in written form if the client is not a professional investor).

ii. What measures are used to protect the Client Assets of each client from losses due to the activities of other clients?

Investment Firms must hold Client Assets in the name of the individual client. Set off between positions of different clients is prohibited under Article 22 of the Consolidated law on Finance and Section II, par. 1, of the Bank of Italy Regulation on Deposit and Sub-deposit. This rule shall apply also in connection with margin transactions. Investment Firms are prohibited from using the assets of one client to cover margins or transactions of other clients.

b. Please describe any requirement that an Investment Firm must reconcile the Client Asset account. For example:

i. How do you calculate the amount of Client Assets that a firm is required to hold in one or more accounts segregated for the benefit of clients?

The amount (and type) of assets to be held must correspond exactly with the amount of the Client Assets deposited with the Investment Firm.

A) Are required Client Assets fungible between or within asset classes, or is the Investment Firm required to hold, *e.g.*, the specific assets deposited by the client?

Client moneys (funds/cash) are fungible assets. Financial instruments having the same ISIN code are also fungible among themselves, since they incorporate exactly the same rights, terms and conditions and they can substituted among each others. In some cases, financial instruments may not be fungible with other assets. For instance, certain non-listed financial instruments are identified by paper-based certificates that the Investment Firm must keep in custody (directly or through a sub-custodian; in all cases, sub-custody is without prejudice to the liability of the Investment Firm towards its client).

B) How is the reconciliation conducted (*e.g.*¸ on an aggregate basis, or a client-by-client basis)?

Reconciliation is carried out by Investment Firms on a client-by-client basis (see Section II, par. 1, of the Bank of Italy Regulation on Deposit and Sub-deposit) and on an aggregate basis for each asset class they hold (see Article 32 of the Regulation on Central Depositories). See also response to question ii (A) below.

C) If a client has a debit balance (*i.e.*, the client owes the Investment Firm), is such balance deducted in determining the amount the Investment Firm is required to hold?

Yes, this netting applies within fungible assets, such as for instance Client Money, i.e.: if the client owes money, the balance of his current account automatically deducts this debit.

ii Timing issues:

A) How often is reconciliation required (*e.g.*, daily, weekly, monthly).

Reconciliation on a client-by-client basis shall be carried out on a regular basis, also taking into account the frequency and volumes of the executed transactions (see Section II, par. 1, of the Bank of Italy Regulation on Deposit and Sub-deposit). Furthermore, according to Article 32 of the Regulation on Central Depositories, Investment Firms shall, within one day of the date of registration, check for each class of financial instrument, that the balance of their own account at the central depository coincides with the balance of the own account they keep and that the sum of the balances of the customer accounts at the central depositories coincides with the sum of the balances of the customer accounts they keep. The internal control function of the Investment Firm must verify compliance with the law.

B) When is such reconciliation required (*e.g.*, noon of the following busness day, the tenth business day of the following month).

See above.

C) Is the Investment Firm required to make good any deficiency from their own funds? If so, in what period? Is any payment by the Investment Firm thereby deemed to be Client Money?

If irregularities or deficiencies are discovered, the Board of Directors and the Board of Supervisors of the Investment Firm must be promptly informed. In its turn, the Board of Supervisors of the Investment Firm has a duty to inform Consob and the Bank of Italy of any such irregularity (see Article 8 of the Consolidated Law on Finance and implementing provisions in the Regulation on Internal Organization).

In any event, under general civil law, the client would have a claim against the Investment Firm if his assets, including Money, are not properly booked or held; the Investment Firm would be liable towards the client to pay damages. The

commingling of Client Assets is criminally sanctioned pursuant to Article168 of the Consolidated Law on Finance.

iii. Is an Investment Firm permitted or encouraged to maintain any of their own assets in a Client Asset account (*e.g.*, as a "buffer")? If so, are any such assets so transferred then deemed to be Client Assets? Is there a requirement to remove any excess assets?

Not applicable.

c. Can the Investment Firm use Client Assets of one client for meeting obligations of another client? If so, how?

No, as mentioned Investment Firms are prohibited from using one Client Assets for meeting the obligations of other clients (see Article 22(3) of the Consolidated Act on Finance and Section II, par. 1, of the Bank of Italy Regulation on Deposit and Sub-deposit).

d. Are there any restrictions on the ability of the Investment Firm (or other party holding Client Assets) to invest, encumber, rehypothecate, stock-lend, or otherwise deal with, the Client Assets? If so, please describe.

Yes. Investment Firms are prohibited from making use of Client Assets on their behalf or on behalf of third parties, unless the client has given specific consent. If the client is a retail one, the consent shall be expressed in writing and the relevant client agreement shall indicate the name of the counterparty, the type of transactions that may be carried out, the relevant security rights and the liabilities of the parties. The Investment Firm shall keep evidence of any transactions executed on the Client Assets and shall inform the client of such transactions and relevant remunerations (see Section II, par. 1, of the Bank of Italy Regulation on Deposit and Sub-deposit).

e. What are the requirements, if any, for clearinghouses or other central counterparties to maintain the separate identification of collateral posted by the Investment Firm for its Client Positions?

Clearing houses and central counterparties (as well as central depositories) are under a duty to register any Client Position, including the collateral posted on behalf of a client, in a separate omnibus account of the Investment Firm, called "third party" account (all the assets deposited in this omnibus account belong to clients and not to the Investment Firm). This collateral is therefore kept separate from any collateral posted by the Investment Firm on his own account.

4. Are Investment Firms permitted to transfer to, or hold Client Assets in, another jurisdiction?

Yes, provided that the client has given his consent (in written for if the client is retail). The transfer is without prejudice for the Investment Firm's liability to restitute

the assets to the client (see Section II, par. 3, of the Bank of Italy Regulation on Deposit and Sub-deposit).

If so, does the Regime in your jurisdiction require Investment Firms to preserve the separate identification of:

a. Client Assets transferred to or located in other jurisdictions?

Yes. Investment Firm are required to keep evidence of the name of the sub-custodians where the Client Assets are held, relevant nationality and whether it belongs to the same group.

These Client Assets must be held in a "third party" account, i.e.: an omnibus account opened in the name of the Investment Firm and indicating that the assets belong to third parties. The third party account shall be kept separately from the one where the Investment Firm deposits its own assets.

The Investment Firms are responsible to periodically monitor their sub-custodians in a view of ensuring that they are effective and reliable in maintaining separate identification of these third party assets. Moreover, when the foreign jurisdiction regulates and supervises custodians, Investment Firms are obliged to transfer the Client Assets to such supervised custodians.

If the foreign jurisdiction does not supervise custodians, the transfer is admitted only provided that: (i) the transfer is necessary in view of the particular financial instrument or the service provided, or (ii) the client is a professional one and has consented in writing to the transfer (see Section II, par. 3 and 4, of the Bank of Italy Regulation on Deposit and Sub-deposit).

b. Client Assets that have been transferred to the Investment Firm from other jurisdictions and that have been identified as Client Assets in those jurisdictions?

Yes. It applies, *mutatis mutandis*, the same rule as above: the Investment Firm shall register the Client Assets in an omnibus account in the name of the foreign Investment Firm, indicating that the Assets belong to third parties.

If so, please provide details of those requirements. See above

5. If the Regime in your jurisdiction permits or requires Client Assets to be held by third party custodians:

a. Please describe the requirements, if any, concerning the qualifications of such custodians e.g., licensing, creditworthiness. May the Client Assets be kept with an affiliate of the Investment Firm?

As mentioned in response to question 1, Clients Money shall be held through a custodian, which shall be a duly authorized banks subject to ongoing supervision by the Bank of Italy. The account where the Moneys are deposited with the custodian shall be opened in the name of the Investment Firm, and shall indicate that the Moneys belong to third parties. The client shall mature interests on the Money (the amount shall be determined contractually). These interests shall be

separated from the interests earned by the Investment Firm on its own money (see Section II, par. 2, of the Bank of Italy Regulation on Deposit and Sub-deposit).

Moreover, as mentioned in response to question 2(a), not all Investment Firms are authorized to hold, even temporarily, Client Assets. In order to get authorized, higher capital requirements shall be met. Investment Firms which are not authorized to hold Client Assets shall put in place appropriate arrangements to ensure that the Client Money and Securities are deposited directly by the client with an authorized Investment Firm. The Bank of Italy shall be informed of these arrangements (see Section II, par. 5, of the Bank of Italy Regulation on Deposit and Sub-deposit).

Furthermore, for all types of collective investment schemes domiciled in Italy, including hedge funds, managers are required to appoint an independent custodian where the Securities and Money shall be deposited. The custodian must be an authorized EU bank (so called depositary bank) subject to ongoing supervision by the Bank of Italy. The appointment of the depositary bank shall be approved by the Bank of Italy, which shall verify that relevant requirements provided for under the Section II, Chapter VII, Title V of the Regulation on Asset Management are met.

In particular, the depositary bank must satisfy experience, capital (100 million €) , organizational and independency requirements and shall act in the interests if unit-holders. The appointment of a bank as a depository is prohibited when the chairman of the board of directors, the managing director, the general manager or the members of the managing committee of the asset management company or the investment company vest one of the following role in the bank: (i) chairman of the board of directors, managing director or general manager; (ii) person responsible of a unit in the bank.

b. Please describe any requirements concerning the custody agreement between intermediary and custodian. In particular, may the custodian be permitted to place a lien, charge or other encumbrance on Client Assets? If so, please explain.

As mentioned (see response to question 3(iii)(d)), as a general rule, the custodian is prohibited from placing lien, charges or other encumbrance on Client Assets, unless the client has consented to them. If the client is a retail one, the agreement between the Investment Firm and the client shall specify the type of charge that may be carried put on the Client Assets, the relevant counterparty and liabilities of the parties. The Investment Firm shall ensure that the sub-custodian complies with the terms and conditions agreed with the client, the sub-custody shall be without prejudice to the Investment Firm's liability towards the clients. The Investment Firm shall keep evidence of any transactions executed on the Client Assets and shall inform the client of such transactions relevant remunerations (see Section II, par. 1, of the Bank of Italy Regulation on Deposit and Sub-deposit).

6. Under what circumstances, if any, is an Investment Firm required to disclose to clients information related to the protection of the client's assets? What is the nature of such required disclosures? How do any such required disclosures apply to Client Assets held in another jurisdiction?

Retail clients must be informed on the arrangements that Investment Firm has undertaken to protect the Client Assets before the agreement with the Investment Firm is executed (see Article 27 and 29 of Regulation on Intermediaries).

As mentioned in previous responses, the client must consent to the use of the assets and to the deposit with a custodian or sub-custodian (in case of retails, this consent must be in writing). Moreover, in case the client has given consent to the use of his assets by the Intermediaries or custodians/sub-custodian, the Investment Firm shall inform the client on the transactions executed on his assets and relevant remuneration.

The failure by an Investment Firm to comply with the above provisions is administratively sanctioned (as a breach of conduct of business rules) and gives rise to civil liability towards the client.

7. Under what conditions, if any, may clients choose to waive any of the Client Asset protection requirements applicable in your jurisdiction (also known as "opting out")? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

Clients cannot opt out the protection regime, including the asset segregation and rules on the appointment of custodians and sub-custodians, described in the above. Information to be given to retail clients is more extensive than to professionals. Clients may give their consent to the "right of use" and to the sub-custody of Assets.

8. Under what circumstances, if any, is an Investment Firm required to notify the regulators, or the market generally, of material changes in their financial position or ability to continue to carry on business? What is the nature of such required disclosures?

As mentioned, Investment Firm are licensed intermediaries subject to prudential regulation. Investment Firms shall comply with reporting requirements, so that the Bank of Italy and Consob exercise ongoing supervision on the Investment Firms' own funds, financial position and ability to carry on business. Consob and the Bank of Italy may also obtain information and perform on-site inspections on Investment Firms. Failure to provide information to the regulators is administratively sanctioned pursuant to Article 187-quinquiesdecies of the Consolidated Law on Finance, and criminally sanctioned pursuant to Article 170-bis of the Consolidated Law on Finance and Article 2638 of the Italian Civil Code.

9. For an Investment Firm whose financial situation is seen to have deteriorated *(e.g.*, capital has fallen below certain thresholds), what actions, if any, may the firm's regulators take to protect Client Assets?

As mentioned, Investment Firms are all prudentially supervised; regulators can take several actions to protect Client Assets.

According to Article 7 of the Consolidated Law on Finance, the Bank of Italy and Consob have the power to: a) convene the directors, members of the board of auditors and managers; b) order the convening of the governing bodies and set the agenda for the meeting; and c) proceed directly to convene the governing bodies where the competent bodies have not complied with their order issued. The Bank of Italy may, for stability purposes, issue specific provisions/decisions to deal with prudential issues, and may prohibit or restrict, where necessary, the provisions of services, activities, transactions by the Investment Firm or its branches, as well as prohibit the distribution of profits or the liquidation of assets. The Bank of Italy and Consob may also order the suspension or temporary limitation of the issue or redemption of units or shares of collective investment schemes.

According to Article 51 of the Consolidated Law on Finance, the Bank of Italy and Consob may order Investment Firms to put an end to any irregularities and prohibit persons, branches or establishments of an Investment Firm from engaging in new transactions, where there is a risk of prejudice to investors and in case of urgency.

According to Article 53 of the Consolidated Law on Finance, the Chairman of Consob may, in situations of danger for customers or markets, suspend the bodies of the Investment firms as a matter of urgency and appoint a provisional administrator to take over its management where serious administrative irregularities or serious violations of laws, regulations or bylaws are found. The appointment of the provisional administrator shall be for a maximum of sixty days. In the performance of his or her duties, the provisional administrator shall be a public official. The Chairman of Consob may establish special safeguards and limitations on the management of the Investment Firm.

Post-Insolvency

10. Please describe the process by which an Investment Firm enters the status of "insolvent" or "bankrupt" or the equivalent. For example, is a petition filed by the firm's regulator or some other administrative agency, by creditors of the firm, or otherwise? Is a decree entered by a court? Is this process different from the process applicable to entities that are not Investment Firms?

The insolvency proceedings applicable to Investment Firms are regulated under Articles 56 and 57 of the Consolidated Law of Finance and corresponding provisions of the Banking Law. The proceedings are directed by the Bank of Italy and are different from those generally applicable to unregulated entities. These proceedings does not necessarily involve an insolvency situation: they may also apply to solvent Investment Firms that have seriously violated the law, as better explained below.

Nonetheless, if the Investment Firm is insolvent, the insolvency shall be declared judicially by the bankruptcy court upon a petition from the Administrative Officers (if already appointed), the creditors of the Investment Firm, or the public prosecutor. The insolvency is declared after having heard the Bank of Italy and the legal representatives of the Investment Firm.

If the insolvency is declared, the general rules of bankruptcy law aimed at protecting claimants and relevant ranking shall be applicable to the liquidation of the Investment Firm, including claw-back actions (see Article 82 of the Consolidated Banking Law and Article 202 of the Royal Decree 267/1942, recently amended by Decree-Law 35/2005 (ratified by Law 80/2005, hereinafter the "**Bankruptcy Law**", mentioned in par. 3 therein).

The proceedings may be of two types:

- special administration, which consists in the dissolution of the boards of the Investment Firm where: a) serious administrative irregularities or serious violations of laws, regulations or bylaws governing its activity are found; b) serious capital losses are expected; or c) the dissolution of the boards was requested by the board of directors, an extraordinary meeting of shareholders or the provisional administrator appointed by Consob Chairman (see response to previous question). The proceeding is temporary, since pursuant to Article 70(5) of the Consolidated Banking Law, it shall last up to 1 year; the Bank of Italy may issue prorogations of two months. At the end of the proceeding, the Investment Firm may continue the business or be subjected to the compulsory administrative liquidation (see Article 75(3) of the Consolidated Banking Law);

- compulsory administrative liquidation, which consists in the withdrawal of the authorization and the liquidation (winding-up) of the Investment Firm where: a) the administrative irregularities or the violations of laws, regulations or bylaws are exceptionally serious; b) the losses of the Investment Firm are exceptionally serious; c) the liquidation was requested by the board of directors, an extraordinary meeting of shareholders or the provisional administrator appointed by Consob Chairman (see response to previous question), the Administrative Officers of the special administration mentioned above, or the ordinary liquidators.

The opening of the two proceedings is declared by decree of the Minister for the Economy and Finance, who acts upon a proposal from the Bank of Italy or Consob. The decree is published in the Italian Official Gazette.

11. Please describe the process by which the Administrative Officer (as defined above), if any, is selected. What qualifications, if any, must an Administrative Officer have? Who selects the Administrative Officer?

The Administrative Officers (both in case of special administration and compulsory administrative liquidation) are appointed by the Bank of Italy. The Officers may be also revoked and replaced by the Bank of Italy. The Officers shall satisfy propriety

requirements established under the Ministry of Treasury Decree no. 161 of 28 March 1998, implementing Article 26 of the Banking Law (see Article 71(6) of Consolidated Banking Law).

12. What are the duties of the Administrative Officer?

a. What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?

The Administrative Officers are subject to the Bank of Italy's direction. Their general duties and functions are established by law (see Article 72 ff. of the Consolidated Banking Law for the special administration and Article 84 ff of the Consolidated Banking Law for the compulsory administrative liquidation).

In particular, the Administrative Officer in the special administration shall manage the Investment Firm, ascertain assets and liabilities, remove irregularities and take any action in the interest of the clients.

The Administrative Officer in the compulsory administrative liquidation is responsible to liquidate the assets of the Investment Firm and restitute the Client Assets to the clients.

In both proceedings, an oversight committee (appointed by the Bank of Italy) shall monitor and assist the Administrative Officers. The Bank of Italy may establish special precautions and obligations that the Administrative Officers shall comply with.

b. Under what standard (*e.g.*, strict liability, negligence), if any, is the Administrative Officer, pursuant to the Regime in your jurisdiction, subject to personal liability for failure to properly perform his or its duties?

The Administrative Officers shall be treated as public officers and shall be personally liable for the failure to comply with the Bank of Italy's directions (see Articles 72(1)(4) and 84(1)(3) of the Consolidated Banking Law). Civil law actions against the Administrative Officers shall be subject to prior authorization by the Bank of Italy (see Articles 72(9) and 84(6) of the Consolidated Banking Law).

13. What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?

a. Does the regulator continue to supervise the Investment Firm?

Yes, the Bank of Italy continues to supervise the Investment Firm and, as mentioned, has the power to direct the proceeding of special administration and compulsory administrative liquidation.

b. How, if at all, is the regulator involved in the process of returning Client Assets?

The Bank of Italy shall supervise that the Client Assets are returned in accordance with the provisions of law. The Bank of Italy shall approve the allotment plan

whereby the assets are distributed among the clients, pursuant to Article 92 of the Consolidated Banking Law.

14. Does the Regime in your jurisdiction facilitate or encourage the transfer of Client Assets from an Investment Firm which has become bankrupt or insolvent to a solvent Investment Firm? Yes, see below.

a. What steps, if any, are prerequisite to accomplishing such a transfer? In general, how long does it take to accomplish those steps?

According to Article 90(2) of the Consolidated Banking Law, the transfer of assets or going concerns to third parties shall be authorized by the Bank of Italy and agreed upon with the oversight committee. The transfer may be effected at any stage of the proceeding, including prior to the statement of liability.

The formalities to perfect the transfer are simplified. Instead of notifying it to each counterparty according to general law, the transfer shall be published on the Italian Official Gazette and entered in the Company Register, pursuant to Article 58 of the Consolidated Banking Law.

b. What factors, if any, affect the time period required to accomplish such a transfer?

As mentioned, the transfer may be accomplished at any time and stage of the proceeding.

15. To what extent are clients at risk of, or protected from, having to return Client Assets (or the value thereof) that were distributed to the client prior to the insolvency proceeding?

In case the Investment Firm is declared insolvent by the bankruptcy court, assets are protected through the general bankruptcy claw-back actions, pursuant to Article 67 of the Bankruptcy Law. This Article is applicable pursuant to Article 82(3) of the Consolidated Banking Law and Article 203 of the Bankruptcy Law.

In particular, the claw-back regime provides that the Administrative Officer can revoke the following transactions unless the party dealing with the bankrupt company is able to prove that it was not aware of the state of insolvency of the bankrupt:
• Any transaction entered into for consideration, but not on arm's length terms, by the bankrupt during the one year prior to the declaration of bankruptcy. The law specifies that a transaction will be assumed to be not on arm's length terms when the value of the assets transferred, value given or the obligations assumed by the bankrupt exceeds by more than one fourth the value of what the bankrupt has received in exchange.
• Any discharge of due and payable obligations made through unusual means of payment (such as, for instance, the transfer of goods to a creditor to discharge a payment obligation) during the one year prior to the bankruptcy declaration.
• Any pledge or mortgage voluntarily granted by the bankrupt during the one year prior to the declaration of bankruptcy as security for pre-existing debts that were not due and payable as of the date of grant of the relevant security.

• Any pledge and mortgage granted by the bankrupt during the six months prior to the declaration of bankruptcy as security for pre-existing debts that were due and payable as of the date of grant of the relevant security.

The following payments and transactions can be revoked by the Administrative Officer, provided that: (i) the Administrative Officer is able to prove (also through circumstantial pieces of evidence and reasonable assumptions) that the third party was aware of the insolvency of the bankrupt party when the payment was made or when the transaction was entered into, and (ii) they have been made or entered into during the six months prior to the bankruptcy declaration:
(a) payments of due debts made through normal means of payment;
(b) pledges and mortgages granted as security for debts (including third party's debts) arising simultaneously with the grant of the security; and/or
(c) any other transaction for consideration.

The following transactions cannot be subject to claw-back actions: payments for goods and services in the bankrupt party's ordinary course of business (if not otherwise unusual), remittances to a bank account not materially and permanently reducing the indebtedness to the bank, sales at fair market price of real estate used by the purchaser as his residence, deeds, payments and securities carried out or granted to implement judicially sanctioned agreements with creditors or under a judicial moratorium.

16. To what extent, if at all, does the Regime in your jurisdiction provide compensation to clients from other sources (for example, an investor protection or similar fund) for loss of Client Assets? Please discuss the scope of protections, conditions on such protection, and the limits of compensation (*e.g.*, maximum compensation per client).

As mentioned in previous responses, Client Assets are protected through mandatory investor compensation schemes. This regime implements the provisions of the EU Investor Compensation Schemes Directive.

The organization and functioning of the schemes are established by Regulation of the Ministry of Finance, having heard the Bank of Italy and Consob (see Regulation no. 485/1997). The Bank of Italy, having heard Consob, shall coordinate the operation of these investor compensation schemes with the proceeding of compulsory administrative liquidation (see Article 59 of the Consolidated Law on Finance).

The investor compensation schemes shall be recognized by the Ministry of Finance, provided that they fulfill the applicable requirements. The aim is to protect investors against the risk of losses in the event of an Investment Firm's inability to repay money or return assets held on behalf of their clients.

More in details, the cover shall be provided for claims arising out of an investment firm's inability to:

- repay money owed to or belonging to investors and held on their behalf in connection with investment business, or

- return to investors any instruments belonging to them and held, administered or managed on their behalf in connection with investment business.

The schemes shall cover up to € 20,000 for each client[2].

17. Are there circumstances in which clients are treated differently based on permissions they have granted pre-bankruptcy. *E.g.*, if any re-hypothecation has been entered into (or a 'right-to-use' exercised), please explain the client's position under the Insolvency Regime in such event.

No, clients shall not be treated differently based on their pre-bankruptcy permissions. In principle, all Client Assets belong to respective clients, regardless to whether or not any "right of use" was exercised by the Investment Firm or relevant custodians/sub-custodians. In case the claims by clients exceed resources dedicated to paying such claims, the clients will be satisfied on a pro rata basis and for the remaining amount will concur with unsecured creditors (see response to question 19 below).

18. Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?

In principle, clients should not be affected, considering that their assets are segregated and Investment Firms are responsible for the selection and monitoring of the foreign sub-custodians pursuant to the above-mentioned provisions of Italian law. Moreover, the appointment of a sub-custodian is without prejudice to the liability if the Investment Firm towards the clients. Therefore, in normal circumstances clients are protected. However, as a matter of fact, clients may be affected if both the Investment Firm and the foreign sub-custodian are insolvent and failed to comply with segregation related requirements.

19. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?

According to Article 91(2)(3) of the Consolidated Banking Law, where the rules on segregation of the Investment Firm's assets from those of clients are complied with, but the segregation among individual clients is not complied with or the Securities are

[2] According to Article 4, par. 3 and 4, of Regulation no. 485:
3. The claims of the following categories of persons shall not be eligible for payment by compensation systems:
*a) investors who have been condemned for crimes referred to in Articles 648-bis and 648-ter of the penal code [*money laundering*];*
b) investors who contributed to the insolvency of the intermediary, as ascertained by the bodies responsible for the insolvency procedure;
c) banks, Italian securities investment firms, financial companies referred to in Title V of the Consolidated Law on Banking, investment firms, insurance companies, collective investment undertakings and pension funds;
d) international organizations, government departments and local authorities;
e) companies belonging to the same group as the intermediary;
f) shareholders who hold, through nominees or otherwise, at least 5 per cent of the intermediary's capital;
g) directors, managers, members of the board of auditors of the intermediary or of other companies belonging to the same group as the intermediary who were in office in the last two financial years;
h) spouses and persons related by consanguinity within the fourth degree to persons specified in subparagraphs a), b), c), f) and g).
4. Transactions carried out through nominees by persons referred to in paragraphs 3f) and 3g) shall not be eligible for any compensation whatsoever.

not sufficient to effect all the restitutions, the Administrative Officer shall, where possible, effect pro rata restitutions or liquidate the Securities belonging to clients and allot the proceeds on the same pro rata basis.

If the rules concerning the segregation of the Investment Firm's assets from the Client Assets (as a whole) are not complied with, the clients are treated as unsecured creditors in full. If the rules on segregation among individual clients is not complied with, the clients shall be treated as unsecured creditors for the part of their rights which has not been satisfied on a pro rata basis.

20. If there is a shortfall, *i.e.*, if claims by clients exceed resources dedicated to paying such claims (whether from Client Assets, investor protection fund, or otherwise), how are Client Assets distributed? *E.g.*, is there a pro rata distribution of Client Assets, are there priorities between classes of clients, is there a priority distribution ahead of the distribution of the general estate/distribution to unsecured creditors?

The rule in case the client claims exceed resources shall be pro rata distribution of Client Assets pursuant to Article 91(2) of the Consolidated Banking Law (see response to question 19 above).

21. Please explain how claims of clients are ranked in the insolvency process relative to those of other creditors. Does your insolvency regime rank domestic creditors above foreign creditors?

Client Assets are registered in a special separate section of the statement of liabilities of the Investment Firm (see Article 86(6) of the Consolidated Banking Law) and are subject to restitutions pursuant to Article 91(1) of the Consolidated Banking Law (when segregation rules are not complied with the provisions of Article 91(2)(3) applies, see response to question 19). Technically, the clients are the owners (and not creditors) of the assets deposited with the Investment Firm, therefore the restitution in their favor takes place with priority compared to the liquidation of the remaining assets to (secured and unsecured) creditors. The remaining assets of the Investment Firm are liquidated according to the ranking generally applicable in any bankruptcy proceedings. The priorities are indicated under Article 111 of the Bankruptcy Law, i.e., secured creditors shall rank with priorities on unsecured creditors.

III. Pertinent references

Please provide, for any statutes, regulations, or other authorities or texts that are referred to in your response, electronic copies (in English translation, if available), or URL links to available copies. How might a person outside your jurisdiction most readily get access to such items? Are there treatises that would be useful for obtaining a general understanding of client asset protection in your jurisdiction?

Most of the statutes are available from this address:

http://www.consob.it/mainen/legal_framework/laws_regulations/laws.html?queryid=mainen.laws.and.regulations&resultmethod=tuf&search=1&symblink=/mainen/legal_framework/laws_regulations/index.html

The Consolidated Law on Banking is here:
http://www.bancaditalia.it/vigilanza/banche/normativa/leggi

The Bank of Italy Regulation on deposit and sub-deposit of client assets is available only in Italian:
http://www.consob.it/main/documenti/Regolamentazione/normativa/bi_1097_2007.htm?hkeywords=&docid=33&page=0&hits=38

Japan

Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets

I. Background

This questionnaire seeks information to aid in understanding the responding jurisdictions' techniques for protecting Client Assets in the event of the insolvency and/or winding up of an Investment Firm, and for promptly transferring such assets to a solvent Investment Firm or distributing them to the client. It is not intended to require information concerning the general legal framework for insolvency, except to the limited extent necessary to understand how rules for the protection of Client Assets fit within that framework.

Definitions.

(1) **"Administrative Officer"** refers to the person or entity who is appointed, whether by a court, regulator, creditors, the Investment Firm itself, or otherwise, to assume control of or power over a bankrupt or insolvent Investment Firm. This term includes administrators, debtors in possession, receivers, liquidators, trustees, and similar titles.

(2) **"Client Assets"** refers collectively to Positions, Securities, and Client Money:

- "**Positions"** are contractual rights and obligations arising from transactions entered into by an investment firm on behalf of its clients, including mark to market accruals arising from the change in value of futures, options and/or other derivatives positions;

- "**Securities"** are defined to incorporate both securities and derivatives, as those terms are defined or understood in the responding jurisdiction; and

- "**Client Money"** refers to funds owed to or held on behalf of clients by an investment firm, and may include margin collateral associated with client positions (both existing and potential), income relating to an investment such as dividends or interest, proceeds of the liquidation of client securities and/or positions, and funds in excess of required margin.

(3) **"Investment Firm"** means an intermediary that holds Client Assets and is engaged in the business of managing client accounts, which could include, without limitation: executing orders on behalf of others, dealing in or distributing Securities (including carrying derivatives positions). In jurisdictions where banks are broadly permitted to engage in such a business, this term includes banks to the extent they are providing such services.

(4) **"Omnibus Account"** means an Investment Firm's account with a third party in which Client Assets are maintained separate from the firm's assets, but are held in the aggregate instead of in accounts designated for individual clients.

(5) **"Regime"** refers to statutes, regulations, rules of exchanges, clearing organizations and other self-regulatory bodies, or other legally binding requirements.

II. Survey Questions *Where appropriate, please provide citations to statutes, regulations, or other authorities supporting your answers below.*

Context

1. Please provide a brief overview setting forth the defining characteristics of your jurisdiction's approach to protecting Client Assets.

In answering the remaining questions:

(1) Please provide details, as appropriate, where the Regime in your jurisdiction applies different treatment or results based on differences in:

a. Categories of Client Assets;

b. Models of trading (e.g., exchange-traded versus over-the-counter).

*c. Categories of clients (*e.g.*, retail versus sophisticated)*

(2) You are requested to provide details of the Regime in your jurisdiction. You are additionally invited to provide information explaining how that Regime is applied in practice, through, e.g.*, informal arrangements between governmental entities.*

Segregation of client assets and investor protection funds are characteristics of our approach to protecting Client Assets under the Financial Instruments and Exchange Act ("FIEA"). Segregation of client assets is stipulated as a requirement for Financial Instruments Business Operators etc. who engage in securities etc. management business. (FIEA Article 43-2 and 43-3)

1. Segregation of client assets

Storage Method (Securities)

(i) Except in mixed storage, client securities should be stored in a location clearly set apart from the storage location for other securities, including in the case of storage by a third party. Also, client securities should be organized by client or securities code number in order to make them immediately identifiable in storage.

(ii) In case of mixed storage, the storage location for all client securities should be separated clearly from the storage location for other securities. Also, all client securities should be made immediately identifiable through methods such as classification by the Financial Instrument Business Operator account and the account for clients, and every client's shares should be made immediately identifiable through the ledgers and records of the business operator.

Moreover, for securities that are owned jointly by the business operator and clients or other parties, every client's shares should be made immediately identifiable in the ledgers and records of the business operator.

Storage Method (Cash)

Money should be earmarked for clients entrusted as follows:

(i) The Financial Instruments Business Operator should be designated as consignor, the trust company or financial institution should be engaged in trust business designated as trustee and the clients of the financial instruments business should be designated as beneficiaries of the principal.
(ii) A trust administrator should be appointed by the Financial Instruments Business Operator. Also, if the business operator concludes trust contracts with a number of trustee organizations, the same trust administrator should be appointed for all concluded contracts.
(iii) If the business operator applies as the notifying Financial Instruments Business Operator under the provisions of Article 79-54 of the FIEA, an investor protection fund should be designated as trust administration as a general rule.
(iv) The types of trust contracts should be money trusts, securities trusts and comprehensive trusts, and management of these trusts should be conducted according to the management method prescribed in laws and regulations.
(v) The necessary value of money for clients and of the total client fund calculated on a daily basis should be earmarked for each client.
(vi) Replacement of necessary money should be earmarked for clients by setting standard dates for calculation of differences of more than one day per week and compensating for shortfalls within three business days from the day following the relevant standard date.
(vii) The necessary value of money should be earmarked for clients. The said value should be the value as of the standard date for calculation of differences. (Not the outstanding average for the week.)
(viii) The value of securities in trust should be assessed appropriately in compliance with laws and regulations, with valuation as a general rule performed on the standard date for calculation of differences.
(ix) If the Financial Instruments Business Operator is classified as a notifying Financial Instruments Business Operator, said operator should issue instructions on management to the trust company or financial institution engaged in trust business (Excluding special cases when approved by the investor protection fund.)

Client assets should be segregated from the assets of the Financial Instruments Business Operator regardless of the category of the client. In addition, as mentioned above, the segregation method depends on the type of asset i.e. cash or securities.

The segregation requirement for OTC securities derivative trades has already been promulgated (not effected yet) as part of amendments to the FIEA, and the related cabinet office ordinance is in the process of public consultation.

2. Investor protection funds
A financial instruments business operator (excluding those specified by a Cabinet Order) shall join any one of the funds as a member. In addition, a financial instruments business operator that is a member of a fund may not withdraw from the fund to which it belongs except in the case of abolition of its financial instruments business, dissolution of the financial instruments business operator, rescission of registration or when the financial instruments business operator becomes a member of another fund with approval of the Prime Minister and the Minister of Finance. Details are as follows:

(1) Business of Investor Protection Funds
The Business of Investor Protection Funds includes, but is not limited to, the following:
- Payment of claim subject to compensation to general clients in certain cases, such as rescission of registration or failure of the financial instruments business operator

− Loan of necessary funds for expeditious performance of the obligation pertaining to the refund of Client Assets
- Preservation of claims of general clients

(2) Payment of claims subject to compensation
Based on a request by a general client of a recognized Financial Instruments Business Operator that is recognized by an investor protection fund as an operator facing difficulty in payment, an investor protection fund shall make payment, out of the claims that said general client had held against said recognized Financial Instruments Business Operator, of an amount which the fund finds it difficult for said recognized Financial Instruments Business Operator to smoothly pay. The maximum amount of payment of claims subject to compensation is 10 million yen.

(Note 1) OTC derivatives and derivatives transactions on overseas exchanges are excluded from client assets with regard to the coverage of our investor's guaranteed fund and, therefore, do not fall under the scope of claims subject to compensation.

(Note 2) General Client refers to the clients of a Financial Instruments Business Operator (excluding qualified institutional investors, states, local governments and other persons specified by a Cabinet Order).

(3) Loan of necessary funds for expeditious performance of the obligation pertaining to the refund of Client Assets
Based on an application from a notifying Financial Instruments Business Operator (excluding a recognized Financial Instruments Business Operator) or an agent for a beneficiary of a trust prescribed in Article 43-2(2) pertaining to a notifying Financial Instruments Business Operator, a fund may loan necessary funds for expeditious performance of the obligation pertaining to the refund of Client Assets (hereinafter referred to as a "Loan of Funds for Refund") to such a person within the scope of the amount that is found to be necessary when having granted recognition of eligibility.

(4) Preservation of claims of general clients
A fund shall, when it finds it necessary for preserving the realization of claims which a general client holds against a notifying Financial Instruments Business Operator (limited to those pertaining to client assets of said general client), have the authority to conduct any and all judicial or extra-judicial acts that are necessary to preserve the realization of said claims on behalf of said general client within the limit necessary.

As described above, the application of compensation by investor protection funds depends on whether the claims are subject to compensation or not. Assets other than the client assets of general clients do not fall under the scope of compensation. In our regime, firstly client assets are protected through segregation and, on top of that, the claims of general clients are preserved by investor protection funds in the case of failure of Financial Instruments Business Operators.

Pre-Insolvency

2. Does the regime in your jurisdiction require an Investment Firm to hold special authorization (*i.e.*, a specific form of license or registration) to be permitted to hold Client Assets?

   a. If special authorization is required, what requirements (both initial and ongoing) is an Investment Firm required to comply with to hold such authorization?

   b. If special authorization is not required, how, if at all, is this activity supervised by a regulator?

Under the FIEA, “securities, etc. management business" means business pertaining to the acceptance of deposits of money, securities or certificates and the transfer of bonds, etc. conducted in response to the opening of an account for transfer of bonds. Securities, etc management business is one of the businesses classified as Type I Financial Instruments Business, and hence financial instruments business operators are required to comply with the capital-to-risk ratio, net assets requirement and so forth. When registration is made, the applicant must not fall under the conditions of refusal of registration, such as by failing to fulfill the asset requirement or the organizational requirement.

3. Does the Regime in your jurisdiction require that Client Assets be maintained separately from the assets of an Investment Firm? If so, please provide a description of the process by which segregation is accomplished, and of the applicable requirements. Specifically:

Yes. Please refer to the answer to Question 1.

   a. Must the Client Assets of one client be maintained separately from those of other clients?

In the case of mixed storage of securities and money earmarked for clients, those assets are managed by Financial Instruments Business Operators in aggregate; however, the interest of each client is managed through the ledgers and records.

      i. Are Investment Firms allowed to hold Omnibus Accounts?

As in the case of mixed storage by third party, when a client invests in foreign securities in an overseas market, the Financial Instruments Business Operator is allowed to open an omnibus account with a foreign intermediary, and the operator entrusts a third party with the task of storing the invested securities.

ii. What measures are used to protect the Client Assets of each client from losses due to the activities of other clients?

Please refer to the answer to Question 3.a.

b. Please describe any requirement that an Investment Firm must reconcile the Client Asset account. For example:

i. How do you calculate the amount of Client Assets that a firm is required to hold in one or more accounts segregated for the benefit of clients?

In the case of securities, securities are deposited and stored in accordance with the method described in the answer to Question 1.

The amount to be refunded to the client shall be calculated by each client, and shall be the total of the amount of money specified in items (i) and (ii) below and the market value (meaning the closing price published on the relevant date or the price equivalent thereto as calculated in accordance with a reasonable formula) of the securities specified in item (iii) below, on which the calculation is to be based.

(i) the money deposited to the Financial Instruments Business Operator, etc. from a client (limited to that deposited with regard to transactions of securities-related derivatives) under derivative transactions on exchange or money deposited to the Financial Instruments Business Operator, etc. from a client under margin transactions;

(ii) the money belonging to the account of a client or money deposited to the Financial Instruments Business Operator, etc. from a client (excluding the money specified in the preceding item), with regard to subject securities-related transactions; and

(iii) the securities listed in the items of the preceding paragraph that have been furnished as securities with written consent from clients.

The following shall be deducted from the amount to be refunded to the clients:

(i) a claim held by the Financial Instruments Business Operator, etc. against a client (limited to the claim related to the advance payment of the purchase price of securities purchased by such client.

(ii) money constituting the sales price of the securities sold by the client based on a margin transaction (limited to the money provided as security for the claim pertaining to the credit granted to the client by the Financial Instruments Business Operator in connection with such margin transaction)

(iii) the amount pertaining to the client's margin transaction, and if such amount exceeds the total of the amount of the money or the market value of the securities deposited as deposited security money pertaining to the client's margin transaction, such total amount)

(iv) the amount of money provided as security by the client under a contract for a *Gensaki* transaction

A) Are required Client Assets fungible between or within asset classes, or is the Investment Firm required to hold, *e.g.*, the specific assets deposited by the client?

In the case of money, an amount of money equal to that deposited by the client is managed separately. Mixed storage is also available for securities.

B) How is the reconciliation conducted (*e.g.*¸ on an aggregate basis, or a client-by-client basis)?

As described above, the Financial Instruments Business Operator, etc. shall calculate the individual amount of client segregated fund to be refunded (meaning the amounts to be refunded to a client as calculated by each client) and the required amount of client segregated fund (meaning the total amount of the individual amount of client segregated fund to be refunded) every day.

In cases where the appraisal value of the principal of the trust property as of the base date, which shall be at least once a week (hereinafter referred to as the "reappraisal base date"), is less than the required amount of client segregated fund, the trust property equivalent to such shortfall amount shall be added within three business days from the day immediately after such reappraisal base date

Securities deposited by a client are separately managed as received.

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C) If a client has a debit balance (*i.e.*, the client owes the Investment Firm), is such balance deducted in determining the amount the Investment Firm is required to hold?

As described above, claims of a Financial Instruments Business Operator against a client could be deducted from the amount of client segregated fund to be refunded when calculating said amount. However, the amount of client segregated fund to be refunded is calculated for each individual client; claims against one client could not be set off with the amount of other clients' segregated fund.

ii Timing issues:

A) How often is reconciliation required (*e.g.*, daily, weekly, monthly)

Please refer to the answer to Question 3.b.i.B).

B) When is such reconciliation required (*e.g.*, noon of the following business day, the tenth business day of the following month).

Please refer to the answer to Question 3.b.i.B).

C) Is the Investment Firm required to make good any deficiency from their own funds? If so, in what period? Is any payment by the Investment Firm thereby deemed to be Client Money?

There is no specific provision stipulated on this point under the FIEA.

iii. Is an Investment Firm permitted or encouraged to maintain any of their own assets in a Client Asset account (*e.g.*, as a "buffer")? If so, are any such assets so transferred then deemed to be Client Assets? Is there a requirement to remove any excess assets?

There is no specific provision on this point under the FIEA. However, if securities are co-owned by a Financial Instruments Business Operator and a client and said securities can not be separated, the said Financial Instruments Business Operator shall manage them in a condition such that the share of each client pertaining to such clients' securities is immediately identifiable based on the books of such Financial Instruments Business Operator. Buffer is not prohibited. However, as it is deemed to have clear linkage between individual assets and individual investors' interest, buffer is not encouraged.

c. Can the Investment Firm use Client Assets of one client for meeting obligations of another client? If so, how?

A Financial Instruments Business Operator, etc. shall, when furnishing as security the securities possessed by him/her based on a client's account or securities deposited to him/her from a client or loaning such securities to another person, obtain written consent from the client.

d. Are there any restrictions on the ability of the Investment Firm (or other party holding Client Assets) to invest, encumber, rehypothecate, stock-lend, or otherwise deal with, the Client Assets? If so, please describe.

As described in the answer to Question 3 c., by obtaining a written consent from the client, a Financial Instruments Business Operator, etc. may furnish as security the securities possessed by him/her based on a client's account or securities deposited to him/her from a client or loaning such securities to another person,

e. What are the requirements, if any, for clearinghouses or other central counterparties to maintain the separate identification of collateral posted by the Investment Firm for its Client Positions?

Under the FIEA, a clearing organization is not required to maintain the separate identification of collateral posted by the investment firm for its client positions. In practice, in the case of the failure of a clearing member, a clearing organization may obtain client information from the failed clearing member.

4. Are Investment Firms permitted to transfer to, or hold Client Assets in, another jurisdiction? If so, does the Regime in your jurisdiction require Investment Firms to preserve the separate identification of:

a. Client Assets transferred to or located in other jurisdictions?

In the case of a client investing in foreign securities traded in an overseas market, the invested securities are stored at a local custodian and managed through an omnibus account at the local intermediary. In this case, Financial Instruments Business Operators shall manage securities through the ledgers and records of the business operator in accordance with separate management requirements under the FIEA.

b. Client Assets that have been transferred to the Investment Firm from other jurisdictions and that have been identified as Client Assets in those jurisdictions?

If so, please provide details of those requirements.

If foreign investors invest in the Japanese market through a foreign intermediary, the foreign investors' interests will be stored in Japan. If such transaction is made through a foreign intermediary, the invested securities are managed in the omnibus account at a Japanese intermediary.

5. If the Regime in your jurisdiction permits or requires Client Assets to be held by third party custodians:

a. Please describe the requirements, if any, concerning the qualifications of such custodians e.g., licensing, creditworthiness. May the Client Assets be kept with an affiliate of the Investment Firm?

Requirement for custodian business, i.e. securities, etc. management business, please refer to the answer to Question 2. In addition, banks with a banking license may engage in providing a safe deposit for securities as ancillary business. In sum, an entity that qualifies as a custodian may act in that capacity for an affilicate.

b. Please describe any requirements concerning the custody agreement between intermediary and custodian. In particular, may the custodian be permitted to place a lien, charge or other encumbrance on Client Assets? If so, please explain.

A sample of a deposit contract and an agreement concerning a foreign securities transaction entered into between a client and Financial Instruments Business Operator are produced by Japan Securities Dealers Association. There is no specific rule stipulating the custody agreement between Financial Instruments Business Operators; however, as described before, a Financial Instruments Business Operator, etc. shall, when furnishing as security the securities possessed by him/her based on a client's account or securities deposited to him/her from a client or loaning such securities to another person, obtain written consent from the client.

6. Under what circumstances, if any, is an Investment Firm required to disclose to clients information related to the protection of the client's assets? What is the nature of such required disclosures? How do any such required disclosures apply to Client Assets held in another jurisdiction?

Under the FIEA, with respect to the condition of clients' trading, a Financial Instruments Business Operator is required to deliver a report on the outstanding balance of transactions. However, there is no specific provision stipulating that a Financial Instruments Business Operator is required to disclose to clients the information related to the protection of client assets.

7. Under what conditions, if any, may clients choose to waive any of the Client Asset protection requirements applicable in your jurisdiction (also known as "opting out")? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

As described in the answer to Question 3 c., by obtaining a written consent from the client, a Financial Instruments Business Operator, etc. may furnish as security the securities possessed by him/her based on a client's account or securities deposited to him/her from a client or loaning such securities to another person,

8. Under what circumstances, if any, is an Investment Firm required to notify the regulators, or the market generally, of material changes in their financial position or ability to continue to carry on business? What is the nature of such required disclosures?

Where the capital-to-risk ratio falls below 140 percent, a Financial Instruments Business Operator should immediately notify the Commissioner of the Financial Services Agency to that effect, and shall prepare a written notification regarding the capital-to-risk ratio for each

business day and submit it to the Commissioner of Financial Services Agency or other competent official without delay. However, said report is not available to the public.

9. For an Investment Firm whose financial situation is seen to have deteriorated *(e.g.*, capital has fallen below certain thresholds), what actions, if any, may the firm's regulators take to protect Client Assets?

In cases where the net assets of a Financial Instruments Business Operator fall to less than 50 million yen, the Prime Minister may rescind said business operator's registration or authorization, or order suspension of all or part of its business by specifying a period not exceeding six months. In addition, in cases where the capital-to-risk ratio of a Financial Instruments Business Operator is less than 100 percent, if the Prime Minister finds it necessary and appropriate for the public interest or protection of investors, he/she may order the suspension of all or part of its business by specifying a period not exceeding three months, within the limit necessary. In cases where the Prime Minister has ordered the suspension of all or part of its business, if he/she finds that the capital-to-risk ratio of said Financial Instruments Business Operator on the day when three months have passed since the day of the order continues to be less than 100 percent and that the status of the capital-to-risk ratio of said Financial Instruments Business Operator is not likely to recover, he/she may rescind the registration of said Financial Instruments Business Operator.

Even when capital to risk ratio is 100% and more, we may order suspension of business and rescind registration if there is other rational purpose than solvency.

Post-Insolvency

10. Please describe the process by which an Investment Firm enters the status of "insolvent" or "bankrupt" or the equivalent. For example, is a petition filed by the firm's regulator or some other administrative agency, by creditors of the firm, or otherwise? Is a decree entered by a court? Is this process different from the process applicable to entities that are not Investment Firms?

The Japanese legislation for insolvency consists mainly of the Civil Rehabilitation Act, the Corporate Reorganization Act and the Bankruptcy Act. An insolvent firm (under certain conditions, creditors of the firm (or stockholders in the case of Corporate Reorganization Act)) can file a petition to a court for the use of insolvency legislation. After receiving the petition, the court starts proceedings for bankruptcy, rehabilitation or reorganization.

11. Please describe the process by which the Administrative Officer (as defined above), if any, is selected. What qualifications, if any, must an Administrative Officer have? Who selects the Administrative Officer?

The court selects the Administrative Officer for bankruptcy proceedings. There is no particular qualification for an Administrative Officer. An entity can become an Administrative Officer. (Lawyers are often selected as an Administrative Officer in practice.)

12. What are the duties of the Administrative Officer?

The Administrative Officer exercises his/her duty based on insolvency legislation.

a. What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?

The Administrative Officer exercises his/her duty based on insolvency legislation.

b. Under what standard (*e.g.*, strict liability, negligence), if any, is the Administrative Officer, pursuant to the Regime in your jurisdiction, subject to personal liability for failure to properly perform his or its duties?

The Administrative Officer exercises his/her duty based on insolvency legislation. Duty of due care of a prudent manner is applied to administrative officer. If he/she fails to exercise his/her duty, he/she will be liable for damage to interested person.

13. What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?

a. Does the regulator continue to supervise the Investment Firm?

b. How, if at all, is the regulator involved in the process of returning Client Assets?

When an application for commencement of bankruptcy proceedings, rehabilitation proceedings, or reorganization proceedings has been filed, a Financial Instruments Business Operator, etc. shall notify the Prime Minister to that effect without delay. (FIEA article 50.)

When the Prime Minister finds it necessary and appropriate for the public interest or protection of investors, he/she may order a Financial Instruments Business Operator to retain the portion of its assets which is equivalent to the amount of liability which should be reported to the liability section of the B/S of the firm (including the liability on guarantee) deducted by the liability to the non-residential person, or order related administrative

dispositions.(FIEA Article 51,56-3, Cabinet Order Article 17-2, Cabinet Office Ordinance for Financial Institutions Article 208.)

When a Financial Instruments Business Operator is at risk of becoming insolvent in light of its operation or the status of its property, the Prime Minister(*) may rescind its registration or authorization, or order suspension of all or part of its business by specifying a period not exceeding six months. (FIEA Article 56-2 (1), 52-1 (7))
In cases where a Financial Instruments Business Operator's capital-to-risk ratio is less than 100 percent, if the Prime Minister finds it necessary and appropriate for the public interest or protection of investors, he/she may order the suspension of all or part of its business. In addition, when the capital-to-risk ratio of said financial business operator continues to be less than 100 percent for three months since the day when such order was issued and when the status is not likely to recover, the Prime Minister may rescind the registration of said Financial Instruments Business Operator. In either case, when the registration is rescinded, a Financial Instruments Business Operator shall provide public notice to the effect that it has ceased to conduct financial instruments business, and shall immediately complete client transactions and return the property deposited by clients and the property he/she possesses on behalf of clients without delay. In this case, a person who was the Financial Instruments Business Operator shall be deemed to be a Financial Instruments Business Operator within the scope of the purpose of completing the client transactions. (FIEA Article 56)

(*) The JFSA. The Prime Minister delegate the authorities to the Commissioner of the JFSA.

14. Does the Regime in your jurisdiction facilitate or encourage the transfer of Client Assets from an Investment Firm which has become bankrupt or insolvent to a solvent Investment Firm?

Please refer to the previous article for the summary.
a. There is no specific rule in the FIEA. The insolvency legislation will cover the issue, so the necessary period depends on each issue.
b. There is no specific rule in the FIEA. The necessary period will be affected by the provisions of the insolvency legislation.

a. What steps, if any, are prerequisite to accomplishing such a transfer? In general, how long does it take to accomplish those steps?

b. What factors, if any, affect the time period required to accomplish such a transfer?

15. To what extent are clients at risk of, or protected from, having to return Client Assets (or the value thereof) that were distributed to the client prior to the insolvency proceeding?

The provisions of the FIEA require a Financial Instruments Business Operator to manage client assets separately from its own assets.

In the context of bankruptcy legislation, there is potential exercise of rights of avoidance by administrative officer, but this is out of scope of client assets.

16. To what extent, if at all, does the Regime in your jurisdiction provide compensation to clients from other sources (for example, an investor protection or similar fund) for loss of Client Assets? Please discuss the scope of protections, conditions on such protection, and the limits of compensation (*e.g.*, maximum compensation per client).

Please refer to the response to Question 1.

17. Are there circumstances in which clients are treated differently based on permissions they have granted pre-bankruptcy. *E.g.*, if any re-hypothecation has been entered into (or a 'right-to-use' exercised), please explain the client's position under the Insolvency Regime in such event.

As explained in Section 1, for the pre-insolvency framework, introducing a requirement for segregated custody is under consideration. The consideration includes securities lending. (Generally speaking, the bankruptcy proceedings differ between those involving secured claims and unsecured claims. Secured claims can receive payment in preference to unsecured claims.)
As described in the answer to Question 3 c., by obtaining a written consent from the client, a Financial Instruments Business Operator, etc. may furnish as security the securities possessed by him/her based on a client's account or securities deposited to him/her from a client or loaning such securities to another person, A client that has granted such consent is treated differently than a client that has not.

Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?

Assets held in another jurisdiction may be affected by the foreign insolvency legislation, so we can not anticipate such procedures as well as we can those in our jurisdiction.

18. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?

When a Financial Instruments Business Operator does not comply with the rules for protection of client assets (before insolvency, the rule will be the requirement for segregated custody) and if loss to clients occurs, the Financial Instrument Business Operator compensates clients for the loss. (Please refer to the response to Question 1 for details.)

19. If there is a shortfall, *i.e.*, if claims by clients exceed resources dedicated to paying such claims (whether from Client Assets, investor protection fund, or otherwise), how are Client Assets distributed? *E.g.*, is there a pro rata distribution of Client Assets, are there priorities between classes of clients, is there a priority distribution ahead of the distribution of the general estate/distribution to unsecured creditors?

As explained in the response to Question 1, compensation by financial instruments operators is strictly limited to 10 million yen. This 10 million yen compensation limit is in addition to the client's share of client assets.

20. Please explain how claims of clients are ranked in the insolvency process relative to those of other creditors. Does your insolvency regime rank domestic creditors above foreign creditors?

There is no ranking for payment by location of creditors. There is an institution that returns the assets to the clients without competing with other creditors as long as the assets are managed separately or are in a client-oriented money trust.

III. Pertinent references

Please provide, for any statutes, regulations, or other authorities or texts that are referred to in your response, electronic copies (in English translation, if available), or URL links to available copies. How might a person outside your jurisdiction most readily get access to such items? Are there treatises that would be useful for obtaining a general understanding of client asset protection in your jurisdiction?

Mexico

Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets

I. Background

This questionnaire seeks information to aid in understanding the responding jurisdictions' techniques for protecting Client Assets in the event of the insolvency and/or winding up of an Investment Firm, and for promptly transferring such assets to a solvent Investment Firm or distributing them to the client. It is not intended to require information concerning the general legal framework for insolvency, except to the limited extent necessary to understand how rules for the protection of Client Assets fit within that framework.

Definitions.

(1) **"Administrative Officer"** refers to the person or entity who is appointed, whether by a court, regulator, creditors, the Investment Firm itself, or otherwise, to assume control of or power over a bankrupt or insolvent Investment Firm. This term includes administrators, debtors in possession, receivers, liquidators, trustees, and similar titles.

(2) **"Client Assets"** refers collectively to Positions, Securities, and Client Money:

- "**Positions"** are contractual rights and obligations arising from transactions entered into by an investment firm on behalf of its clients, including mark to market accruals arising from the change in value of futures, options and/or other derivatives positions;

- "**Securities"** are defined to incorporate both securities and derivatives, as those terms are defined or understood in the responding jurisdiction; and

- "**Client Money"** refers to funds owed to or held on behalf of clients by an investment firm, and may include margin collateral associated with client positions (both existing and potential), income relating to an investment such as dividends or interest, proceeds of the liquidation of client securities and/or positions, and funds in excess of required margin.

(3) **"Investment Firm"** means an intermediary that holds Client Assets and is engaged in the business of managing client accounts, which could include, without limitation: executing orders on behalf of others, dealing in or distributing Securities (including carrying derivatives positions). In jurisdictions where banks are broadly permitted to engage in such a business, this term includes banks to the extent they are providing such services.

(4) **"Omnibus Account"** means an Investment Firm's account with a third party in which Client Assets are maintained separate from the firm's assets, but are held in the aggregate instead of in accounts designated for individual clients.

(5) **"Regime"** refers to statutes, regulations, rules of exchanges, clearing organizations and other self-regulatory bodies, or other legally binding requirements.

II. Survey Questions *Where appropriate, please provide citations to statutes, regulations, or other authorities supporting your answers below.*

Context

1. Please provide a brief overview setting forth the defining characteristics of your jurisdiction's approach to protecting Client Assets.

Mexico doesn't have a specific protection scheme or protection fund for Investment firms (Casas de Bolsa), but it has been implemented a very strict regulation to separate, safeguarded and properly accounted client assets, and in case of insolvency financial authorities encourage transferring client assets to another investment firm. The regulation has incorporated almost all international standards such as: accounting principles, capital, risk management, internal controls, external auditors, anti-money laundry procedures, liquidity, ordering assignment in capital markets, DEA regulation, etc. With the recent sub-prime crisis arose some misleading selling practices and suitability as consequence we are working on improving this regulation.

The regulatory entity in charge of the supervision, regulation, intervention, suspension and liquidation of investment Firms is the National Banking and Securities Commission.

For Banks exists a complete protection scheme for deposits through regulated by special entity calls Instituto de Protección al Ahorro Bancario (IPAB).

In answering the remaining questions:

(1) Please provide details, as appropriate, where the Regime in your jurisdiction applies different treatment or results based on differences in:

a. Categories of Client Assets;

b. Models of trading (e.g., exchange-traded versus over-the-counter).

*c. Categories of clients (*e.g., *retail versus sophisticated)*

(2) You are requested to provide details of the Regime in your jurisdiction. You are additionally invited to provide information explaining how that Regime is applied in practice, through, e.g., *informal arrangements between governmental entities.*

Pre-Insolvency

2. Does the regime in your jurisdiction require an Investment Firm to hold special authorization (*i.e.*, a specific form of license or registration) to be permitted to hold Client Assets?

Yes

a. If special authorization is required, what requirements (both initial and ongoing) is an Investment Firm required to comply with to hold such authorization?

In order to organize and operate Investment Firm requires authorization of the National Banking and Securities Commission (in ahead Commission). By their nature, these authorizations will be untransferable and they will not imply certification on the solvency of the entity.

The requirements that an Investment Firm required to comply are, among other:

Shareholder list
Status project
Shareholders information, Board of Members and executive positions.
Coherent lines of responsibility
Business Plan
Audit Committee
Manuals
Guidelines and procedures to perform all its activities
Minimum capital stock fully paid
Risk management and risk unit
Internal control procedures
IT systems, security and control
Protection of client assets

b. If special authorization is not required, how, if at all, is this activity supervised by a regulator?

Always is required an authorization

3. Does the Regime in your jurisdiction require that Client Assets be maintained separately from the assets of an Investment Firm? If so, please provide a description of the process by which segregation is accomplished, and of the applicable requirements. Specifically:

Yes, client assets must be maintained completely separated from other clients or investment firms assets

a. Must the Client Assets of one client be maintained separately from those of other clients?

Yes, the client assets must be perfectly separated and identified client by client with all the information requested by law and regulation.

i. Are Investment Firms allowed to hold Omnibus Accounts?

Yes, in Mexico permits global accounts or Omnibus accounts, which are managed by: investment firms (broker dealers), banks, foreign entities and mutual funds, where it registers transactions of different clients following their instructions individually and anonymous.

ii. What measures are used to protect the Client Assets of each client from losses due to the activities of other clients?

The client assets are managed separately; in non circumstances allow covering transactions or margins with other client assets.

b. Please describe any requirement that an Investment Firm must reconcile the Client Asset account. For example:

The broker dealers have to reconcile assets for each client showing all assets and liabilities, income, expense, and capital accounts. Then the amount of assets to be held reflects exactly the same amount assets deposited with the investment firm

i. How do you calculate the amount of Client Assets that a firm is required to hold in one or more accounts segregated for the benefit of clients?

All client assets are segregated in a depositary institution or clearinghouse; each position is valuated applying a price vector which is provided by authorized independent entity

A) Are required Client Assets fungible between or within asset classes, or is the Investment Firm required to hold, *e.g.*, the specific assets deposited by the client?

Cash is fungible; securities are not in general, only with the exception when they incorporate exactly the same rights, terms and conditions and they can substitute among each others.

B) How is the reconciliation conducted (*e.g.*, on an aggregate basis, or a client-by-client basis)?

Client by client and then on an aggregate basis for each asset class, afterwards segregated in local, foreign and proprietary positions. In other words is done on an aggregate basis, but securities firm needs to keep records reflecting the positions of each client.

C) If a client has a debit balance (*i.e.*, the client owes the Investment Firm), is such balance deducted in determining the amount the Investment Firm is required to hold?

Only with cash. Exists a netting process between debit and credit money balance, if after process keeps a debit process, it remains till account has enough credit cash to deduct.

ii Timing issues:

A) How often is reconciliation required (*e.g.*, daily, weekly, monthly).

Daily basis

B) When is such reconciliation required (*e.g.*, noon of the following business day, the tenth business day of the following month).

The reconciliation takes place on line, because markets and systems count with this function. Nonetheless could be done next business day.

C) Is the Investment Firm required to make good any deficiency from their own funds? If so, in what period? Is any payment by the Investment Firm thereby deemed to be Client Money?

There are two alternatives:

Securities firm can make good any deficiency from its own funds with respect to client orders or instructions. Afterwards charges administrative and financial costs to clients.

Securities firm can default to markets due to client's deficit either resources or securities, then firm has to assume different costs impose by depositary institution or compensation entity, transferring all these costs to client account. In general this alternative hasn't been used.

iii. Is an Investment Firm permitted or encouraged to maintain any of their own assets in a Client Asset account (*e.g.*, as a "buffer")? If so, are any such assets so transferred then deemed to be Client Assets? Is there a requirement to remove any excess assets?

Not allowed, isn't recommended

c. Can the Investment Firm use Client Assets of one client for meeting obligations of another client? If so, how?

Not allowed by Law

d. Are there any restrictions on the ability of the Investment Firm (or other party holding Client Assets) to invest, encumber, rehypothecate, stock-lend, or otherwise deal with, the Client Assets? If so, please describe.

The only way to apply is through specific client authorization or due to court order. The restrictions can be written in the contract between intermediary and client.

e. What are the requirements, if any, for clearinghouses or other central counterparties to maintain the separate identification of collateral posted by the Investment Firm for its Client Positions?

There's no imposition to clearinghouses or central counterparties to separate client collaterals.

4. Are Investment Firms permitted to transfer to, or hold Client Assets in, another jurisdiction? If so, does the Regime in your jurisdiction require Investment Firms to preserve the separate identification of:

Yes, is allowed either transfer or hold client assets in another jurisdictions.

a. Client Assets transferred to or located in other jurisdictions?

The requirement to allocate client in other jurisdictions only if exists a sub-custody contract

b. Client Assets that have been transferred to the Investment Firm from other jurisdictions and that have been identified as Client Assets in those jurisdictions?

If so, please provide details of those requirements.

5. If the Regime in your jurisdiction permits or requires Client Assets to be held by third party custodians:

Third party custodians are permitted; they have to be either commercial banks or investment firm to act as custodian locally, then they need to establish an agreement with a depositary institution. For foreign transactions custodians should be financial intermediaries registered or licensed in their respective jurisdictions.

a. Please describe the requirements, if any, concerning the qualifications of such custodians e.g., licensing, creditworthiness. May the Client Assets be kept with an affiliate of the Investment Firm?

Once licensing is approved the entity present a general process related with services (custody) that will be provided, internal controls and IT infrastructure.

In order to organize and operates as depositary institution is necessary Federal Government authorization, which will be provided by Ministry of Finance and the opinion of National Banking and Securities Commission (CNBV)

The depositary institution's orders can be done by Central Bank, Investment firms, commercial banks, pension funds, mutual funds, insurance and bonding companies, financial groups, stock exchanges, clearinghouses (central counterpart).

b. Please describe any requirements concerning the custody agreement between intermediary and custodian. In particular, may the custodian be permitted to place a lien, charge or other encumbrance on Client Assets? If so, please explain.

There is no specific requirement by regulation only a contractual basis

6. Under what circumstances, if any, is an Investment Firm required to disclose to clients information related to the protection of the client's assets? What is the nature of such required disclosures? How do any such required disclosures apply to Client Assets held in another jurisdiction?

Investment Firms are required to inform to clients compensation schemes, product risk, financial information if is available, account statement in a monthly basis showing security positions or through internet in a daily basis (when this service is offered by the firm), terms and conditions of the services. We don't have specific requirements for assets held in another jurisdiction.

7. Under what conditions, if any, may clients choose to waive any of the Client Asset protection requirements applicable in your jurisdiction (also known as "opting out")? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

There is no option to do it. In Mexico doesn't count with a protection scheme for investment firms. On the contrary for banks there is a deposits protection scheme through an institution calls IPAB.

8. Under what circumstances, if any, is an Investment Firm required to notify the regulators, or the market generally, of material changes in their financial position or ability to continue to carry on business? What is the nature of such required disclosures?

In a periodical basis depend upon information, it can be in a daily, weekly, monthly or quarterly basis to relevant authorities.

In the case that investment firm is listed in the stock exchange (Bolsa Mexicana de Valores), has to comply with all requirements for issuers related with disclosure information with relevant events.

All investment firms are subject to prompt corrective actions where in specific capital level (100%) or ability carry on business must notify to CNBV and follow different corrective measures and present for its approval a recovering plan.

9. For an Investment Firm whose financial situation is seen to have deteriorated *(e.g.*¸ capital has fallen below certain thresholds), what actions, if any, may the firm's regulators take to protect Client Assets?

There is a very completely prompt corrective actions scheme. The scheme has established 4 categories:

Category 1, requirement capital ratio <= 80%
Category 2, requirement capital ratio > 80% but <= 100%
Category 3, requirement capital ratio >100% and <= 120%
Category 4, requirement capital ratio > 120%

Depend on the category the CNBV has established different preventive and corrective measures. In preventive measures here are the important ones:

- To abstain to celebrate operations whose accomplishment generates that its index of capital consumption is located by above of the 100%.
- To suspend the payment of dividends to the shareholders, as well as any mechanism or act that imply transference of patrimonial benefits.
- To suspend the programs of acquisition of representative investment firm's shares.
- To defer the payment from interests and, in case of considering it necessary, of calling off the payment of principal or call to conversion of subordinated debentures.
- To both suspend to the payment of the compensations or extraordinary bonuses to CEO and second hierarchy
- To grant additional loans to credit related lending.

Post-Insolvency

10. Please describe the process by which an Investment Firm enters the status of "insolvent" or "bankrupt" or the equivalent. For example, is a petition filed by the firm's regulator or some other administrative agency, by creditors of the firm, or otherwise? Is a decree entered by a court? Is this process different from the process applicable to entities that are not Investment Firms?

There are 15 cases where authorities can ask a revocation of the license some are related with firm's insolvency and bankruptcy. Also the CNBV has chance to enter in an intervention process when stability, solvency or liquidity put at risk client assets or creditors.

The petition for bankruptcy can be filed by firm's regulator, creditors of the firms, shareholders and investment firm have the rights to ask a declaration of insolvency, but in all of these cases the petition is filed only by Ministry of Finance.

11. Please describe the process by which the Administrative Officer (as defined above), if any, is selected. What qualifications, if any, must an Administrative Officer have? Who selects the Administrative Officer?

There might be different steps before going into liquidation or dilution and then revocation of the entity.

The possibilities are:

a) Activities suspension for irregularities detected by CNBV

b) Administrative Intervention due to also irregularities detected which can put at risk (sustainability, solvency and liquidity). Administrative Inspector is assigned with duties and functions established by law, the Investment firm will be managed by him, solve irregularities and take any action in the interest of the clients.

c) Bankruptcy is presented by Ministry of Finance, an administrative officer also is assigned by it

Once some these possibilities take place and irregularities haven't been solved the liquidation of the entity is the next step. The administrative officer can be selected either by shareholders or Ministry of Finance.

The administrative officer can be either a commercial bank or an investment firm or SAE (government agency for liquidating companies or selling assets) or individual or companies with experience in liquidation financial entities.

If is elected a person, is necessary to comply with some requirements established by law such as experience, credit worthiness, etc.

12. What are the duties of the Administrative Officer?

a. What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?

The guidance that the Administrative Officer is as follows:

a) Elaborate an integral report of financial situation of the Firm. Depend upon the outcome, he can call a bankruptcy.

b) Present to Ministry of Finance all the procedures in place to transfer all the client assets (securities) and cash and a timeframe to do it.

c) Adopt a working plan which contains measures and procedures to liquidate or transfer liabilities or client assets to another investment or commercial bank as maximum one year later he took the position as an Administrative Officer.

d) Receive assets pending and pay liabilities. The Administrative Officer must separate and perform delivery or transfer of client assets or client cash.

e) Call to shareholders' assembly for the conclusion of his duties and present a liquidation process report for their approval.

f) In case of not getting shareholders approval of previous point request to the court.

g) Exercise legal actions in order to determine economic responsibilities and delimitate responsibilities.

h) Absent to buy for him or others properties belong to investment firm

In summary he has to liquidate in orderly manner firm's assets and reimburse as much as he can, creditors rights.

b. Under what standard (*e.g.*, strict liability, negligence), if any, is the Administrative Officer, pursuant to the Regime in your jurisdiction, subject to personal liability for failure to properly perform his or its duties?

The Administrative Officer and Administrative inspector is completely subject to personal liability for failure to properly perform his or its duties by Securities and Banking Law.

13. What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?

a. Does the regulator continue to supervise the Investment Firm?

Yes, but in specific issues either liquidation or Bankruptcy. Nonetheless the CNBV has the right to revoke the license of the investment firm when this procedures start.

b. How, if at all, is the regulator involved in the process of returning Client Assets?

Intervention Process

The administrative inspector reports all the time to CNBV but he has all legal powers in its ample sense.

Bankruptcy process

The Commission is involved exclusively in transferring or delivering either assets or cash to clients and the timetable established by Administrative Officer and judge approval once he listen Ministry of Finance's opinion.

Liquidation process

The Commission is involved in transferring or delivering either assets or cash to client and the timetable to consider and applicable sanctions. See answer 12, d).

14. Does the Regime in your jurisdiction facilitate or encourage the transfer of Client Assets from an Investment Firm which has become bankrupt or insolvent to a solvent Investment Firm?

    a. What steps, if any, are prerequisite to accomplishing such a transfer? In general, how long does it take to accomplish those steps?

The financial authorities either facilitate or encourage the transferring

In liquidation is one year since the Administrative Officer take his position. In bankruptcy there's no time but Commission ask mention in the previous questions need to check timetable.

    b. What factors, if any, affect the time period required to accomplish such a transfer?

If assets aren't enough to return to clients

15. To what extent are clients at risk of, or protected from, having to return Client Assets (or the value thereof) that were distributed to the client prior to the insolvency proceeding?

The clients are protected only because they go first in line with all the creditors as often as they have documents to show position of their investments.

16. To what extent, if at all, does the Regime in your jurisdiction provide compensation to clients from other sources (for example, an investor protection or similar fund) for loss of Client Assets? Please discuss the scope of protections, conditions on such protection, and the limits of compensation (*e.g.*, maximum compensation per client).

In Mexico there is no protection fund.

17. Are there circumstances in which clients are treated differently based on permissions they have granted pre-bankruptcy. *E.g.*, if any re-hypothecation has been entered into (or a 'right-to-use' exercised), please explain the client's position under the Insolvency Regime in such event.

There are not

18. Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?

No circumstances

19. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?

The only protection exists is that they go first, but in case of deficit the Administrative Officer can call a bankruptcy procedure.

20. If there is a shortfall, *i.e.*, if claims by clients exceed resources dedicated to paying such claims (whether from Client Assets, investor protection fund, or otherwise), how are Client Assets distributed? *E.g.*, is there a pro rata distribution of Client Assets, are there priorities between classes of clients, is there a priority distribution ahead of the distribution of the general estate/distribution to unsecured creditors?

As mention in previous question Administrative Office can call a bankruptcy procedure. There is a priority to clients and then unsecured or subordinate creditors.

21. Please explain how claims of clients are ranked in the insolvency process relative to those of other creditors. Does your insolvency regime rank domestic creditors above foreign creditors?

See answer 20. There are no distinctions among foreign or domestic creditors.

III. Pertinent references

Please provide, for any statutes, regulations, or other authorities or texts that are referred to in your response, electronic copies (in English translation, if available), or URL links to available copies. How might a person outside your jurisdiction most readily get access to such items? Are there treatises that would be useful for obtaining a general understanding of client asset protection in your jurisdiction?

Singapore

Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets

I. Background

This questionnaire seeks information to aid in understanding the responding jurisdictions' techniques for protecting Client Assets in the event of the insolvency and/or winding up of an Investment Firm, and for promptly transferring such assets to a solvent Investment Firm or distributing them to the client. It is not intended to require information concerning the general legal framework for insolvency, except to the limited extent necessary to understand how rules for the protection of Client Assets fit within that framework.

Definitions.

(1) **"Administrative Officer"** refers to the person or entity who is appointed, whether by a court, regulator, creditors, the Investment Firm itself, or otherwise, to assume control of or power over a bankrupt or insolvent Investment Firm. This term includes administrators, debtors in possession, receivers, liquidators, trustees, and similar titles.

(2) **"Client Assets"** refers collectively to Positions, Securities, and Client Money:

- "**Positions"** are contractual rights and obligations arising from transactions entered into by an investment firm on behalf of its clients, including mark to market accruals arising from the change in value of futures, options and/or other derivatives positions;

- "**Securities"** are defined to incorporate both securities and derivatives, as those terms are defined or understood in the responding jurisdiction; and

- "**Client Money"** refers to funds owed to or held on behalf of clients by an investment firm, and may include margin collateral associated with client positions (both existing and potential), income relating to an investment such as dividends or interest, proceeds of the liquidation of client securities and/or positions, and funds in excess of required margin.

(3) **"Investment Firm"** means an intermediary that holds Client Assets and is engaged in the business of managing client accounts, which could include, without limitation: executing orders on behalf of others, dealing in or distributing Securities (including carrying derivatives positions). In jurisdictions where banks are broadly permitted to engage in such a business, this term includes banks to the extent they are providing such services.

(4) **"Omnibus Account"** means an Investment Firm's account with a third party in which Client Assets are maintained separate from the firm's assets, but are held in the aggregate instead of in accounts designated for individual clients.

(5) **"Regime"** refers to statutes, regulations, rules of exchanges, clearing organizations and other self-regulatory bodies, or other legally binding requirements.

II. Survey Questions *Where appropriate, please provide citations to statutes, regulations, or other authorities supporting your answers below.*

Context

1. Please provide a brief overview setting forth the defining characteristics of your jurisdiction's approach to protecting Client Assets.

The rules and regulations on Client Assets are detailed in the Singapore Securities and Futures Act (Cap. 289) ["SFA"] and Singapore Securities and Futures (Licensing and Conduct of Business) Regulations (Rg. 10) ["SFR"].

Under the Singapore SFA, Investment Firms conducting regulated activities are required to deposit client moneys and assets into a trust or custody account maintained with specified financial institutions in Singapore. The regulated activities under the Singapore SFA include dealing in securities, trading in futures contracts, fund management and providing custodial services for securities ["Regulated Activities"]. Please refer to response below for details.

Under the SFR, client assets refer to securities and assets (other than money), that are beneficially owned by a customer of the Investment Firm. Client money refers to money received from, or on account of the customer in respect of the Regulated Activities or in the course of business of the Investment Firm, but does not include

- money which is to be used to reduce the amount owed by the customer to the Investment Firm;
- money which is to be paid to the customer or in accordance with the customer's written direction;
- money which is to be used to defray the Investment Firm's brokerage and other proper charges; and
- money which is to be paid to any other person entitled to the money.

In answering the remaining questions:

(1) Please provide details, as appropriate, where the Regime in your jurisdiction applies different treatment or results based on differences in:

a. Categories of Client Assets;

b. Models of trading (e.g., exchange-traded versus over-the-counter).

*c. Categories of clients (*e.g., *retail versus sophisticated)*

In general, client moneys and assets are required to be deposited into trust or custody accounts maintained with specified financial institutions in Singapore.

(2) *You are requested to provide details of the Regime in your jurisdiction. You are additionally invited to provide information explaining how that Regime is applied in practice, through,* e.g., *informal arrangements between governmental entities.*

Pre-Insolvency

2. Does the regime in your jurisdiction require an Investment Firm to hold special authorization (i.e., a specific form of license or registration) to be permitted to hold Client Assets?

   a. If special authorization is required, what requirements (both initial and ongoing) is an Investment Firm required to comply with to hold such authorization?

An Investment Firm which conducts Regulated Activities is required to hold a capital markets services ["CMS"] licence under the Singapore SFA. In assessing an application for a CMS licence, the Monetary Authority of Singapore ["MAS"] takes into consideration, inter alia, the following factors:

a) track record, management expertise and financial soundness of the applicant;
b) ability to meet the minimum financial requirements prescribed under the Singapore SFA;
c) internal compliance systems;
d) business plans and projections; and
e) fitness and propriety of the applicant.

Upon the grant of the CMS licence, the CMS licensee is required to comply with the requirements prescribed in the Singapore SFA and the SFR, including minimum financial and business conduct requirements.

Client Moneys

In particular, the CMS licensee is required to deposit client moneys into a trust account maintained with a specified financial institution, namely a bank, merchant bank or finance company licensed in Singapore. The CMS licensee is required to obtain an acknowledgement from the specified financial institution that:

- the moneys in the trust account are held on trust by the CMS licensee for its clients and the specified financial institution cannot exercise any right of set-off against moneys owed by the CMS licensee to the specified financial institution; and
- the account is designated as a trust account or customer's or customers' account, which must be distinguished and maintained separately from any other account in which the CMS licensee deposits its own moneys.

Client Assets

The CMS licensee shall deposit the client assets in a custody account maintained a specified financial institution or with any of the following institutions:

- a depository agent, only in relation to securities deposited into the Singapore Central Depository system;

- an approved trustee for a collective investment scheme in respect of assets under the collective investment scheme; or
- a firm holding a CMS licence to provide custodial services for securities.

Subject to the client's prior written consent, the CMS licensee may deposit moneys or assets received on account of its client which are denominated in a foreign currency in a trust or custody account maintained with a custodian outside Singapore. Nevertheless, such a custodian must be licensed to conduct banking business or to act as custodian in the country where the account is maintained.

b. If special authorization is not required, how, if at all, is this activity supervised by a regulator?

Please refer to the response to Q2(a) on the licensing requirements.

3. Does the Regime in your jurisdiction require that Client Assets be maintained separately from the assets of an Investment Firm? If so, please provide a description of the process by which segregation is accomplished, and of the applicable requirements. Specifically:

Yes, segregation is required. Please refer to the response to Q2(a) above for the applicable requirements.

a. Must the Client Assets of one client be maintained separately from those of other clients?

i. Are Investment Firms allowed to hold Omnibus Accounts?

Yes, moneys and assets received by the Investment Firm on account of its customers may be commingled and deposited in the same trust or custody account.

ii. What measures are used to protect the Client Assets of each client from losses due to the activities of other clients?

The Investment Firm is not permitted to use the moneys received on account of a particular client in the trust account as margin or guarantee for, or to secure any transaction of, or to extend the credit of, any person other than that client.

Withdrawal of moneys/assets from a client's trust/custody account is only permitted for specific purposes (such as making payment to meet the client's obligation, making a payment to any other person or account in accordance with the written direction of the client etc).

The Investment Firm is also required to maintain records of the client's interest in the moneys and assets that have been commingled.

b. Please describe any requirement that an Investment Firm must reconcile the Client Asset account. For example:

i. How do you calculate the amount of Client Assets that a firm is required to hold in one or more accounts segregated for the benefit of clients?

A) Are required Client Assets fungible between or within asset classes, or is the Investment Firm required to hold, *e.g.*, the specific assets deposited by the client?

Please refer to Q3(a) above for details on the requirements.

B) How is the reconciliation conducted (*e.g.*¸ on an aggregate basis, or a client-by-client basis)?

Reconciliation is conducted on an aggregate basis.

C) If a client has a debit balance (*i.e.*, the client owes the Investment Firm), is such balance deducted in determining the amount the Investment Firm is required to hold?

Withdrawal of moneys/assets from a client's trust/custody account is permitted only for specific purposes. In particular, the Investment Firm is allowed to withdraw money from a client's trust account for the purpose of defraying its brokerage and other proper charges.

ii Timing issues:

A) How often is reconciliation required (*e.g.*, daily, weekly, monthly).

Daily computation of the client moneys and assets maintained in trust and custody accounts is required of a CMS licensee conducting regulated activities in respect of trading in futures contracts and in respect of leveraged foreign exchange trading.

B) When is such reconciliation required (*e.g.*, noon of the following business day, the tenth business day of the following month).

The computation referred to in Q3(b)(ii)(A) above should be completed before noon of the next business day and such computation with all supporting data shall be kept by the CMS licensee for 5 years under the Singapore SFA.

C) Is the Investment Firm required to make good any deficiency from their own funds? If so, in what period? Is any payment by the Investment Firm thereby deemed to be Client Money?

The Investment Firm may pay an advance of its own funds ["Advance"] into the client's trust account to prevent the trust account

from being under-margined or under-funded or to ensure the continued maintenance of that trust account.

The Investment Firm may reimburse itself of the Advance and interest/returns arising from such moneys as long as this reimbursement does not result in the account being under-margined or under-funded.

iii. Is an Investment Firm permitted or encouraged to maintain any of their own assets in a Client Asset account (*e.g.*, as a "buffer")? If so, are any such assets so transferred then deemed to be Client Assets? Is there a requirement to remove any excess assets?

Please see Q3(b)(ii)(C) above.

c. Can the Investment Firm use Client Assets of one client for meeting obligations of another client? If so, how?

The Investment Firm is not permitted to use the moneys received on account of a particular client in the trust account as margin or guarantee for, or to secure any transaction of, or to extend the credit of, any person other than that client.

However, where the moneys are held in an Omnibus trust account, the Investment Firm may withdraw any money from the Omnibus trust account for the purpose of making a payment to meet an obligation of a client whose money is deposited in that Omnibus trust account, being an obligation that arises from any dealing in securities, trading in futures contracts, or leveraged foreign exchange trading, by the CMS licensee for the client.

d. Are there any restrictions on the ability of the Investment Firm (or other party holding Client Assets) to invest, encumber, rehypothecate, stock-lend, or otherwise deal with, the Client Assets? If so, please describe.

The Investment Firm may only deal with the client moneys and assets as provided under regulations 20, 21, 31, 32, 33, 34 and 35 of the Singapore SFR. A summary is as follows:

<u>1) Investment of moneys received on account of clients:</u>
The Investment Firm may invest moneys received on account of its clients in any Government securities; any debt instrument of the government of the country of the securities/futures market or securities/futures exchange on which the CMS licensee normally transacts its business; or any other securities/instrument as MAS may determine. The CMS licensee shall keep proper record of such transactions.

<u>2) Withdrawal of client assets from trust/custody account:</u>

Withdrawal of client's moneys and assets from a trust or custody account is restricted to the specified purposes as provided under the Singapore SRR.

Examples include making a payment to any other person or account in accordance with the written direction of the client and defraying CMS licensee's brokerage and other proper charges.

3) Lending of client securities:

The Investment firm which lends out securities belonging to a client or arrange for a custodian to lend out securities belonging to a client must explain the risks involved to the client (unless the client is an accredited investor), and obtain the client's written consent The Investment Firm must also enter into an agreement with the client, setting out the terms and conditions for the lending of the securities and disclose such terms and conditions to the client.

Additionally, in respect of any securities lent, the Investment Firm must obtain from the borrower collateral which must have a value of not less than 100% of the market value of the securities lent, unless the client is an accredited investor and the securities are lent to persons who are accredited investors.

4) Mortgage of client assets

The Investment Firm may mortgage, charge, pledge or hypothecate client assets together if and only if the sum of the claims to which these client assets are subject as a result of such mortgage, charge, pledge or hypothecation does not exceed the aggregate amounts owed by the clients to the CMS licensee; and the claim to which each client's assets are subject as a result of such mortgage, charge, pledge or hypothecation does not exceed the amount owed by the client to the CMS licensee.

In addition to the above, the Investment Firm has to abide by the terms and conditions in the client agreement and custody agreement.

e. What are the requirements, if any, for clearinghouses or other central counterparties to maintain the separate identification of collateral posted by the Investment Firm for its Client Positions?

Under section 62 of the SFA, where the Investment Firm has notified the designated clearing house that the moneys or assets are deposited or paid for or in relation to a contract of a client of the member, the designated clearing house shall:

(i) ensure that such moneys/assets are deposited in a trust/custody account to be held for the benefit of clients of the member and disposed of or used only in relation to contracts of clients of the member;

(ii) ensure that such moneys/assets are kept separate from all moneys/assets received by the designated clearing house which are not deposited or paid for or in relation to contracts of clients of those members;

(iii) keep books for moneys/assets deposited in relation to the contracts of clients of one firm separate from the books for moneys/assets deposited in relation to contracts of clients of another firm.

4. Are Investment Firms permitted to transfer to, or hold Client Assets in, another jurisdiction? If so, does the Regime in your jurisdiction require Investment Firms to preserve the separate identification of:

The Investment Firm is permitted to do so with the client's prior consent, in respect of the client's moneys and assets denominated in a foreign currency. The foreign custodian must be licensed to conduct banking business or, in the case of the client's assets, to act as a custodian, in the country where the account is maintained.

a. Client Assets transferred to or located in other jurisdictions?

b. Client Assets that have been transferred to the Investment Firm from other jurisdictions and that have been identified as Client Assets in those jurisdictions?

If so, please provide details of those requirements.

The same requirements as for clients assets maintained in Singapore apply.

5. If the Regime in your jurisdiction permits or requires Client Assets to be held by third party custodians:

a. Please describe the requirements, if any, concerning the qualifications of such custodians e.g., licensing, creditworthiness. May the Client Assets be kept with an affiliate of the Investment Firm?

Please refer to the response for Q2(a) above. Client moneys and assets may be kept with an affiliate of the Investment Firm if the affiliate is itself a specified financial institution.

b. Please describe any requirements concerning the custody agreement between intermediary and custodian. In particular, may the custodian be permitted to place a lien, charge or other encumbrance on Client Assets? If so, please explain.

Before placing its client's assets in a custody account with a custodian, the Investment Firm has to agree with the custodian, in writing certain terms and conditions, including that the account being designated as that of the client or clients; the custodian shall hold and record the assets in accordance with the Investment Firm's instructions; the records shall identify the assets as belonging to the client of the Investment Firm and the assets shall be kept separate from any asset belonging to the Investment Firm or to the custodian.

The custodian shall not claim any lien, right of retention or sale over any asset standing to the credit of the custody account, except —

(i) where the CMS licensee has obtained the client's written consent and notified the custodian in writing of the written consent; or

(ii) in respect of any charges as agreed upon in relation to the administration or custody of the assets.

6. Under what circumstances, if any, is an Investment Firm required to disclose to clients information related to the protection of the client's assets? What is the nature of such required disclosures? How do any such required disclosures apply to Client Assets held in another jurisdiction?

The Investment Firm which provides custodial services to its clients is required to notify the clients of the terms and conditions in respect of the custodial services.

The Investment Firm which assists its clients to deposit their assets with another custodian is required to disclose to its clients the terms and conditions agreed with the custodian before depositing the clients' assets in a custody account.

7. Under what conditions, if any, may clients choose to waive any of the Client Asset protection requirements applicable in your jurisdiction (also known as "opting out")? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

The Singapore SFR does not cater for any situation or condition under which clients may choose to waive the requirements.

8. Under what circumstances, if any, is an Investment Firm required to notify the regulators, or the market generally, of material changes in their financial position or ability to continue to carry on business? What is the nature of such required disclosures?

Under the Singapore Securities and Futures (Financial And Margin Requirements For Holders Of Capital Markets Services Licences) Regulations (Rg 13) ["SF(FMR)R"], a CMS licensee must notify MAS and the approved exchange or designated clearing house of which the CMS licensee is a member when its
(i) base capital falls below the base capital requirement; or
(ii) financial resources fall below the total risk requirements or 120% of total risk requirements.

The CMS licensee is also required to immediately inform MAS of any matter which may adversely affect its financial position to a material extent.

9. For an Investment Firm whose financial situation is seen to have deteriorated (e.g., capital has fallen below certain thresholds), what actions, if any, may the firm's regulators take to protect Client Assets?

For the scenarios under the Singapore SF(FMR)R mentioned in Q8, MAS may direct the CMS licensee to, inter-alia, transfer all or part of any client's positions, securities margins, collateral, assets and accounts to another CMS licensee(s); operate its business in such manner and on such conditions as MAS may impose; or to cease carrying on all or part of its business.

Post-Insolvency

10. Please describe the process by which an Investment Firm enters the status of "insolvent" or "bankrupt" or the equivalent. For example, is a petition filed by the firm's regulator or some other administrative agency, by creditors of the firm, or otherwise? Is a decree entered by a court? Is this process different from the process applicable to entities that are not Investment Firms?

The provisions of the Singapore Companies Act (Cap. 50) are base-line requirements which apply to all companies in Singapore, including CMS licensees (such as brokers and fund managers). Our responses below focus on the requirements under the Singapore Companies Act. Liquidation and judicial management of a CMS licensee is governed by the Singapore Companies Act.

A company that is unable to pay its debts can be wound up by the Singapore Courts.

The petition for judicial management of a company can be filed by the company or its creditors. The judicial manager attempts to rehabilitate the company or preserve all or part of its business of the company, if this better serves the interests of the creditors.

A petition for liquidation of the company can be filed by the company, its creditors or the company's judicial manager.

11. Please describe the process by which the Administrative Officer (as defined above), if any, is selected. What qualifications, if any, must an Administrative Officer have? Who selects the Administrative Officer?

Judicial management:

Where the company or its creditors consider that the company is or will be unable to pay its debts, and there is a reasonable probability of rehabilitating the company; or of preserving all or part of its business as a going concern; or that otherwise the interests of creditors would be better served than by resorting to a winding up, an application may be made to the Singapore Court for an order that the company should be placed under the judicial management of a judicial manager.

In any application for a judicial management order, the applicant shall nominate a public accountant, who is not the auditor of the company, to act as its judicial manager. The Court may reject the nomination of the applicant and appoint another person in his stead. The Minister in charge of the Singapore Companies Act may himself nominate a person to act as a judicial manager if he considers that the public interest so requires and in such a case the minister may be heard in support of his nomination and for this purpose be represented. Where a person is appointed by the Court or nominated by the Minister to act as a judicial manager that person need not be a public accountant.

Winding up:

For a members' voluntary winding up filed by the company, where the company is able to pay off all its debts in full within 12 months, the members of the company may have the option to appoint its own liquidator.

For a creditors' voluntary winding up filed by the company, the company will appoint a liquidator subject to the preference of the company's creditors at a meeting of the company's creditors.

Any person who does not fall within a class of persons declared by the Minister in charge of the Singapore Companies Act to be approved liquidators for the purposes of the Act, may apply to the Minister to be approved as a liquidator for the purposes of the Act. The Minister, if satisfied as to the experience and capacity of the applicant, may approve such person as a liquidator for the purposes of the Act.

If no liquidator is appointed, the Official Receiver ["OR"] shall summon separate meetings of the creditors and contributories of the company for the purpose of determining whether or not an application is to be made to the Singapore Court for appointing a liquidator in the place of the OR. The Court may make any appointment of an approved liquidator to be the liquidator of the company; in a case where a liquidator is not appointed by the Singapore Court, the OR shall be the liquidator of the company. The OR has control of all liquidators (such as those appointed by the members or creditors in voluntary winding up) and is the default liquidator of a company when no other liquidators have been proposed in a voluntary winding up.

12. What are the duties of the Administrative Officer?

a. What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?

Judicial management:

The judicial manager of a company shall do all such things as may be necessary for the management of the affairs, business and property of the company; and shall do all such other things as the Singapore Court may order. He is also required to submit a statement of proposals on the management of the company within 60 days of the judicial management order.

Winding up:

The liquidator shall use his discretion in the management of the affairs and property of the company and the distribution of its assets. The powers and duties of the liquidator are expressly provided in the Singapore Companies Act. The liquidator may appoint a solicitor to assist him in his duties and may apply to the Court for directions in relation to any particular matter arising under the winding up.

b. Under what standard (*e.g.*, strict liability, negligence), if any, is the Administrative Officer, pursuant to the Regime in your jurisdiction, subject to personal liability for failure to properly perform his or its duties?

Judicial management:
At any time when a judicial management order is in force, a creditor or member of the company may apply to the Singapore Court for an order on the ground that the company's affairs, business and property are being or have been managed by the judicial manager in a manner which is or was unfairly prejudicial to the interests of its creditors or members generally or specifically; or that any actual or proposed act or omission of the judicial manager is or would be so prejudicial.

On an application for such order, the Singapore Court may make such order as it thinks fit for giving relief in respect of the matters complained of.

Winding up:
The Singapore Court shall take cognizance of the conduct of liquidators, and if a liquidator does not faithfully perform his duties and observe the prescribed requirements or the requirements of the Singapore Court or if any complaint is made to the Court by any creditor or contributory or by the OR in regard thereto, the Singapore Court shall inquire into the matter and take such action as it thinks fit.

13. What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?

a. Does the regulator continue to supervise the Investment Firm?

b. How, if at all, is the regulator involved in the process of returning Client Assets?

MAS will continue to supervise the Investment Firm as long as it is licensed by MAS.

MAS will work with the relevant parties, including the OR, if necessary.

14. Does the Regime in your jurisdiction facilitate or encourage the transfer of Client Assets from an Investment Firm which has become bankrupt or insolvent to a solvent Investment Firm?

a. What steps, if any, are prerequisite to accomplishing such a transfer? In general, how long does it take to accomplish those steps?

b. What factors, if any, affect the time period required to accomplish such a transfer?

Under the Singapore SF(FMR)R, when MAS is notified by a CMS licensee or becomes aware that the base capital of the CMS licensee has fallen below the minimum requirement; or the financial resources of the CMS licensee have fallen below 120% of its total risk requirements, MAS may require the CMS licensee to transfer all or part of any client's margins, collateral, assets and accounts to another CMS licensee(s).

There will be close monitoring to ensure that the transfer is done without undue delay.

15. To what extent are clients at risk of, or protected from, having to return Client Assets (or the value thereof) that were distributed to the client prior to the insolvency proceeding?

In relation to a company which is being wound up, there are express provisions provided in the Singapore Companies Act against transactions giving an undue preference, transactions at an undervalue, and fraudulent trading.
Notwithstanding, the laws relating to the distribution of the assets of a person on insolvency, bankruptcy or winding up shall not interfere with finality of settlement of securities in accordance with the business rules of a designated clearing house.

16. To what extent, if at all, does the Regime in your jurisdiction provide compensation to clients from other sources (for example, an investor protection or similar fund) for loss of Client Assets? Please discuss the scope of protections, conditions on such protection, and the limits of compensation (*e.g.*, maximum compensation per client).

Under the Singapore Deposit Insurance Scheme, if a bank under the Scheme fails, the bank client's eligible accounts (which include deposits held in trust and client accounts on behalf of individual clients) are aggregated and insured up to S$20,000, net of the bank client's liabilities to the bank.
More information can be found at http://www.sdic.org.sg.

In addition, an Approved Exchange is required to set up a fidelity fund under the Singapore SFA. The fund is to be applied for the purpose of compensating any person (other than an accredited investor) who suffers a pecuniary loss because of a defalcation committed –

a) in the course of, or in connection with, a dealing in securities or trading in futures contract by a member of the Approved Exchange or an agent of the member;
b) in relation to any money or property received by the member or its agent for or on behalf of any person; or by the member either as the sole trustee or as trustee with any other person, or by its agent as trustee or for or on behalf of the trustees of that money or property.

17. Are there circumstances in which clients are treated differently based on permissions they have granted pre-bankruptcy. *E.g.*, if any re-hypothecation has been entered into (or a 'right-to-use' exercised), please explain the client's position under the Insolvency Regime in such event.

This would depend on the terms and conditions of the client's agreement with the CMS licensee.

18. Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?

Under the SFR, the Investment Firm may deposit client money and assets, which are denominated in a foreign currency, with a foreign custodian, subject to the client's prior written consent and other conditions. Please refer to the response to Q2(a) for details. In a liquidation of the Investment Firm, the liquidator would claim the assets back from the foreign custodian for distribution to the clients.

19. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?

A failure to comply with Client Asset protection requirements would amount to a breach of the requirements, subject to the appropriate regulatory action. MAS may take the necessary action to aid the recovery process.

20. If there is a shortfall, *i.e.*, if claims by clients exceed resources dedicated to paying such claims (whether from Client Assets, investor protection fund, or otherwise), how are Client Assets distributed? *E.g.*, is there a pro rata distribution of Client Assets, are there priorities between classes of clients, is there a priority distribution ahead of the distribution of the general estate/distribution to unsecured creditors?

In the winding up of a company, the priority for payment of debts is expressly provided in the Singapore Companies Act. Preferential creditors such as employees are paid ahead of other unsecured debts. All creditors of equal rank are paid pari passu in equal proportions.

21. Please explain how claims of clients are ranked in the insolvency process relative to those of other creditors. Does your insolvency regime rank domestic creditors above foreign creditors?

Please refer to the response to Q20 above.

III. Pertinent references

Please provide, for any statutes, regulations, or other authorities or texts that are referred to in your response, electronic copies (in English translation, if available), or URL links to available copies. How might a person outside your jurisdiction most readily get access to such items? Are there treatises that would be useful for obtaining a general understanding of client asset protection in your jurisdiction?

Acts

1) Singapore Banking Act (Cap. 19)

2) Singapore Companies Act (Cap. 50)

4) Singapore Securities and Futures Act (Cap. 289)

http://statutes.agc.gov.sg/

Regulations:

1) Singapore Securities and Futures (Licensing and Conduct of Business) Regulations (Rg. 10)

2) Singapore Securities and Futures (Financial and Margin Requirements for Holders of Capital Markets Services Licences) Regulations (Rg. 13)

http://www.mas.gov.sg/legislation_guidelines/securities_futures/sub_legislation/SFA_Regulations.html

Website:

1) Singapore Deposit Insurance Corporation

http://www.sdic.org.sg/scheme_members.html

Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets

(SPAIN)

I. Background

This questionnaire seeks information to aid in understanding the responding jurisdictions' techniques for protecting Client Assets in the event of the insolvency and/or winding up of an Investment Firm, and for promptly transferring such assets to a solvent Investment Firm or distributing them to the client. It is not intended to require information concerning the general legal framework for insolvency, except to the limited extent necessary to understand how rules for the protection of Client Assets fit within that framework.

Definitions.

(1) **"Administrative Officer"** refers to the person or entity who is appointed, whether by a court, regulator, creditors, the Investment Firm itself, or otherwise, to assume control of or power over a bankrupt or insolvent Investment Firm. This term includes administrators, debtors in possession, receivers, liquidators, trustees, and similar titles.

(2) **"Client Assets"** refers collectively to Positions, Securities, and Client Money:

- "**Positions"** are contractual rights and obligations arising from transactions entered into by an investment firm on behalf of its clients, including mark to market accruals arising from the change in value of futures, options and/or other derivatives positions;

- "**Securities"** are defined to incorporate both securities and derivatives, as those terms are defined or understood in the responding jurisdiction; and

- "**Client Money"** refers to funds owed to or held on behalf of clients by an investment firm, and may include margin collateral associated with client positions (both existing and potential), income relating to an investment such as dividends or interest, proceeds of the liquidation of client securities and/or positions, and funds in excess of required margin.

(3) **"Investment Firm"** means an intermediary that holds Client Assets and is engaged in the business of managing client accounts, which could include, without limitation: executing orders on behalf of others, dealing in or distributing Securities (including carrying derivatives positions). In jurisdictions where banks are broadly permitted to engage in such a business, this term includes banks to the extent they are providing such services.

(4) **"Omnibus Account"** means an Investment Firm's account with a third party in which Client Assets are maintained separate from the firm's assets, but are held in the aggregate instead of in accounts designated for individual clients.

(5) **"Regime"** refers to statutes, regulations, rules of exchanges, clearing organizations and other self-regulatory bodies, or other legally binding requirements.

II. Survey Questions *Where appropriate, please provide citations to statutes, regulations, or other authorities supporting your answers below.*

Context

1. Please provide a brief overview setting forth the defining characteristics of your jurisdiction's approach to protecting Client Assets.

In answering the remaining questions:

(1) Please provide details, as appropriate, where the Regime in your jurisdiction applies different treatment or results based on differences in:

a. Categories of Client Assets;

b. Models of trading (e.g., exchange-traded versus over-the-counter).

*c. Categories of clients (*e.g.*, retail versus sophisticated)*

(2) You are requested to provide details of the Regime in your jurisdiction. You are additionally invited to provide information explaining how that Regime is applied in practice, through, e.g.*, informal arrangements between governmental entities.*

The monitoring of financial institutions solvency and the prevention of financial crisis in Spain rely on the three financial supervisors: Banco de España (credit institutions, such as banks, saving banks and other financial entities), Comisión Nacional del Mercado de Valores – CNMV (investment firms) and Dirección General de Seguros – DGS (insurance undertakings). In order to answer this survey, banks are permitted to engage in all kind of securities business, in consequence all the following answers are referred to both investment firms and banks, except those in which differences are expressly indicated. To achieve the goal of protecting clients assets all three supervisors can adopt administrative measures, such as injunctions, sanctioning proceedings, restrictions of activities, etc. They are also entitled to take control of the firm concerned in exceptional circumstances, by removing members of the board and appointing temporary directors or "interventores" (appointed person by the supervisory authority who have to approve any decision taken in the investment firm or credit institution). The appointment of interventores or directors by CNMV requires exceptional circumstances where the own funds, stability or liquidity of an investment firm is in danger.

Financial intermediaries, such as banks, saving banks or investment firms, are required to be registered and are allowed to hold client assets. These client assets, such as financial instruments, securities or money should be hold in individual accounts, even in derivative markets. Financial intermediaries are allowed to use omnibus accounts on behalf of their clients when investing in

other jurisdictions that require that type of accounts, not in the Spanish markets.

There are no differences between retail clients and professional ones, except for compensations schemes. Professionals are excluded of such compensations. Only retail clients have the right to access to compensation schemes (either from investment firms or from credit entities).

In case of insolvency, as a general rule, securities and financial instruments of any type of clients are segregated from financial intermediaries positions. On the other hand, in spite of individual accounts, money is not segregated from the rest of creditors (money accounts are covered by de ICS up to the limit of 100.000 euros. These rules apply to every type of securities or financial instruments, no matter if it is traded on a regulated market or not (OTC).

In case of insolvency, there is an Investor Compensation Scheme(ICS) to ensure the coverage of client assets when providing investment services and other ancillary activities such as custody and administration of financial instruments. The Investor Compensation Scheme is as a separate estate, without legal personality, represented and managed by a managing public company limited by shares, whose capital is distributed among the investment services firms in the same proportion as their contributions to the Fund (article 77 of Securities Markets Act).

Regarding credit institutions the Deposit Guarantee Funds (DGFs) will pay the depositors' insurance within three months and cooperate with the judge through the appointment or nomination of the three bankruptcy officials. The usual result of this alternative is the liquidation of the institution through a composition agreement with its creditors.

Nowadays on both cases, ICS and DGS, the coverage for individuals is 100.000 euros.

Pre-Insolvency

2. Does the regime in your jurisdiction require an Investment Firm to hold special authorization (*i.e.*, a specific form of license or registration) to be permitted to hold Client Assets?

Yes. Spanish regulation requires authorization to provide investment or credit services, which is vested in the Minister of Economy and Finance, subject to a proposal from the CNMV (Comisión Nacional del Mercado de Valores), Spanish securities supervisor, or by Banco de España (Central Bank of Spain), Spanish supervisor of credit entities.

a. If special authorization is required, what requirements (both initial and ongoing) is an Investment Firm required to comply with to hold such authorization?

Requirements are compulsory, under an initial and ongoing basis. To this extent, such requirements must be proportioned in accordance with the nature, scale and complexity of their activities.

Basically the main requirements to enable a firm to obtain authorization as an investment firm are:

a) Its sole object must be the performance of the activities pertaining to investment firms.

b) It must be a corporation (sociedad anónima).

d) The minimum capital stock must be fully paid in cash and the minimum own funds established by regulation on the basis of the services and activities to be performed and the projected volume of business must have been provided.

Investment firms that are authorized only to provide the service of investment advice or receive and transmit orders from investors without holding money or securities belonging to their clients and which for that reason may not at any time place themselves in debt to those clients, must have the minimum capital stock or arrange professional liability insurance, or both, as may be established by secondary legislation.

e) It must have at least three directors or, where there is a Board of Directors, it must consist of no less than three members. Depending on the investment and ancillary services that the firm is to provide, a larger number of directors may be required by regulation. Where a financial advisory firm is a legal person, the undertaking may appoint a sole director.

f) All the directors or members of the Board of Directors, including natural persons representing legal persons on the Boards and on those of the controlling undertakings, if any, and those holding executive positions in the undertaking or in its controlling undertaking, if any, must of proven business or professional repute.

g) The majority of the directors or, as the case may be, members of its Board of Directors and, in any case, three of them, as well as the persons holding executive positions, must have suitable knowledge and experience in matters connected with the securities market.

h) It must have the necessary procedures, measures and means to fulfill the organization requirements envisaged in the Securities Markets Act., with clearly-defined, transparent and coherent lines of responsibility.

i) It must have an internal regulation of conduct of business, controls and security mechanisms for its information systems as well as adequate internal control procedures including, in particular, a system governing personal transactions by directors, executives, employees and authorized signatories of the firm.

j) It must join the Investment Guarantee Scheme.

k) It must have presented a business plan that reasonably accredits that the investment firm's plans are viable.

Regarding the ongoing requirements, apart for the aforementioned requirements, in solvency terms are requirements based on Basle Capital Agreement (Directives 2006/48/EC and 2006/49/EC) and, as an active entities, must comply with all relevant regulation of financial intermediaries (Securities Market Act, Ley 24/1988, de 28 de julio, del Mercado de Valores, or Ley 26/1988, de 29 de julio, Disciplina e Intervención de las Entidades de Crédito, for credit institutions).

b. If special authorization is not required, how, if at all, is this activity supervised by a regulator?

N/A

3. Does the Regime in your jurisdiction require that Client Assets be maintained separately from the assets of an Investment Firm? If so, please provide a description of the process by which segregation is accomplished, and of the applicable requirements. Specifically:

Yes, as aforementioned, clients assets must be maintained separated from others clients or investment firms assets (for all financial instruments. In general terms, investment firms can hold cash from their clients only temporarily. They must invest the clients cash in liquid assets (banking accounts, public debt and similar whose denomination refers to the fact that they hold clients cash). These banking accounts must be permanently conciliated with clients cash.

Even in omnibus accounts (required in some markets) clients assets must be separated from the investment firm assets (Circular 1/98. Norma 12).

a. Must the Client Assets of one client be maintained separately from those of other clients?

Investment Firms must take the appropriate measures to protect the financial instruments entrusted to them by clients and avoid improper use thereof. In particular, they may not use client financial instruments for their own account except with the client's express consent. They must also keep an effective separation between the company's securities and financial instruments and those of each client. The undertaking's internal records must make it possible to ascertain, at any time and without delay, and particularly in the event of the undertaking becoming insolvent, each client's position in terms of securities and pending transactions (article 70.ter.1.f of Securities Market Act – Ley 24/1988, del Mercado de Valores).

Investment firms must take the appropriate measures, in connection with the funds entrusted to them by clients, to protect their rights and avoid improper use of the funds. Undertakings may not use clients' funds for their own account apart from exceptional cases that may be established by secondary legislation, and only with the client's express consent. The undertaking's internal records must make it possible to ascertain each client's position in terms of funds at any time and without delay, and particularly in the event of the undertaking becoming insolvent (article 70.ter.2.c of Securities Market Act – Ley 24/1988, del Mercado de Valores).

i. Are Investment Firms allowed to hold Omnibus Accounts?

Yes, but only in foreign jurisdictions where individuals account are not possible.

ii. What measures are used to protect the Client Assets of each client from losses due to the activities of other clients?

As far as clients assets are separated from others clients assets it is difficult to foresee losses due to other clients.

When omnibus account is required/allowed, the investment firm must obtain the clients written authorization (Circular 1/98. Norma 12.1.a)). Moreover, clients assets must be separated from the investment firm assets and investment funds.

b. Please describe any requirement that an Investment Firm must reconcile the Client Asset account. For example:

There is just one possibility to reconcile clients assets, money, not securities or financial instruments. Cash deposited by clients in investment firms are maintained by investment firms (this rule does not apply to credit institutions) in repo transactions (public debt as underlying), on investment funds (short term fixed income debt) or deposited in credit institutions. In

all those three cases money is deposited on behalf of clients and the general amount of deposits, repo or investment funds should match the total amount of money held in individuals clients accounts of the investment firm.

i. How do you calculate the amount of Client Assets that a firm is required to hold in one or more accounts segregated for the benefit of clients?

N/A

A) Are required Client Assets fungible between or within asset classes, or is the Investment Firm required to hold, *e.g.*, the specific assets deposited by the client?

As a general rule all positions are fungible, except securities. Every kind of shares, traded or not in regulated markets are specifically deposited client by client and are identified specifically on account of each client.

B) How is the reconciliation conducted (*e.g.*, on an aggregate basis, or a client-by-client basis)?

On aggregate basis and when there is a sub custodian, client by client.

C) If a client has a debit balance (*i.e.*, the client owes the Investment Firm), is such balance deducted in determining the amount the Investment Firm is required to hold?

Yes, it is deducted. Financing clients should be offered against investment firms own resources.

ii Timing issues:

A) How often is reconciliation required (*e.g.*, daily, weekly, monthly).

At every moment, as part of liquidity coefficient and capital requirements.

B) When is such reconciliation required (*e.g.*, noon of the following business day, the tenth business day of the following month).

See previous question.

C) Is the Investment Firm required to make good any deficiency from their own funds? If so, in what period? Is any payment by the Investment Firm thereby deemed to be Client Money?

Yes, there should be no differences, investment firm is responsible for clients assets.

iii. Is an Investment Firm permitted or encouraged to maintain any of their own assets in a Client Asset account (*e.g.*, as a "buffer")? If so, are any such assets so transferred then deemed to be Client Assets? Is there a requirement to remove any excess assets?

N/A

c. Can the Investment Firm use Client Assets of one client for meeting obligations of another client? If so, how?

No, it not possible.

d. Are there any restrictions on the ability of the Investment Firm (or other party holding Client Assets) to invest, encumber, rehypothecate, stock-lend, or otherwise deal with, the Client Assets? If so, please describe.

Investment firms can make stock-lend with clients assets. In order to do so they are required to obtain prior consent of the client.

e. What are the requirements, if any, for clearinghouses or other central counterparties to maintain the separate identification of collateral posted by the Investment Firm for its Client Positions?

With the exception of initial collaterals, derivatives markets require collaterals or variation margins on individual accounts. Members of the market should deposit those margins and should charge them among their clients positions.

4. Are Investment Firms permitted to transfer to, or hold Client Assets in, another jurisdiction? If so, does the Regime in your jurisdiction require Investment Firms to preserve the separate identification of:

Yes, an investment firm can transfer client assets to other jurisdictions. These assets should be accounted in individual accounts. Notwithstanding, in jurisdictions where individuals account are not possible, investment firms can hold this assets in omnibus accounts.

a. Client Assets transferred to or located in other jurisdictions?

b. Client Assets that have been transferred to the Investment Firm from other jurisdictions and that have been identified as Client Assets in those jurisdictions?

If so, please provide details of those requirements.

5. If the Regime in your jurisdiction permits or requires Client Assets to be held by third party custodians:

a. Please describe the requirements, if any, concerning the qualifications of such custodians e.g., licensing, creditworthiness. May the Client Assets be kept with an affiliate of the Investment Firm?

Third party custodians or sub custodians should be financial intermediaries registered or licensed in their respective jurisdictions. A subsidiary could be custodian of an investment firm if meet the previous requirement.

b. Please describe any requirements concerning the custody agreement between intermediary and custodian. In particular, may the custodian be permitted to place a lien, charge or other encumbrance on Client Assets? If so, please explain.

There are no specific requirements. Contractual basis should be enough. Investment firm remains responsible for assets deposited in other intermediaries or custodians. No encumbrance is allowed if it is not authorized by the client.

6. Under what circumstances, if any, is an Investment Firm required to disclose to clients information related to the protection of the client's assets? What is the nature of such required disclosures? How do any such required disclosures apply to Client Assets held in another jurisdiction?

Firms must inform client's of any compensation schemes or guarantees applying to investment services prior to any business relation. Where a firm provides investment or ancillary services, such as custody, on behalf of a client on the instructions of another investment firm, the investment firm which issues the instructions shall remain liable for the assets deposited in other custodians.

7. Under what conditions, if any, may clients choose to waive any of the Client Asset protection requirements applicable in your jurisdiction (also known as "opting out")? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

A retail client, who meets some particular requirements in terms of experience, knowledge and portfolio, can waive specific protections for retail customers (opting out), in such case no protection of compensation scheme is applied to their assets (treated as professional),and vice versa, professionals can ask to be treated as retail (opting in). On both cases, it should be made in writing.

8. Under what circumstances, if any, is an Investment Firm required to notify the regulators, or the market generally, of material changes in their financial position or ability to continue to carry on business? What is the nature of such required disclosures?

Investment firms should notify CNMV, as solvency supervisor, if they are not in a position to carry on business. For starting an insolvency proceeding, shareholders, the investment firm, any creditor or CNMV, have the right to ask in a court a declaration of insolvency.
The opening of formal insolvency proceedings is subject to official publication and information to the competent authorities.

Any investment firm, or group, suffering an own resources deficit is obliged to inform CNMV immediately and present for its approval a recovering plan. The plan will include a description of the causes of the situation, the recovering measures envisaged (eg, selling of assets, capital increase) and the proposed calendar. CNMV is entitled to request additional measures within a three months deadline.

9. For an Investment Firm whose financial situation is seen to have deteriorated *(e.g.*, capital has fallen below certain thresholds), what actions, if any, may the firm's regulators take to protect Client Assets?

To that end the CNMV is empowered to adopt administrative measures, such as injunctions, sanctioning proceedings, restrictions of activities or risks assumed by the investment firm, etc. CNMV is also entitled to take control of the firm concerned in exceptional circumstances, by removing members of the board and appointing temporary directors or "interventores".

Equal powers are entitled to Bank of Spain regarding credit institutions.

Post-Insolvency

10. Please describe the process by which an Investment Firm enters the status of "insolvent" or "bankrupt" or the equivalent. For example, is a petition filed by the firm's regulator or some other administrative agency, by creditors of the firm, or otherwise? Is a decree entered by a court? Is this process different from the process applicable to entities that are not Investment Firms?

For starting an insolvency proceeding, shareholders, the investment firm, any creditor or CNMV, have the right to ask in a court a declaration of insolvency.

11. Please describe the process by which the Administrative Officer (as defined above), if any, is selected. What qualifications, if any, must an Administrative Officer have? Who selects the Administrative Officer?

Although some correction measures (replacement of directors) are common to all financial intermediaries, the procedure applicable to

investment firms and banks is based on general insolvency law with some important exceptions (Ley 22/2003, de 9 de Julio, Concursal).

The judge is responsible to the appointment or nomination of the three bankruptcy officials, an auditor or economist, a lawyer and a creditor (a person who represent general creditors). In case of investment firms the appointment of the auditor or economist should be replaced by CNMV's employee or a person proposed by CNMV, and the lawyer will be appointed by judge as a proposal of Investors Compensation Scheme. For banks, Deposit Guarantee Funds should made a proposal to appoint the creditor, lawyer and economist (article 27 of Act 22/2003).

12. What are the duties of the Administrative Officer?

Administrative Officer, under judge supervision, have to resolve company liquidity problems. If it is not a problem of liquidity, such as insolvency (bankruptcy), Administrative Officer must liquidate orderly company assets and reimburse, to the maximum possible, creditors rights.

a. What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?

b. Under what standard (*e.g.*, strict liability, negligence), if any, is the Administrative Officer, pursuant to the Regime in your jurisdiction, subject to personal liability for failure to properly perform his or its duties?

Administrative Officer have personal responsibility (negligence performing his duties).

13. What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?

Once insolvency proceedings have commenced against a securities depository, the National Securities Market Commission, without prejudice to the powers of the Bank of Spain, may immediately transfer, to another undertaking authorised to perform this activity, the securities deposited in clients' names, even if those assets are deposited at third entities in the name of the undertaking providing the depository service. For these purposes, both the competent judge and the bodies involved in the insolvency proceedings shall provide the entity to which the securities are to be transferred with access to the documentation and the accounting and computer entries necessary to make the transfer effective. The insolvency proceedings shall not prevent the clients who own the securities from receiving the cash generated by the exercise of their economic rights or their sale (article 70.ter.f of Securities Market Act – Ley 24/1988, del Mercado de Valores).

a. Does the regulator continue to supervise the Investment Firm?

No, if a declaration of insolvency is made by a court CNMV has the right to revoke the license of the investment firm (article 73.h Securities markets Act).

b. How, if at all, is the regulator involved in the process of returning Client Assets?

See first paragraph of this question.

14. Does the Regime in your jurisdiction facilitate or encourage the transfer of Client Assets from an Investment Firm which has become bankrupt or insolvent to a solvent Investment Firm?

If the investment firm is operating normally, clients can take their own decisions. In other cases CNMV encourage to transfer client assets to other investment firm or bank. Investment firms in this situation must obtain clients instructions (article 7.5 Securities markets Act).

a. What steps, if any, are prerequisite to accomplishing such a transfer? In general, how long does it take to accomplish those steps?

It just requires clients instructions, the transfer of clients assets should be made immediately.

b. What factors, if any, affect the time period required to accomplish such a transfer?

It depends on the type of securities or instruments, on the type of intermediary who hold it, but it should be transfer in a very short period of time.

15. To what extent are clients at risk of, or protected from, having to return Client Assets (or the value thereof) that were distributed to the client prior to the insolvency proceeding?

Complex to give the correct answer. As far as the CNMV can proceed to transfer clients securities and financial instruments to another intermediary in case of insolvency it is difficult to foresee a return. Notwithstanding, the judge have the power to order that return and, under exceptional circumstances, such measure can be taken.

16. To what extent, if at all, does the Regime in your jurisdiction provide compensation to clients from other sources (for example, an investor protection or similar fund) for loss of Client Assets? Please discuss the scope of protections, conditions on such protection, and the limits of compensation (*e.g.*, maximum compensation per client).

Investor Compensation Scheme(ICS, for securities) and Deposit Guarantee Funds (DGFs, for money) are in place. The maximum amount covered by one of de aforementioned funds is 100.000 euros per client (article 77 of Securities Markets Act).

17. Are there circumstances in which clients are treated differently based on permissions they have granted pre-bankruptcy. *E.g.*, if any re-hypothecation has been entered into (or a 'right-to-use' exercised), please explain the client's position under the Insolvency Regime in such event.

It depends on contractual agreements and the creditors qualification (see question 21). Resolution is made case by case.

18. Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?

19. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?

No, there are no differences between clients.

20. If there is a shortfall, *i.e.*, if claims by clients exceed resources dedicated to paying such claims (whether from Client Assets, investor protection fund, or otherwise), how are Client Assets distributed? *E.g.*, is there a pro rata distribution of Client Assets, are there priorities between classes of clients, is there a priority distribution ahead of the distribution of the general estate/distribution to unsecured creditors?

Judge criteria should apply. Pro rata distribution could be the criteria, but prior to applying that criteria qualifications between creditors should be made (see type of creditors in the last answer). There is no differences between clients, just between type of creditors.

21. Please explain how claims of clients are ranked in the insolvency process relative to those of other creditors. Does your insolvency regime rank domestic creditors above foreign creditors?

There are three types of creditors (article 89, Act 22/2003, Concursal):

- Privileged creditors (creditors with some kind of guarantee, collateral or hypothecation, etc.).

- General creditors.

- Subordinate creditors.

None of de abovementioned creditors made distinctions among foreign or national.

III. Pertinent references

Please provide, for any statutes, regulations, or other authorities or texts that are referred to in your response, electronic copies (in English translation, if available), or URL links to available copies. How might a person outside your jurisdiction most readily get access to such items? Are there treatises that would be useful for obtaining a general understanding of client asset protection in your jurisdiction?

Ley 24/1988, de 28 de julio, del Mercado de Valores (and its secondary legislation).

Ley 26/1988, de 29 de julio, Disciplina e Intervención de las Entidades de Crédito (and its secondary legislation).

Ley 22/2003, de 9 de julio, Concursal

At the present is foreseen to publish, probably December 2009, a new CNMV regulation (circular) regarding client assets protection. In this regulation auditors must conclude in an special report about securities, financial instruments and money of clients held by the investment firms.

United Kingdom

Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets

I. Background

This questionnaire seeks information to aid in understanding the responding jurisdictions' techniques for protecting Client Assets in the event of the insolvency and/or winding up of an Investment Firm, and for promptly transferring such assets to a solvent Investment Firm or distributing them to the client. It is not intended to require information concerning the general legal framework for insolvency, except to the limited extent necessary to understand how rules for the protection of Client Assets fit within that framework.

Definitions.

(1) **"Administrative Officer"** refers to the person or entity who is appointed, whether by a court, regulator, creditors, the Investment Firm itself, or otherwise, to assume control of or power over a bankrupt or insolvent Investment Firm. This term includes administrators, debtors in possession, receivers, liquidators, trustees, and similar titles.

(2) **"Client Assets"** refers collectively to Positions, Securities, and Client Money:

- "**Positions"** are contractual rights and obligations arising from transactions entered into by an investment firm on behalf of its clients, including mark to market accruals arising from the change in value of futures, options and/or other derivatives positions;

- "**Securities"** are defined to incorporate both securities and derivatives, as those terms are defined or understood in the responding jurisdiction; and

- "**Client Money"** refers to funds owed to or held on behalf of clients by an investment firm, and may include margin collateral associated with client positions (both existing and potential), income relating to an investment such as dividends or interest, proceeds of the liquidation of client securities and/or positions, and funds in excess of required margin.

(3) **"Investment Firm"** means an intermediary that holds Client Assets and is engaged in the business of managing client accounts, which could include, without limitation: executing orders on behalf of others, dealing in or distributing Securities (including carrying derivatives positions). In jurisdictions where banks are broadly permitted to engage in such a business, this term includes banks to the extent they are providing such services.

(4) **"Omnibus Account"** means an Investment Firm's account with a third party in which Client Assets are maintained separate from the firm's assets, but are held in the aggregate instead of in accounts designated for individual clients.

(5) **"Regime"** refers to statutes, regulations, rules of exchanges, clearing organizations and other self-regulatory bodies, or other legally binding requirements.

II. Survey Questions *Where appropriate, please provide citations to statutes, regulations, or other authorities supporting your answers below.*

Context

1. Please provide a brief overview setting forth the defining characteristics of your jurisdiction's approach to protecting Client Assets.

The protection of client assets has been a cornerstone of the UK regulatory regime since 1988. The client assets regime consists of two aspects of protection. The first relates to client money, which applies to a firm that receives money from or holds money for, or on behalf of, a client in the course of, or in connection with its MiFID and/or its designated investment business, in respect of any investment agreement entered into, or to be entered into, with or for a client. As a unified regulator, the client money protections extend to General Insurance Intermediaries. The client money protections are based on English trust law principles as expounded in the FSA's Client Assets sourcebook (CASS). The second aspect is the protection of client assets, which applies to a firm when it holds financial instruments belonging to a client in the course of its MiFID business; and/or when safeguarding and administering non-MiFID investments.

The fundamental principle governing the whole regime is that a "firm must arrange adequate protection of clients' assets when it is responsible for them"[1]. This is generally achieved at a high level by requiring that a firm must, when holding safe custody assets or client money, 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 safe custody assets or client money on the firm's own account (as implemented in MiFID articles 13(7) and 13(8)). Further, the firm must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client assets, or of rights in connection with client assets, as a result of misuse of client assets, fraud, poor administration, inadequate record keeping or negligence (as implemented in article 16(1)(f) of the MiFID implementing Directive).

In the event of an insolvency of an investment firm, client money is held on trust (and therefore separate from the general estate of the firm) and is distributed back to clients in accordance with the CASS rules.

In relation to assets held by an investment firm, clients retain beneficial ownership of the assets at all times, and in the event of an insolvency can trace these assets or have a pro rata share of an omnibus account of securities. This is not the case however, when clients transfer assets to the investment firm under full title transfer collateral agreements (both client money and assets) and also if they grant rights of use (re-hypothecation) of assets. Both arrangements are permitted under MiFID and the UK regime and allow sophisticated clients to select an appropriate risk return for themselves.

Client asset protections do not seek to prevent a firm from failing, but they do attempt to ensure that wherever possible, assets and money belonging to clients of a firm are not used by the firm itself and in the event of the firm's insolvency are safe from claims by the general creditors of the firm's estate. The protections cannot prevent loss from occurring, but aim to achieve a timely distribution of client assets. Retail customers have access to an insurance fund if a shortfall does occur.

[1] FSA Principle for Business 10

In answering the remaining questions:

(1) Please provide details, as appropriate, where the Regime in your jurisdiction applies different treatment or results based on differences in:

a. Categories of Client Assets;

b. Models of trading (e.g., exchange-traded versus over-the-counter).

*c. Categories of clients (*e.g.*, retail versus sophisticated)*

(2) You are requested to provide details of the Regime in your jurisdiction. You are additionally invited to provide information explaining how that Regime is applied in practice, through, e.g.*, informal arrangements between governmental entities.*

Pre-Insolvency

2. Does the regime in your jurisdiction require an Investment Firm to hold special authorization (*i.e.*, a specific form of license or registration) to be permitted to hold Client Assets?

   a. If special authorization is required, what requirements (both initial and ongoing) is an Investment Firm required to comply with to hold such authorization?

If a firm intend to hold client money or client assets, it must apply for this to be added to its permission under the Financial Services and Markets Act 2000 (FSMA) Regulated Activities Order (RAO).

Permission to hold client money: The starting point is that an authorised firm is able to hold and control client money. Although, unless a firm applies to hold client money and we consider them fit and proper to do so, we prevent firms from holding client money by imposing a standard requirement that they cannot hold and control client money.

Client assets (custody): Following MiFID, there are a number of activities which a firm may undertake, when holding clients' assets depending upon their businesses. Generally, investment firms would usually have the following activities within their permission:

Safeguard and administering investments (RAO article 40);
Dealing in investments as principle (RAO article 14);
Dealing in investments as agent (RAO article 21); and
Managing investments (RAO article 37).

As an investment firm which acts as a custodian cannot be an Exempt MiFID firm or Exempt CAD, a person who holds either client money or securities in relation to MiFID business will fall to be at least a BIPRU €125k firm as we set out in Q61 of PERG 13 and in the BIPRU sourcebook. Both the client money and custody regime can apply simultaneously.

On application to hold client money or assets, we typically would require the:

A) Firm to set out how the client monies are held (e.g. in a segregated bank account established in accordance with the CASS rules, with the monies held under the Statutory Trust)

B) Whether or not the client money account is held with an appropriate bank that meets the requirements of CASS 7.4.7 R – 10 R (article 18(3) of the MiFID Implementing Directive)

C) We ask the firm to confirm that they have read and understood the relevant client money rules under CASS.

The FSA has increased its supervisory focus on the protection of CASS since Lehman Brothers entered insolvency in September 2008. Accordingly, CASS is a key risk for the FSA which is monitored on the risk-based FSA's risk dashboard, and is a risk that is addressed through individual firm supervision and on a thematic basis.

b. If special authorization is not required, how, if at all, is this activity supervised by a regulator?

NA

3. Does the Regime in your jurisdiction require that Client Assets be maintained separately from the assets of an Investment Firm? If so, please provide a description of the process by which segregation is accomplished, and of the applicable requirements. Specifically:

a. Must the Client Assets of one client be maintained separately from those of other clients?

i. Are Investment Firms allowed to hold Omnibus Accounts?

Client Assets have to be maintained separately from the assets of the Investment Firms. An approach is to hold client assets in Omnibus Accounts, as the key requirement under MiFID is to ensure that client assets are kept separately from the firm's assets. Accordingly, the firm is required to keep such records and accounts as are necessary to enable it, at any time and without delay, to distinguish client assets held for one client from client assets held for any other client, and from its own money (article 16(1)(a) of the MiFID implementing Directive). Further, a firm must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the client money held for clients (article 16(1)(b) of the MiFID implementing Directive).

ii. What measures are used to protect the Client Assets of each client from losses due to the activities of other clients?

As discussed above, the UK requires firms, on a continuous basis to arrange adequate protection of clients' assets and be able to account for all of those assets at any given point in time. We understand that this question relates to the potential losses caused in the client money pool by derivatives trading clients. The UK has always adopted a single pool method of pooling client money. This has the benefits of cost and efficiency (because it is the administratively simplest system for firms to implement and maintain, for example in relation to records); it is easier to calculate client entitlements to the client money pool; any shortfall is shared equitably across all clients with no preference payments; and it should allow a timely distribution. However, the single pool method results in the risk of each client's risk

being shared by all clients. This exposes a low risk customer to the investment risks assumed by consumers with a larger appetite for risk.

We consider that once the limits of the single pooling method are understood, the model is not fundamentally flawed for the majority of firm insolvencies. The FSA last consulted on these rules in 2000 and it was found that the cost benefit analysis (CBA) supported the conclusion that the single pooling method was the most efficient. We now understand that IT systems have developed sufficiently that the CBA may now support a more sophisticated pooling method where the risk profile of clients can be accurately mapped to different pools. The FSA is considering consulting upon the distribution rules in due course.

Assets (other than money) should be distributed in accordance with the trust under which they are held. It is understood that if there are shortfalls clients may share pro-rata in the losses per stockline but this is not prescribed by the CASS rules.

b. Please describe any requirement that an Investment Firm must reconcile the Client Asset account. For example:

   i. How do you calculate the amount of Client Assets that a firm is required to hold in one or more accounts segregated for the benefit of clients?

Client money requirement:

CASS 7 Annex 1: The client money requirement is either:

(1) the sum of, for all clients:

(a) the individual client balances calculated in accordance, 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 the margined transaction requirement; 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

Client assets reconciliation:

Internal reconciliation of safe custody assets held for clients:

CASS 6.5.4 G (1) Carrying out internal reconciliations of the safe custody assets held for each client with the safe custody assets held by the firm and third parties is an important step in the discharge of the firm's obligations under CASS 6.5.2 R, and where relevant,1 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) Reconciliation methods which can be adopted for these purposes include the 'total count method', which requires that all safe custody assets be counted and reconciled as at the same date.

(4) If a firm chooses to use an alternative reconciliation method (for example the 'rolling stock method') it needs to ensure that:

(a) all of a particular safe custody asset are counted and reconciled as at the same date; and

(b) all safe custody assets are counted and reconciled during a period of six months.

CASS 6.5.5 R: A firm that uses an alternative reconciliation method 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 the method effectively.

Reconciliations with external records

CASS 6.5.6 R: A firm must conduct on a regular basis, reconciliations between its internal accounts and records and those of any third parties by whom those safe custody assets are held.

[Note: article 16(1)(c) of the MiFID implementing Directive]

CASS 6.5.7 G: Where a firm deposits safe custody assets belonging to a client with a third party, in complying with the requirements of CASS 6.5.6 R, the firm should seek to ensure that the third party will deliver to the firm a statement as at a date or dates specified by the firm which details the description and amounts of all the safe custody assets credited to the account, and that this statement is delivered in adequate time to allow the firm to carry out the periodic reconciliations required in CASS 6.5.6 R.

A) Are required Client Assets fungible between or within asset classes, or is the Investment Firm required to hold, *e.g.*, the specific assets deposited by the client?

Client money is fungible.

Generally, specific assets would have to be held for clients if the clients entered a specific custody agreement to that effect. More commonly however, we understand that most clients sign custody agreements that allow equivalent securities to be held. For example, a client could enter an agreement with an investment firm whereby they purchase a share in company A, and have that dematerialized share registered within their own name within CREST. Alternatively, the share could be registered in a company nominee name and held in an omnibus account in CREST. Within the omnibus account, the securities are fungible, but

only to the extent that an equivalent share would have to be returned (i.e. a share of the same value in the same company, but not the share necessarily with the same individual share identification number).

B) How is the reconciliation conducted (*e.g.*¸ on an aggregate basis, or a client-by-client basis)?

Client money:

Client money requirements state that internal reconciliations have to be undertaken 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.

Further, 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 (CASS 7.6.9 R; MiFID article 16(1)(c) of the MiFID implementing Directive).

Client assets:

Please see 3b.

C) If a client has a debit balance (*i.e.*, the client owes the Investment Firm), is such balance deducted in determining the amount the Investment Firm is required to hold?

Reduced client money requirement option

CASS Annex 7 A

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 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 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, and, by so doing, reduce the amount the firm is required to segregate for that client.

ii Timing issues:

A) How often is reconciliation required (*e.g.*, daily, weekly, monthly).

MiFID states that reconciliations must be performed as often as necessary (article 19(1)(c) of the MiFID Implementing Directive). However, for the vast majority of firms we supervise, we consider this requirement to require firms to conduct a daily reconciliation in accordance with CASS 7 Annex 1. CASS 7 Annex 1 is the standard client money calculation.

B) When is such reconciliation required (*e.g.*, noon of the following business day, the tenth business day of the following month).

By the close of the following business day.

C) Is the Investment Firm required to make good any deficiency from their own funds? If so, in what period? Is any payment by the Investment Firm thereby deemed to be Client Money?

Client money:

Reconciliation discrepancies

CASS 7.6.13: 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 CASS 7.4.20 G and CASS 7.4.21 R).

CASS 7.6.14: 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.

CASS 7.6.15: 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.

Notification requirements

CASS 7.6.16: A firm must inform the FSA in writing without delay:

(1) if it has not complied with, or is unable, in any material respect, to comply with the requirements in CASS 7.6.1 R, CASS 7.6.2 R or CASS 7.6.9 R;

(2) if having carried out a reconciliation it has not complied with, or is unable, in any material respect, to comply with CASS 7.6.13 R to CASS 7.6.15 R.

iii. Is an Investment Firm permitted or encouraged to maintain any of their own assets in a Client Asset account (*e.g.*, as a "buffer")? If so, are any such assets so transferred then deemed to be Client Assets? Is there a requirement to remove any excess assets?

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 the client money chapter of CASS.

c. Can the Investment Firm use Client Assets of one client for meeting obligations of another client? If so, how?

An investment firm cannot use the assets of one client for meeting an obligation of another client, unless the investment firm has a right to use. Please see below (answer d for further detail).

d. Are there any restrictions on the ability of the Investment Firm (or other party holding Client Assets) to invest, encumber, rehypothecate, stock-lend, or otherwise deal with, the Client Assets? If so, please describe.

The CASS regime allows market participants varying degrees of participation and protection as appropriate. This is diagrammatically shown below. The first example on the left is most appropriate for retail clients and represents the full application of CASS, including segregation of assets that are held on a statutory trust basis. The second example represents re-hypothecation or a 'right-to-use' over a client's assets. The exercise by a Prime Broker (PB) of a 'right-to-use' over a client's assets removes those assets from the protection the CASS regime offers. Assets which have yet to be re-hypothecated, or have been re-hypothecated and returned to the client segregated accounts, fall within the protections offered by the CASS regime. Re-hypothecation in the UK is a contractual and regulatory hybrid between full segregation and an opt-out from the CASS rules. The final option represents a full title transfer of a client's assets (under recital 27 to MiFID, implemented by CASS 6.1.6 R) to the PB which removes them from the CASS regime, and results in those clients ranking as general creditors in the event of the insolvency of the PB.

Scope of client asset protections

Pure custody (CASS 6.2.1 R)	Re-hypothecation (CASS 3.1.7 G)	Full title transfer of collateral (CASS 6.1.6 R)
Segregation of client assets and money from that of the firms. Full compliance with the client asset sourcebook. Client has a claim over the trust assets in the event of the firm's insolvency.	Segregation of client assets from that of the firms, until the firm elects to re-hypothecate the assets consistent with agreed limits in the TOBA. To the extent assets are re-hypothecated, the client is an unsecured creditor in the event of the firm's insolvency.	Full title in collateral transfers from the client to the firm. Assets cease to be client assets and the client is an unsecured creditor in the event of the firm's insolvency.

The UK has a large and active leveraged securities financing market that utilises re-hypothecation extensively.

Stock lending:

CASS 6.4.2 G: Firms are reminded of the client's best interests rule, which requires the firm to act honestly, fairly and professionally in accordance with the best interests of their clients. An example of what is generally considered to be such conduct, in the context of stock lending activities involving retail clients is that:

(1) the firm ensures that relevant collateral is provided by the borrower in favour of the client;

(2) the current realisable value of the safe custody asset and of the relevant collateral is monitored daily; and
(3) the firm provides relevant collateral to make up the difference where the current realisable value of the collateral falls below that of the safe custody asset, unless otherwise agreed in writing by the client.

CASS 6.4.3 R: Where a firm uses safe custody assets as permitted in this section, the records of the firm must include details of the client on whose instructions the use of the safe custody assets has been effected, as well as the number of safe custody assets used belonging to each client who has given consent, so as to enable the correct allocation of any loss (article 19(2) of the MiFID implementing Directive).

e. What are the requirements, if any, for clearinghouses or other central counterparties to maintain the separate identification of collateral posted by the Investment Firm for its Client Positions?

The client assets regime does not extend to clearing houses or exchanges, but they are required to account separately for assets held on behalf of members' clients.

4. Are Investment Firms permitted to transfer to, or hold Client Assets in, another jurisdiction? If so, does the Regime in your jurisdiction require Investment Firms to preserve the separate identification of:

a. Client Assets transferred to or located in other jurisdictions?

A firm is required to keep such records and accounts as are necessary to enable it, at any time and without delay, to distinguish client assets held for one client from client assets held for any other client, and from its own money (article 16(1)(a) of the MiFID implementing Directive).

This includes assets located in another jurisdiction.

b. Client Assets that have been transferred to the Investment Firm from other jurisdictions and that have been identified as Client Assets in those jurisdictions?

If so, please provide details of those requirements.

The UK regime does not differentiate between assets held within the UK or other jurisdictions.

5. If the Regime in your jurisdiction permits or requires Client Assets to be held by third party custodians:

a. Please describe the requirements, if any, concerning the qualifications of such custodians e.g., licensing, creditworthiness. May the Client Assets be kept with an affiliate of the Investment Firm?

CASS 6.3 Depositing assets and arranging for assets to be deposited with third parties

CASS 6.3.1 R: (1) A firm may deposit safe custody assets held by it on behalf of its clients into an account or accounts opened with a third party, but only if it exercises all due skill, care and diligence in the selection, appointment and periodic review of the third party and of the arrangements for the holding and safekeeping of those safe custody assets.

(1A) A firm which arranges the registration of a safe custody investment through a third party must exercise all due skill, care and diligence in the selection and appointment of the third party.

(2) A firm must take the necessary steps to ensure that any client's safe custody assets deposited with a third party, in accordance with this rule are identifiable separately from the applicable assets belonging to the firm and from the applicable assets 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.

(3) When a firm makes the selection, appointment and conducts the periodic review referred to under this rule, it must take into account:

(a) the expertise and market reputation of the third party; and

(b) any legal requirements or market practices related to the holding of those safe custody assets that could adversely affect clients' rights.

(4) A firm must make a record of the grounds upon which it satisfies itself as to the appropriateness of its selection of a third party as required in this rule. 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 safe custody assets belonging to clients.

[Note: articles 16(1)(d) and 17(1) of the MiFID implementing Directive]

CASS 6.3.2 G: In discharging its obligations under this section, a firm should also consider, together with any other relevant matters:

(1) once a safe custody asset has been lodged by the firm with the third party, the third party's performance of its services to the firm;

(2) the arrangements that the third party has in place for holding and safeguarding the safe custody asset;

(3) current industry standard reports, for example Financial Reporting and Auditing Group (FRAG) 21 report or its equivalent;

(4) the capital or financial resources of the third party;

(5) the credit rating of the third party; and

(6) any other activities undertaken by the third party and, if relevant, any affiliated company.

b. Please describe any requirements concerning the custody agreement between intermediary and custodian. In particular, may the custodian be permitted to place a lien, charge or other encumbrance on Client Assets? If so, please explain.

CASS 6.3.3 G: A firm should consider carefully the terms of its agreements with third parties with which it will deposit safe custody assets belonging to a client. The following terms are examples of the issues firms should address in this agreement:

(1) that the title of the account indicates that any safe custody asset credited to it does not belong to the firm;

(2) that the third party will hold or record a safe custody asset belonging to the firm's client separately from any applicable asset belonging to the firm or to the third party;

(3) the arrangements for registration or recording of the safe custody asset if this will not be registered in the client's name;

(4) the restrictions over the third party's right to claim a lien, right of retention or sale over any safe custody asset standing to the credit of the account;

(5) the restrictions over the circumstances in which the third party may withdraw assets from the account;

(6) the procedures and authorities for the passing of instructions to or by the firm;

(7) the procedures regarding the claiming and receiving of dividends, interest payments and other entitlements accruing to the client; and

(8) the provisions detailing the extent of the third party's liability in the event of the loss of a safe custody asset caused by the fraud, wilful default or negligence of the third party or an agent appointed by him.

CASS 6.3.4 R: (1) A firm must only deposit safe custody assets with a third party in a jurisdiction which specifically regulates and supervises the safekeeping of safe custody assets for the account of another person with a third party who is subject to such regulation.

(2) A firm must not deposit safe custody assets held on behalf of a client with a third party in a country that is not an EEA State (third country) and which does not regulate the holding and safekeeping of safe custody assets for the account of another person unless:

> (a) the nature of the safe custody assets or of the investment services connected with those safe custody assets requires them to be deposited with a third party in that third country; or
>
> (b) the safe custody assets are held on behalf of a professional client and the client requests the firm in writing to deposit them with a third party in that third country.

The FSA is preparing to consult upon prohibiting any lien, charge or other encumbrance upon safe custody assets.

6. Under what circumstances, if any, is an Investment Firm required to disclose to clients information related to the protection of the client's assets? What is the nature of such required disclosures? How do any such required disclosures apply to Client Assets held in another jurisdiction?

Firms are required to disclose to clients their arrangements relating to the protection of client assets. For example, firms would have to include within their terms of business agreements (ToBAs) details surrounding their placement of client money and custody provisions. Similarly, firms are required to provide statements to clients, at least, on an annual basis under MiFID.

7. Under what conditions, if any, may clients choose to waive any of the Client Asset protection requirements applicable in your jurisdiction (also known as "opting out")? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

A client may only opt out of client asset protections, through the full title transfer collateral agreement mechanism noted at question 3.d above, if they are sophisticated (i.e. generally professional clients under the MiFID classification scheme) and that the full title transfer collateral agreement is in their best interests.

8. Under what circumstances, if any, is an Investment Firm required to notify the regulators, or the market generally, of material changes in their financial position or ability to continue to carry on business? What is the nature of such required disclosures?

A firm would be required to notify the FSA of any material changes in their financial position or ability carry on business. This does not necessarily have to be communicated to the market. Dependent upon the risk profile of the firm in question, the disclosure would be communication under the FSA's 'close and continuous' supervision, to a firm's supervisory team, or by notification if a smaller firm. The firm would be required to explain its position and to provide plans for recovery or wind-down.

9. For an Investment Firm whose financial situation is seen to have deteriorated *(e.g.*, capital has fallen below certain thresholds), what actions, if any, may the firm's regulators take to protect Client Assets?

Whether a firm's financial situation is deteriorating or it drops below minimum capital thresholds, the FSA will consider what is the appropriate course of action in the particular circumstance. The most usual orders the FSA would make are to require the firm to raise new capital, remove the firm's permissions, require the firm to transfer business, return client assets and money or enter insolvency proceedings.

The Client Asset regime is not designed to prevent firms from entering insolvency, but is focused upon ensuring the best possible return of client assets and money.

Post-Insolvency

10. Please describe the process by which an Investment Firm enters the status of "insolvent" or "bankrupt" or the equivalent. For example, is a petition filed by the firm's regulator or some other administrative agency, by creditors of the firm, or otherwise? Is a decree entered by a court? Is this process different from the process applicable to entities that are not Investment Firms?

In the UK, investment firms generally enter an administration process, rather than a liquidation. Under the UK regime there are three statutory objectives of administration:

1. rescuing the company as a going concern, which should be taken to mean retaining as much as possible of its business;

2. achieving a better result for the creditors as a whole than would be likely in an immediate winding-up, for example by sale of the business(es) or its assets. This objective can only be pursued where rescue is not reasonably practicable, or where it would give a better outcome for creditors than objective 1;

3. realising the company's property so as to make a distribution to one or more secured or preferential creditors. This objective can only be pursued where it is not reasonably practicable to achieve either of objectives 1 or 2. Usually the Directors of

the firm would apply to court to make an administration order. Alternatively, if the firm is being liquidated, the firm's creditors apply to court for a winding-up order.

Administrators can be appointed by the Court or by the company, the directors or the holder of a qualifying floating charge.

11. Please describe the process by which the Administrative Officer (as defined above), if any, is selected. What qualifications, if any, must an Administrative Officer have? Who selects the Administrative Officer?

The administrator is either appointed by the Court or by the company. The administrators have to pass relevant insolvency examinations to become a licensed Insolvency Practitioner and be a member of the Insolvency Practitioners Association (IPA).

12. What are the duties of the Administrative Officer?

a. What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?

Insolvency Practitioners licensed by the IPA have to comply with the Statements of Insolvency Practice and take into account Guidance issued by it. Further guidance can be found through the IPA, and other UK sources, such as UK insolvency service. In addition, Insolvency Practitioners have to comply with the relevant statutes and statutory instruments.

b. Under what standard (*e.g.*, strict liability, negligence), if any, is the Administrative Officer, pursuant to the Regime in your jurisdiction, subject to personal liability for failure to properly perform his or its duties?

Insolvency Practitioners (IPs) who are appointed as administrators or liquidators have total personal liability.

13. What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?

a. Does the regulator continue to supervise the Investment Firm?

Yes, the investment firm remains an authorized person and is still subject the FSA Handbook.

b. How, if at all, is the regulator involved in the process of returning Client Assets?

The FSA is not directly involved in the process of returning Client Assets – that is the role for the administrator or liquidator. However, the FSA exerts regulatory influence over the insolvency to ensure an efficient and orderly return of assets.

14. Does the Regime in your jurisdiction facilitate or encourage the transfer of Client Assets from an Investment Firm which has become bankrupt or insolvent to a solvent Investment Firm?

a. What steps, if any, are prerequisite to accomplishing such a transfer? In general, how long does it take to accomplish those steps?

The FSA would form a view of the transfer in light of supervisory, policy and legal issues and act accordingly. The FSA would ensure that the transfer appropriately protected client assets, and ensured the fair treatment of customers. Steps may involve the firm applying for

waivers of certain rules before the transfer could be affected. The FSA responds quickly to such requests if necessary.

b. What factors, if any, affect the time period required to accomplish such a transfer?

Factors would include the size of the firm, amounts involved, number of clients and internal resourcing requirements.

15. To what extent are clients at risk of, or protected from, having to return Client Assets (or the value thereof) that were distributed to the client prior to the insolvency proceeding?

Client assets and money form part of trust property. If client assets or monies were returned before insolvency, this would not be considered to be a preference payment.

16. To what extent, if at all, does the Regime in your jurisdiction provide compensation to clients from other sources (for example, an investor protection or similar fund) for loss of Client Assets? Please discuss the scope of protections, conditions on such protection, and the limits of compensation (*e.g.*, maximum compensation per client).

The FSCS is the UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation if a firm is unable, or likely to be unable, to pay claims against it. This is usually because it has stopped trading or has been declared in default. The FSCS will declare a firm in default if:

(1) it has received at least one eligible claim against it, and the customer has made a financial loss;

(2) it is satisfied that the firm is unable, or likely to be unable, to pay claims against it. We will investigate the firm's financial position to establish this.

The scheme covers both individual clients and small businesses if they have invested with an FSA authorised firm performing regulated activities. Designated investment business is insured up to a maximum of £48,000, with 100% of first £20,000 being insured and then 90% of the next £30,000. From 1 January 2010, this will be increased to the first 100% of the first £50,000.

17. Are there circumstances in which clients are treated differently based on permissions they have granted pre-bankruptcy. *E.g.*, if any re-hypothecation has been entered into (or a 'right-to-use' exercised), please explain the client's position under the Insolvency Regime in such event.

If a client has transferred title to the firm, or granted a right-to-use and the firm has exercised that right, i.e. re-hypothecated those assets, then the client will rank as a general creditor to the firm.

Client assets and money which are subject to the full regime, are held on trust and are therefore separate from the general estate of the firm and are distributed back to clients.

18. Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?

Clients are not affected to the extent that return of assets may be delayed during complex cross-border insolvencies. Where clients have asked for assets to be held in jurisdictions which are perceived to offer less protection, the firm should give the client full disclosure of those risks.

19. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?

The client money regime creates a statutory trust upon the receipt of client money, the result of which is that clients have an entitlement to that amount of client money as soon as the firm receives the client money. If the firm enters insolvency and there is a shortfall in the client money pool the firm's administrators may be required to top-up the client money pool from the general estate.

The client assets should be traceable and returned to clients. If a firm misapplies, looses, or simply holds too few assets there will be a shortfall (see below).

In either case, the client would have a breach of trust claim against the firm.

20. If there is a shortfall, *i.e.*, if claims by clients exceed resources dedicated to paying such claims (whether from Client Assets, investor protection fund, or otherwise), how are Client Assets distributed? *E.g.*, is there a pro rata distribution of Client Assets, are there priorities between classes of clients, is there a priority distribution ahead of the distribution of the general estate/distribution to unsecured creditors?

Client money is distributed on a pro rata (pari passu) basis. Shortfalls can be claimed against the FSCS as described above.

Any distribution of client assets depends on the factual scenario. If assets are held in a pooled omnibus account they would be distributed on a pro rata basis. If however, assets were segregated on behalf of one client and there was a shortfall – that client would have a claim as unsecured creditor of the general estate, and would be able to claim against the FSCS if they suffered loss.

21. Please explain how claims of clients are ranked in the insolvency process relative to those of other creditors. Does your insolvency regime rank domestic creditors above foreign creditors?

The UK does not distinguish between domestic and foreign clients. Trust property and client assets are held separate from the firm's and therefore never forms part of the general estate. This segregation allows the trust property to be distributed before administration dividends.

III. Pertinent references

Please provide, for any statutes, regulations, or other authorities or texts that are referred to in your response, electronic copies (in English translation, if available), or URL links to available copies. How might a person outside your jurisdiction most readily get access to such items? Are there treatises that would be useful for obtaining a general understanding of client asset protection in your jurisdiction?

http://fsahandbook.info/FSA/html/handbook/CASS

Statutes:
The Enterprise Act 2002
The Financial Services and Markets Act 2000
The Insolvency Act 1986

United States - CFTC

Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets

I. Background

This questionnaire seeks information to aid in understanding the responding jurisdictions' techniques for protecting Client Assets in the event of the insolvency and/or winding up of an Investment Firm, and for promptly transferring such assets to a solvent Investment Firm or distributing them to the client. It is not intended to require information concerning the general legal framework for insolvency, except to the limited extent necessary to understand how rules for the protection of Client Assets fit within that framework.

Definitions.

(1) **"Administrative Officer"** refers to the person or entity who is appointed, whether by a court, regulator, creditors, the Investment Firm itself, or otherwise, to assume control of or power over a bankrupt or insolvent Investment Firm. This term includes administrators, debtors in possession, receivers, liquidators, trustees, and similar titles.

(2) **"Client Assets"** refers collectively to Positions, Securities, and Client Money:

- "**Positions"** are contractual rights and obligations arising from transactions entered into by an investment firm on behalf of its clients, including mark to market accruals arising from the change in value of futures, options and/or other derivatives positions;

- "**Securities"** are defined to incorporate both securities and derivatives, as those terms are defined or understood in the responding jurisdiction; and

- "**Client Money"** refers to funds owed to or held on behalf of clients by an investment firm, and may include margin collateral associated with client positions (both existing and potential), income relating to an investment such as dividends or interest, proceeds of the liquidation of client securities and/or positions, and funds in excess of required margin.

(3) **"Investment Firm"** means an intermediary that holds Client Assets and is engaged in the business of managing client accounts, which could include, without limitation: executing orders on behalf of others, dealing in or distributing Securities (including carrying derivatives positions). In jurisdictions where banks are broadly permitted to engage in such a business, this term includes banks to the extent they are providing such services.

(4) **"Omnibus Account"** means an Investment Firm's account with a third party in which Client Assets are maintained separate from the firm's assets, but are held in the aggregate instead of in accounts designated for individual clients.

(5) **"Regime"** refers to statutes, regulations, rules of exchanges, clearing organizations and other self-regulatory bodies, or other legally binding requirements.

II. Survey Questions *Where appropriate, please provide citations to statutes, regulations, or other authorities supporting your answers below.*

Context

1. Please provide a brief overview setting forth the defining characteristics of your jurisdiction's approach to protecting Client Assets.

Every Investment Firm holding Client Assets is a futures commission merchant ("FCM"), and is required to keep all such assets in accounts segregated (or set aside) for the benefit of clients. As discussed further below, the Investment Firm is required to, at all times, have sufficient Client Assets in segregated accounts to meet all obligations to clients, without deduction for client accounts in deficit.[1] The Investment Firm is, however, permitted to treat segregated accounts (or set-aside accounts) on an omnibus basis, *i.e.*, Client Assets are not segregated for each client.

An Investment Firm maintains separate "account classes" (as Answer 20 describes further below) for clients trading domestic futures (*i.e.*, futures traded on a contract market designated as such by the CFTC) and for clients trading foreign futures (*i.e.*, futures traded on contract markets outside the United States). In the event that an Investment Firm becomes subject to bankruptcy proceedings, there is no discrimination in distribution of Client Assets, however, between clients who are U.S. citizens and those who are not.

The provisions of the U.S. Bankruptcy Code related to commodity futures (Subchapter IV of Chapter 7, 11 U.S.C. §761-767) and the regulations promulgated by the CFTC (17 C.F.R. Part 190) are designed to promote the prompt transfer of client positions and associated Client Assets from an insolvent Investment Firm to a solvent Investment Firm. Where that is not practicable (*e.g.*, where there is a shortfall in Client Assets due to a client default that exceeds the resources of the Investment Firm), Client Assets in each "account class" are distributed *pro rata* among the client claims for that "account class," with each client claim receiving the same percentage economic distribution, regardless of the form of Client Assets deposited.

In answering the remaining questions:

(1) Please provide details, as appropriate, where the Regime in your jurisdiction applies different treatment or results based on differences in:

a. Categories of Client Assets;

b. Models of trading (e.g., exchange-traded versus over-the-counter).

*c. Categories of clients (*e.g., *retail versus sophisticated)*

[1] As discussed below, slightly different requirements apply to Client Assets in accounts set aside for customers – *i.e.*, accounts for foreign futures.

(2) *You are requested to provide details of the Regime in your jurisdiction. You are additionally invited to provide information explaining how that Regime is applied in practice, through,* e.g., *informal arrangements between governmental entities.*

Pre-Insolvency

2. Does the regime in your jurisdiction require an Investment Firm to hold special authorization (*i.e.*, a specific form of license or registration) to be permitted to hold Client Assets?

Yes, any Investment Firm holding Client Assets securing commodity futures transactions is an FCM, and pursuant to Section 4d(a)(1) of the Commodity Exchange Act (the "Act"), must register with the CFTC. The CFTC has delegated certain of its registration responsibilities to the National Futures Association ("NFA"), a self-regulatory organization ("SRO").[2]

a. If special authorization is required, what requirements (both initial and ongoing) is an Investment Firm required to comply with to hold such authorization?

In order for an Investment Firm to operate as an FCM, it must meet minimum capital requirements. Pursuant to CFTC regulation ("Regulation") 1.17, such Investment Firm must maintain, at all times, adjusted net capital equalling or exceeding the greatest of the following:

- $1,000,000;
- The minimum amount of net capital required by the NFA;
- A risk-based capital computation equal to the sum of (i) 8% of the margin requirements of clients (whether or not affiliated with the Investment Firm); and
- For an Investment Firm also registered as a securities broker or dealer, the amount of capital required by the Securities Exchange Commission.

Further, in order for an Investment Firm to operate as an FCM, it must demonstrate moral and operational fitness. It may so demonstrate by taking the following actions, among others:

- disclosing information regarding the organization of its business, including information concerning any holding company and/or branch offices;
- disclosing criminal or regulatory actions;
- nominating contact persons for issues concerning membership, accounting arbitration, compliance, and enforcement; and

[2] An SRO is an exchange or registered futures association (*i.e.*, the National Futures Association) that enforces financial and sales practice requirements for their members. The term "Designated Self-Regulatory Organization" ("DSRO") refers to the SRO that is primarily responsible for a specific Investment Firm that is an FCM. If such Investment Firm is a member of more than one SRO, all relevant SROs may decide among themselves which of them will be primarily responsible for that Investment Firm, and that SRO will be appointed the DSRO for that Investment Firm.

- submitting procedures and materials relating to the following for approval:
    - (i) anti-money laundering; (ii) business continuity; (iii) electronic order routing systems; (iv) promotional materials; (v) supervision of associated persons; and (vi) handling of client complaints.

Specifically with respect to Client Assets:

- During the FCM registration process, an Investment Firm may demonstrate operational fitness by submitting for approval its procedures for maintaining the segregation (or separation) of Client Assets in accordance with applicable Sections of the Act and the Regulations (as such Sections and Regulations are described further below).
- In order for such Investment Firm to operate as an FCM, it must deposit Client Assets with a third-party depository (*e.g.*, a bank, trust company, clearing organization, or another Investment Firm that is an FCM) in an account that clearly identifies such assets as "Client Assets."
- The Investment Firm must also obtain a written acknowledgment from its third-party depository stating that such depository was informed that the funds deposited within the account entitled "Client Assets" (i) belong to clients of the Investment Firm, (ii) are being held to support transactions in commodity futures markets, and (iii) are being held in accordance with applicable Sections of the Act and the Regulations (as such Sections and Regulations are described further below).

b. If special authorization is not required, how, if at all, is this activity supervised by a regulator?

Not applicable.

3. Does the Regime in your jurisdiction require that Client Assets be maintained separately from the assets of an Investment Firm? If so, please provide a description of the process by which segregation is accomplished, and of the applicable requirements. Specifically:

Yes.

- *Futures.* Section 4d of the Act and Regulation 1.20 require that an Investment Firm segregate (i) proprietary assets from (ii) Client Assets securing commodity futures transactions executed on a designated contract market ("DCM") or a derivatives transaction execution facility ("Futures").
- *Foreign Futures.* Regulation 30.7 requires that an Investment Firm set aside from its proprietary assets an amount sufficient to cover or satisfy all of its current obligations to clients that are (i) located within the United States and (ii) transacting in commodity futures or options listed on a foreign board of trade ("Foreign Futures").
    - Regulation 30.7 may permit an Investment Firm to set aside a lesser amount of Client Assets to cover its current obligations to clients that are (i) located outside of the United States and (ii) transacting in Foreign Futures. However, as further described in Answers 20 and 21, in the event that the Investment Firm becomes subject to bankruptcy proceedings, such clients will share the Client Assets allocated to the Foreign Futures "account class" equally with clients that are (i) located in the United States and (ii) transacting in Foreign Futures.

a. Must the Client Assets of one client be maintained separately from those of other clients?

i. Are Investment Firms allowed to hold Omnibus Accounts?

Yes. Section 4d of the Act and Regulation 1.20 permit an Investment Firm to hold Client Assets securing Futures in an Omnibus Account (the "Futures Omnibus Account"). Regulation 30.7 permits an Investment Firm to hold Client Assets securing Foreign Futures in an Omnibus Account (the "Foreign Futures Omnibus Account"), provided that the Foreign Futures Omnibus Account is separate from the Futures Omnibus Account.

ii. What measures are used to protect the Client Assets of each client from losses due to the activities of other clients?

As Answer 20 states below, if a shortfall (as such term is defined below) exists, then clients with Client Assets in the same Omnibus Account as the client whose losses caused the shortfall will share such losses on a *pro rata* basis. Therefore, the best method of preventing such sharing of loss is to ensure, in the first instance, that an Investment Firm will not permit a client to accumulate losses that would be sufficient to cause the default and insolvency of the Investment Firm. Currently, a DCM is required, under Core Principle 11, to conduct financial surveillance of Investment Firms, to, *inter alia*, ensure that the capital of such Investment Firms is appropriate to cover client exposures to Futures.

b. Please describe any requirement that an Investment Firm must reconcile the Client Asset account. For example:

i. How do you calculate the amount of Client Assets that a firm is required to hold in one or more accounts segregated for the benefit of clients?

- *Futures Omnibus Account.* Pursuant to Section 4d of the Act, an Investment Firm is required, at all times, to hold sufficient Client Assets in the Futures Omnibus Account to pay all clients transacting in Futures with credit balances.
- *Foreign Futures Omnibus Account*. Pursuant to Regulation 30.7, an Investment Firm is required, at all times, to hold sufficient Client Assets in the Foreign Futures Omnibus Account to cover or satisfy all of its current obligations to clients that are (i) located within the United States and (ii) transacting in Foreign Futures (the "Secured Amount"). Further, if an Investment Firm decides to hold, in the Foreign Futures Omnibus Account, Client Assets for clients that are (i) located outside the United States and (ii) transacting in Foreign Futures, then such Investment Firm is required, at all times, to hold Client Assets equaling or exceeding the greater of:
  - the sum of (i) the Secured Amount and (ii) an amount sufficient to cover or satisfy all current obligations of the Investment Firm to clients that are (A) located outside of the United States and (B) transacting in Foreign Futures; and
  - the sum of (i) the Secured Amount and (ii) an amount that is required, by the Regime of the relevant depository or clients, to be held separately for clients that are (A) located outside of the United States and (B) transacting in Foreign Futures.

A) Are required Client Assets fungible between or within asset classes, or is the Investment Firm required to hold, *e.g.*, the specific assets deposited by the client?

In general, Client Assets are fungible. If an Investment Firm becomes subject to bankruptcy proceedings, a client can apply for return of "specifically identifiable property," which is generally comprised of property held to facilitate physical settlement of a *bona fide* hedging transaction. Pursuant to Regulation 190.08(d), an Administrative Officer would usually return such "specifically identifiable property" only if the client provides in cash the amount necessary to result in the client suffering the same *pro rata* loss as other clients.

B) How is the reconciliation conducted (*e.g.*, on an aggregate basis, or a client-by-client basis)?

Investment Firms perform reconciliations on an aggregate basis.

C) If a client has a debit balance (*i.e.*, the client owes the Investment Firm), is such balance deducted in determining the amount the Investment Firm is required to hold?

No. If a client has a debit balance, the Investment Firm must deposit in the relevant Omnibus Account an amount at least equal to such balance from its own capital.

ii Timing issues:

A) How often is reconciliation required (*e.g.*, daily, weekly, monthly).

Investment Firms must perform daily reconciliations.

B) When is such reconciliation required (*e.g.*, noon of the following business day, the tenth business day of the following month).

Investment Firms must perform reconciliations for each business day by noon on the following business day.

C) Is the Investment Firm required to make good any deficiency from their own funds? If so, in what period? Is any payment by the Investment Firm thereby deemed to be Client Money?

Yes, if the reconciliation shows a deficiency in Client Assets, the Investment Firm must immediately make good such deficiency. Any amount that the Investment Firm deposits in the relevant Omnibus Account would be considered Client Assets.

Further, the Investment Firm must immediately report, pursuant to Regulation 1.12(h), the existence of a deficiency to the CFTC. As a practical matter, all Investment Firms maintain a cushion of their own assets in the Futures Omnibus Account and the Foreign Futures Omnibus Account, to avoid deficiencies in Client Assets and the attendant reporting obligation.

iii. Is an Investment Firm permitted or encouraged to maintain any of their own assets in a Client Asset account (*e.g.*, as a "buffer")? If so, are any such assets so transferred then deemed to be Client Assets? Is there a requirement to remove any excess assets?

Yes. *See* Answer 3(b)(ii)(C) above. Neither the Act nor the Regulations require an Investment Firm to remove any excess assets.

c. Can the Investment Firm use Client Assets of one client for meeting obligations of another client? If so, how?

Section 4d of the Act and Regulation 1.20 prohibit the Investment Firm from using the Client Assets of one client in the Futures Omnibus Account to meet the obligations of another client. Regulation 30.7 does not contain a similar prohibition, because Regulation 30.7 does not require an Investment Firm to hold, at all times, sufficient Client Assets in the Foreign Futures Omnibus Account to pay all clients transacting in Foreign Futures with credit balances.

d. Are there any restrictions on the ability of the Investment Firm (or other party holding Client Assets) to invest, encumber, rehypothecate, stock-lend, or otherwise deal with, the Client Assets? If so, please describe.

- *Futures Omnibus Account.* Pursuant to Section 4d of the Act, an Investment Firm may invest Client Assets in the Futures Omnibus Account only "in obligations of the United States, in general obligations of any State or of any political subdivision thereof, and in obligations fully guaranteed as to principal and interest by the United States, such investments to be made in accordance with such rules and regulations and subject to such conditions as the Commission may prescribe." Regulation 1.25 sets forth permitted investments for Client Assets in the Futures Omnibus Account. Regulation 1.25 further sets forth specified requirements with respect to permitted investments that are designed to minimize exposure to credit, liquidity, and market risks.

- *Foreign Futures Omnibus Account.* Neither the Act nor the Regulations place restrictions on the ability of an Investment Firm to invest Client Assets in the Foreign Futures Omnibus Account. However, the Investment Firm has an incentive to invest such Client Assets conservatively, because the Investment Firm is required to immediately make good and to report a deficiency in such Client Assets.

e. What are the requirements, if any, for clearinghouses or other central counterparties to maintain the separate identification of collateral posted by the Investment Firm for its Client Positions?

- *Futures Omnibus Account.*

  - Section 4d(b) of the Act states that "[i]t shall be unlawful for any person, including but not limited to any clearing agency…and any depository, that has received any money, securities, or property for deposit in [the Futures Omnibus Account], to hold, dispose of, or use any such money, securities, or property as belonging to the depositing futures commission merchant or any person other than the customers of such futures commission merchant."

  - Additionally, Regulation 1.20 states that "[a]ll customer funds received by a clearing organization from a member of the clearing organization to purchase, margin, guarantee, secure, or settle the trades, contracts, or commodity options of the clearing member's commodity or option customers as the result of trades, contracts or commodity options so carried shall be separately accounted for and segregated as belonging to such commodity or option customers."

  - Further, Regulation 1.20 requires that:

- the clearing organization deposit Client Assets with a third-party depository (*i.e.*, a bank or trust company) in an account that clearly identifies such assets as "Client Assets" from the Futures Omnibus Accounts of Investment Firms, which assets are segregated in accordance with Section 4d of the Act and Regulation 1.20;

- the clearing organization obtain a written acknowledgment from its third-party depository (*i.e.*, a bank or trust company) stating that such depository was informed that such Client Assets (i) belong to clients of Investment Firms, (ii) are being held to support Futures, and (iii) are being held in accordance with Section 4d of the Act and Regulation 1.20.

- *Foreign Futures Omnibus Account.*

  - Regulation 30.7 does not specifically impose requirements on clearing organizations to maintain the separate identification of Client Assets from the Foreign Futures Omnibus Account. However, as Answer 2(a) states, Regulation 30.7 does require:

    - each Investment Firm to deposit such Client Assets with a third-party depository, including a clearing organization, in an account that clearly identifies such assets as "Client Assets" from the Foreign Futures Omnibus Account, which assets are set aside in accordance with Regulation 30.7; and

    - each Investment Firm to obtain a written acknowledgment from such third-party depository, including a clearing organization, stating that such depository was informed that such Client Assets (i) belong to clients of the Investment Firm, (ii) are being held to support Foreign Futures, and (iii) are being held in accordance with Regulation 30.7.

  - Further, Regulation 30.7 generally prohibits Client Assets in the Foreign Futures Omnibus Account from being "commingled with the money, securities or property of such futures commission merchant, with any proprietary account of such futures commission merchant, or used to secure or guarantee the obligations of, or extend credit to, such futures commission merchant or any proprietary account of such futures commission merchant." Such prohibition would extend to the activities of clearing organizations.

4. Are Investment Firms permitted to transfer to, or hold Client Assets in, another jurisdiction? If so, does the Regime in your jurisdiction require Investment Firms to preserve the separate identification of:

Yes, Investment Firms are generally permitted to transfer to, or hold Client Assets in, other jurisdictions, pursuant to: (i) Regulation 1.49 with respect to Client Assets in the Futures Omnibus Account; and (ii) Regulation 30.7 with respect to Client Assets in the Foreign Futures Omnibus Account.

a. Client Assets transferred to or located in other jurisdictions?

Yes.

- *Futures Omnibus Account.*
    - Pursuant to Regulation 1.20, an Investment Firm must:
        - deposit Client Assets with a third-party depository, whether located in the United States or in another jurisdiction, in an account that clearly identifies such assets as "Client Assets" from the Futures Omnibus Account, which assets are segregated in accordance with Section 4d of the Act and Regulation 1.20; and
        - obtain a written acknowledgment from its third-party depository, whether located in the United States or in another jurisdiction, stating that such depository was informed that such Client Assets (i) belong to clients of Investment Firms, (ii) are being held to support Futures, and (iii) are being held in accordance with Section 4d of the Act and Regulation 1.20.
    - Pursuant to Regulation 1.49(e), each Investment Firm that has either transferred to, or held Client Assets from the Futures Omnibus Account in, another jurisdiction must have sufficient Client Assets, as of the close of each business day, to meet all obligations to clients from the Futures Omnibus Account.
    - Pursuant to Regulation 1.32, each Investment Firm must perform a daily reconciliation of the amount of Client Assets in the Futures Omnibus Account, on a currency-by-currency basis.
- *Foreign Futures Omnibus Account.* Pursuant to Regulation 30.7, an Investment Firm must:
    - deposit Client Assets with a third-party depository, whether located in the United States or another jurisdiction, in an account that clearly identifies such assets as "Client Assets" from the Foreign Futures Omnibus Account, which assets are set aside in accordance with Regulation 30.7;
    - obtain a written acknowledgment from such third-party depository, whether located in the United States or another jurisdiction, stating that such depository was informed that such Client Assets (i) belong to clients of the Investment Firm, (ii) are being held to support Foreign Futures, and (iii) are being held in accordance with Regulation 30.7; and
    - perform a daily reconciliation of the amount of Client Assets in the Foreign Futures Omnibus Account.

b. Client Assets that have been transferred to the Investment Firm from other jurisdictions and that have been identified as Client Assets in those jurisdictions?

If so, please provide details of those requirements.

Yes. Section 4d of the Act and Regulation 1.20 would require the Investment Firm to place such Client Assets in the Futures Omnibus Account, to the extent that such Client Assets currently, or are intended to in the future, secure Futures. Regulation 30.7 would require the Investment Firm to place such Client Assets in the Foreign Futures Omnibus Account, to the extent that such Client Assets must be included in the Secured Amount or any additional amount, as described in Answer 3(b)(i). Neither the Act nor the Regulations require that the Investment Firm identify, within the relevant Omnibus Account, the

jurisdiction from which such Client Assets originated (*e.g.*, the Investment Firm would not need to separately identify (i) USD originating from the United States and (ii) USD transferred from another jurisdiction).

5. If the Regime in your jurisdiction permits or requires Client Assets to be held by third party custodians:

   a. Please describe the requirements, if any, concerning the qualifications of such custodians e.g., licensing, creditworthiness. May the Client Assets be kept with an affiliate of the Investment Firm?

- *Futures Omnibus Account.*
  - Pursuant to Regulation 1.49(d):
    - If an Investment Firm holds the Futures Omnibus Account with a third-party depository located in the United States, such depository must be: (i) a bank or trust company (each of which is subject to the oversight of applicable banking regulators); (ii) an FCM registered as such with the Commission; or (iii) a derivatives clearing organization ("DCO").
    - If an Investment Firm holds the Futures Omnibus Account with a third-party depository located outside of the United States, such depository must be: (i) a bank or trust company that has (A) more than $1 billion of regulatory capital or (B) debt instruments (or that is part of a holding company with debt instruments) that are rated in one of the two highest rating categories by at least one nationally recognized statistical rating organization; (ii) an FCM registered as such with the Commission; or (iii) a DCO.
  - The Investment Firm may hold the Futures Omnibus Account with an affiliate.
- *Foreign Futures Omnibus Account.*
  - Pursuant to Regulation 30.7, an Investment Firm may hold the Foreign Futures Omnibus Account in any third-party depository in which it may hold the Futures Omnibus Account, in addition to the following: (i) a bank or trust company located outside of the United States as designated; (ii) a member of any foreign board of trade; and (iii) the designated depository of such member or a DCO.
  - The Investment Firm may hold the Foreign Futures Omnibus Account with an affiliate.

   b. Please describe any requirements concerning the custody agreement between intermediary and custodian. In particular, may the custodian be permitted to place a lien, charge or other encumbrance on Client Assets? If so, please explain.

- *Futures Omnibus Accounts.* Regulation 1.20 states that "[u]nder no circumstances shall any portion of [Client Assets in Futures Omnibus Accounts] be obligated to a clearing organization, any member of a contract market, a futures commission merchant, or any depository except to purchase, margin, guarantee, secure, transfer, adjust or settle trades, contracts or commodity option transactions of commodity or option customers."

- *Foreign Futures Omnibus Accounts*. Regulation 30.7 generally prohibits Client Assets in the Foreign Futures Omnibus Account from being "used to secure or guarantee the obligations of, or extend credit to, such futures commission merchant or any proprietary account of such futures commission merchant." Such prohibition would extend to custodians.

6. Under what circumstances, if any, is an Investment Firm required to disclose to clients information related to the protection of the client's assets? What is the nature of such required disclosures? How do any such required disclosures apply to Client Assets held in another jurisdiction?

Prior to opening a transactional account for a client, an Investment Firm is required to provide such client (except for certain "institutional customers" as defined in Regulation 1.3(g)) specific disclosures pertaining to (i) the protection of Client Assets in the Futures Omnibus Account (pursuant to Regulation 1.55) and (ii) the protection of Client Assets in the Foreign Futures Omnibus Account (pursuant to Regulation 30.6). Such disclosures emphasize that:

- Client Assets in the Foreign Futures Omnibus Account may not be provided the same level of protection as Client Assets in the Futures Omnibus Account;
- the client should consult with the Investment Firm concerning the nature of protections available to Client Assets, especially in the event of the Investment Firm experiencing insolvency;
- if the client gives the Investment Firm permission, either explicitly or implicitly, to deposit Client Assets in a jurisdiction outside of the United States, then in the event that the Investment Firm experiences insolvency, the laws of the relevant jurisdiction may apply, which may result in the client recovering less than all of the Client Assets that the client provides to the Investment Firm; and
- the CFTC cannot compel enforcement of the laws of the relevant jurisdiction.

7. Under what conditions, if any, may clients choose to waive any of the Client Asset protection requirements applicable in your jurisdiction (also known as "opting out")? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

The Act and the Regulations do not permit clients to choose a lesser level of protection for Client Assets than the level that (i) Section 4d of the Act and Regulations 1.20 to 1.30 afford to Client Assets in the Futures Omnibus Account, and (ii) Regulation 30.7 affords to Client Assets in the Foreign Futures Omnibus Account.

8. Under what circumstances, if any, is an Investment Firm required to notify the regulators, or the market generally, of material changes in their financial position or ability to continue to carry on business? What is the nature of such required disclosures?

An Investment Firm has affirmative responsibilities under the Regulations to notify the CFTC upon the occurrence of one of a number of events, any of which may indicate financial distress. For example, pursuant to Regulation 1.12:

- an Investment Firm must provide the CFTC with notice within twenty-four (24) hours, if such Investment Firm knows or should know that its capital exceeds its minimum capital requirement, but is less than a certain percentage specified in Regulation 1.12;

- an Investment Firm must provide the CFTC with immediate notice, if such Investment Firm knows or should know that its capital is less than the amount specified in its minimum capital requirement;

- an Investment Firm must provide the CFTC with immediate notice, if such Investment Firm determines that it has a deficiency in either (i) the Client Assets in the Futures Omnibus Account or (ii) the Client Assets in the Foreign Futures Omnibus Account; and

- an Investment Firm must provide the CFTC with immediate notice, if such Investment Firm determines that either the Futures Omnibus Account or the Foreign Futures Omnibus Account is undermargined by an amount that exceeds the adjusted net capital of such Investment Firm.

Additionally, the CFTC may receive information from a DSRO or a DCO that an Investment Firm is either currently not fulfilling its financial obligations, or has a risk profile indicating that it may shortly become unable to fulfill such obligations. Further, the CFTC Risk Surveillance Group may identify such an Investment Firm.

In general, the Act and the Regulations do not impose affirmative responsibilities on the Investment Firm to notify the market of material changes in financial position or ability to continue operations.

9. For an Investment Firm whose financial situation is seen to have deteriorated (*e.g.*, capital has fallen below certain thresholds), what actions, if any, may the firm's regulators take to protect Client Assets?

If the CFTC ascertains, from the notifications described in Answer 8, that the financial situation of an Investment Firm is deteriorating, then the CFTC will attempt to effect the transfer of Client Assets. For example, pursuant to Regulation 1.17(a)(4), if an Investment Firm holds less capital than the amount specified in its minimum capital requirement, then it generally must transfer all Client Assets and immediately cease conducting business as an Investment Firm, until such time as the Investment Firm is able to demonstrate compliance with its minimum capital requirement. The Investment Firm itself or its DSRO would actually arrange the transfer of Client Assets, and the CFTC would facilitate such transfer as necessary.

Post-Insolvency

10. Please describe the process by which an Investment Firm enters the status of "insolvent" or "bankrupt" or the equivalent. For example, is a petition filed by the firm's regulator or some other administrative agency, by creditors of the firm, or otherwise? Is a decree entered by a court? Is this process different from the process applicable to entities that are not Investment Firms?

In general, an Investment Firm becomes subject to bankruptcy proceedings in the same manner as an entity that is not an Investment Firm – *i.e.*, either (i) the Investment Firm itself files a voluntary bankruptcy petition or (ii) the creditors of such Investment Firm file an

involuntary bankruptcy petition. However, there are two key differences in the manner in which bankruptcy proceedings for an Investment Firm may be initiated, as contrasted with the manner in which bankruptcy proceedings for an entity that is not an Investment Firm may be initiated.

- First, if an Investment Firm has engaged, is engaging, or is about to engage in any act or practice constituting a violation of the Act, the Regulations, or any CFTC order, then pursuant to Section 6(c) of the Act, the CFTC may petition in federal court for the appointment of a receiver for the Investment Firm. If appropriate, the receiver would then file a voluntary bankruptcy petition on behalf of the Investment Firm.

- Second, pursuant to Section 109(d) of the Bankruptcy Code, an Investment Firm is only eligible for liquidation under Subchapter IV of Chapter 7 of the Bankruptcy Code. An Investment Firm is not eligible for reorganization under Chapter 11 of the Bankruptcy Code.

11. Please describe the process by which the Administrative Officer (as defined above), if any, is selected. What qualifications, if any, must an Administrative Officer have? Who selects the Administrative Officer?

In general, the relevant United States Trustee, an officer of the executive branch, will appoint an Administrative Officer from a panel of private trustees. There are twenty-one United States Trustees, and they are organized on a regional basis. In practice, the CFTC coordinates with the relevant United States Trustee to provide for the appointment of an Administrative Officer who is familiar with the commodity futures markets and the role of Investment Firms in such markets. In general, the Administrative Officer would also retain a law firm with knowledge of the Regime governing the Investment Firm, particularly with respect to bankruptcy.

12. What are the duties of the Administrative Officer?

a. What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?

Section 704 of the Bankruptcy Code sets forth the general duties of the Administrative Officer. Such duties include the following: (i) investigating the financial affairs of the Investment Firm; (ii) reducing the estate of the Investment Firm to money and closing such estate as expeditiously as possible; (iii) accounting for property in such estate; (iv) examining and objecting to claims from creditors; (v) providing information on the administration of such estate; and (v) making a final report and filing a final account of the administration of such estate with the United States Trustee or the relevant bankruptcy court.

Subchapter IV of Chapter 7 of the Bankruptcy Code and Regulation Part 190 set forth certain duties of the Administrative Officer specific to the bankruptcy of an Investment Firm, and provide guidance to the Administrative Officer on satisfying such duties. Such duties include, and such guidance pertains, to the following: (i) the expeditious transfer, as described further below, of Client Assets from the Investment Firm to a solvent Investment Firm; (ii) the expeditious liquidation and distribution of Client Assets, as described further below, if a transfer of Client Assets is not feasible (because of, *e.g.*, the existence of a shortfall); and (iii) the requisite consultation with clients of the Investment Firm prior to the liquidation of Client Assets.

b. Under what standard (*e.g.*, strict liability, negligence), if any, is the Administrative Officer, pursuant to the Regime in your jurisdiction, subject to personal liability for failure to properly perform his or its duties?

The standard under which the Administrative Officer would be subject to personal liability for failure to properly perform his or its duties is not articulated in the Bankruptcy Code, the Act, or the Regulations. Rather, such standard has been developed through case law. The leading case on this question, *Mosser v. Dunn*, 341 U.S. 267 (1951), articulated principles that have been interpreted to permit the Administrative Officer to be held personally liable for gross negligence or for willful disregard of his or its fiduciary duties.

13. What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?

a. Does the regulator continue to supervise the Investment Firm?

Yes, the Investment Firm remains an FCM and is still subject to the Act and the Regulations.

b. How, if at all, is the regulator involved in the process of returning Client Assets?

The CFTC would be involved in discussions with the Administrative Officer, the DSRO of the Investment Firm, and the DCO of the Investment Firm to facilitate efficient and orderly returns of Client Assets. The CFTC also has the right to appear and be heard in the bankruptcy proceedings for the Investment Firm. The CFTC, however, does not directly participate in disbursements of Client Assets. Rather, the Administrative Officer is responsible for such disbursements.

14. Does the Regime in your jurisdiction facilitate or encourage the transfer of Client Assets from an Investment Firm which has become bankrupt or insolvent to a solvent Investment Firm?

Yes, if an Investment Firm becomes subject to bankruptcy proceedings before it transfers Client Assets as described in Answer 9, the Administrative Officer must immediately use best efforts, pursuant to Regulation 190.02(e), to transfer eligible Client Assets, as determined in accordance with Regulation 190.06(e) and (f).

a. What steps, if any, are prerequisite to accomplishing such a transfer? In general, how long does it take to accomplish those steps?

The Administrative Officer must use best efforts, pursuant to Regulation 190.02(e), to transfer eligible Client Assets no later than the close of business on the seventh business day after the petition for bankruptcy has been filed with respect to the Investment Firm. Such transfers are generally accomplished if there is no shortfall in Client Assets. Indeed, in such cases (*e.g.*, the bankruptcy cases of Refco, LLC and Lehman Brothers, Inc.), transferees may pay for the client business of the Investment Firm. In such cases, a transferee may be identified before the Investment Firm formally becomes subject to bankruptcy proceedings, the transfer may be approved by the Court within hours of the filing of such proceedings, and the transfer accomplished over a weekend.

b. What factors, if any, affect the time period required to accomplish such a transfer?

The key factor is the presence or absence of a shortfall in Client Assets. If such a shortfall exists, Client Assets will generally be distributed as part of a bankruptcy proceeding. As Answer 20 discusses further below, the presence or absence of a shortfall is computed separately for each "account class."

15. To what extent are clients at risk of, or protected from, having to return Client Assets (or the value thereof) that were distributed to the client prior to the insolvency proceeding?

In general, clients are protected from being required to return Client Assets distributed in accordance with the Act and the Regulations, whether such distributions occurred before or after a petition for bankruptcy has been filed with respect to the Investment Firm. Specifically:

- Pursuant to Section 764(b) of the Bankruptcy Code, in conjunction with Regulations 190.06(g)(1) and (3), the Administrative Officer cannot avoid the following pre-petition actions:
    - a transfer of Client Assets by the Investment Firm as described in Answer 9, provided that the CFTC does not disapprove of such transfer; or
    - a transfer or withdrawal of Client Assets by the relevant client, provided that (i) the client is not affiliated with the Investment Firm, (ii) the client is not colluding with the Investment Firm or its principals, and (iii) the CFTC does not disapprove of the transfer or withdrawal.
- Pursuant to Section 764(b) of the Bankruptcy Code, in conjunction with Regulation 190.06(g)(2), the Administrative Officer cannot avoid the following post-petition actions:
    - a transfer of Client Assets by the Administrative Officer as described in Answer 14, or a transfer of Client Assets by the DSRO or the DCO of the Investment Firm, provided that (i) the relevant transfer occurs no later than the close of business on the seventh business day after the filing of the petition for bankruptcy with respect to the Investment Firm, and (ii) the CFTC receives notification of such transfer, pursuant to Regulation 190.02(a)(2), and does not disapprove of such transfer; and
    - a transfer of Client Assets at the direction of the CFTC upon such terms and conditions that the CFTC may deem appropriate and in the public interest, provided that such transfer occurs no later than the close of business on the seventh business day after the filing of the petition for bankruptcy with respect to the Investment Firm.

16. To what extent, if at all, does the Regime in your jurisdiction provide compensation to clients from other sources (for example, an investor protection or similar fund) for loss of Client Assets? Please discuss the scope of protections, conditions on such protection, and the limits of compensation (*e.g.*, maximum compensation per client).

Neither the Bankruptcy Code nor the Act establishes a fund, separate from Client Assets, which would compensate clients in the event that the Investment Firm becomes subject to bankruptcy proceedings.

17. Are there circumstances in which clients are treated differently based on permissions they have granted pre-bankruptcy. *E.g.*, if any re-hypothecation has been entered into (or a 'right-to-use' exercised), please explain the client's position under the Insolvency Regime in such event.

No. The Act and the Regulations do not permit clients to choose a lesser level of protection for Client Assets than the level that (i) Section 4d of the Act and Regulations 1.20 to 1.30 afford to Client Assets in the Futures Omnibus Account, and (ii) Regulation 30.7 affords to Client Assets in the Foreign Futures Omnibus Account.

18. Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?

If clients permit, either explicitly or implicitly, an Investment Firm to hold Client Assets in another jurisdiction, then such clients may suffer "sovereign loss" in the event that such Investment Firm becomes subject to bankruptcy proceedings. In general, "sovereign loss" refers to any loss generated by the application of the law of the relevant jurisdiction to Client Assets, in a manner that is different than the manner applicable under United States law.

- *Futures Omnibus Account.* Pursuant to Framework 2 of Appendix B to Regulation Part 190, if there is "sovereign loss" in one jurisdiction, then such loss would be allocated as follows:
    - those clients that permitted the Investment Firm to hold their portions of the Futures Omnibus Account only in the United States will be fully insulated from such loss;
    - those clients that permitted, explicitly or implicitly, the Investment Firm to hold their portions of the Futures Omnibus Account in the jurisdiction with "sovereign loss" would have such portions exposed to such loss; and
    - if "sovereign loss" exceeds those portions of the Futures Omnibus Account referenced immediately above, then those clients that permitted, explicitly or implicitly, the Investment Firm to hold their portions of the Futures Omnibus Account outside the United States, but in a jurisdiction without "sovereign loss," would have their portions exposed to such excess loss.
- *Foreign Futures Omnibus Account.* If "sovereign loss" causes a shortfall in the Foreign Futures Omnibus Account, then such loss would be allocated among all clients with Client Assets in the Foreign Futures Omnibus Account, in the manner that Answer 20 describes, regardless of which clients permitted, either explicitly or implicitly, the Investment Firm to hold portions of the Foreign Futures Omnibus Account outside of the United States.

19. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?

All clients would share *pro rata* in the event of losses resulting from such failure.

20. If there is a shortfall, *i.e.*, if claims by clients exceed resources dedicated to paying such claims (whether from Client Assets, investor protection fund, or otherwise), how are Client Assets distributed? *E.g.*, is there a pro rata distribution of Client Assets, are there priorities between classes of clients, is there a priority

distribution ahead of the distribution of the general estate/distribution to unsecured creditors?

If a shortfall exists, then the Administrative Officer would separate the claims of clients into "account classes" based on the segregation or set-aside requirements applicable to the contracts underlying such claims and the Client Assets securing such contracts. For example, the Administrative Officer would place claims pertaining to Futures in one "account class" (*i.e.*, the Futures account class) and claims pertaining to Foreign Futures in another "account class" (*i.e.*, the Foreign Futures account class).

Within each "account class," the claims of each client would be satisfied on a *pro rata* basis from the aggregate Client Assets relevant to such "account class," subject to the adjustment for "sovereign loss" (as further described in Answer 18), and to the priority accorded to clients that are not affiliated with the Investment Firm (as further described in Answer 21). As a practical matter, if the Investment Firm becomes subject to bankruptcy proceedings due to the losses of a client trading in one "account class," other clients with claims in that "account class" will suffer losses, while clients with claims in another "account class" without a shortfall may benefit from a prompt transfer.

Pursuant to Section 766(j)(2) of the Bankruptcy Code, if the Administrative Officer cannot satisfy the claims of a client from applicable Client Assets, then the client will have a claim as an unsecured creditor against the general estate of the Investment Company.

21. Please explain how claims of clients are ranked in the insolvency process relative to those of other creditors. Does your insolvency regime rank domestic creditors above foreign creditors?

The Bankruptcy Code, the Act, and the Regulations do not differentiate between foreign and domestic clients. Pursuant to Section 766(h) of the Bankruptcy Code, clients are entitled to have their claims satisfied from "customer property" (*i.e.*, Client Assets) in priority to all other claims, other than certain administrative expenses of the estate. Pursuant to Section 766(h) of the Bankruptcy Code and Regulation 190.08(b), clients that are not affiliated with the Investment Firm are entitled to have their claims satisfied from "customer property" (*i.e.*, Client Assets) in priority to clients that are affiliated with the Investment Firm.

III. Pertinent references

Please provide, for any statutes, regulations, or other authorities or texts that are referred to in your response, electronic copies (in English translation, if available), or URL links to available copies. How might a person outside your jurisdiction most readily get access to such items? Are there treatises that would be useful for obtaining a general understanding of client asset protection in your jurisdiction?

Statutes:
The Commodity Exchange Act, 7 U.S.C. §1 *et seq.* available at
http://www4.law.cornell.edu/uscode/html/uscode07/usc_sup_01_7_10_1.html

The Bankruptcy Code, 11 U.S.C. §101 *et. seq.*, and in particular Subchapter IV of Chapter 7, 11 U.S.C. §§ 7661-767, available at
http://www.law.cornell.edu/uscode/html/uscode11/usc_sup_01_11.html

Regulations (all references are found in 17 C.F.R.), and are available at http://cfr.law.cornell.edu/cfr/cfr.php?title=17&type=chapter&value=1

CFTC Regulation 1.12 (Maintenance of Minimum Financial Requirements by Futures Commission Merchants and Introducing Brokers)
CFTC Regulation 1.17 (Minimum Financial Requirements for Futures Commission Merchants and Introducing Brokers)
CFTC Regulations 1.20 to 1.30 (Customers' Money, Securities, and Property)
CFTC Regulation 1.32 (Segregation Account; Daily Computation and Record)
CFTC Regulation 1.49 (Denomination of Customer Funds and Location of Depositories)
CFTC Regulation 1.55 (Distribution of "Risk Disclosure Statement" by Futures Commission Merchants and Introducing Brokers)
CFTC Regulation 30.6 (Disclosure)
CFTC Regulation 30.7 (Treatment of Foreign Futures or Foreign Options Secured Amount)
CFTC Regulation Part 190 (Bankruptcy Rules)

United States - SEC

Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets

I. Background

This questionnaire seeks information to aid in understanding the responding jurisdictions' techniques for protecting Client Assets in the event of the insolvency and/or winding up of an Investment Firm, and for promptly transferring such assets to a solvent Investment Firm or distributing them to the client. It is not intended to require information concerning the general legal framework for insolvency, except to the limited extent necessary to understand how rules for the protection of Client Assets fit within that framework.

Definitions.

(1) **"Administrative Officer"** refers to the person or entity who is appointed, whether by a court, regulator, creditors, the Investment Firm itself, or otherwise, to assume control of or power over a bankrupt or insolvent Investment Firm. This term includes administrators, debtors in possession, receivers, liquidators, trustees, and similar titles.

(2) **"Client Assets"** refers collectively to Positions, Securities, and Client Money:

- "**Positions"** are contractual rights and obligations arising from transactions entered into by an investment firm on behalf of its clients, including mark to market accruals arising from the change in value of futures, options and/or other derivatives positions;

- "**Securities"** are defined to incorporate both securities and derivatives, as those terms are defined or understood in the responding jurisdiction; and

- "**Client Money"** refers to funds owed to or held on behalf of clients by an investment firm, and may include margin collateral associated with client positions (both existing and potential), income relating to an investment such as dividends or interest, proceeds of the liquidation of client securities and/or positions, and funds in excess of required margin.

(3) **"Investment Firm"** means an intermediary that holds Client Assets and is engaged in the business of managing client accounts, which could include, without limitation: executing orders on behalf of others, dealing in or distributing Securities (including carrying derivatives positions). In jurisdictions where banks are broadly permitted to engage in such a business, this term includes banks to the extent they are providing such services.

(4) **"Omnibus Account"** means an Investment Firm's account with a third party in which Client Assets are maintained separate from the firm's assets, but are held in the aggregate instead of in accounts designated for individual clients.

(5) **"Regime"** refers to statutes, regulations, rules of exchanges, clearing organizations and other self-regulatory bodies, or other legally binding requirements.

II. Survey Questions *Where appropriate, please provide citations to statutes, regulations, or other authorities supporting your answers below.*

Context

1. Please provide a brief overview setting forth the defining characteristics of your jurisdiction's approach to protecting Client Assets.

Under authority granted in the Securities Exchange Act of 1934 ("Exchange Act"), the SEC adopted Rule 15c3-3 to protect customer securities and cash held at a broker-dealer. Rule 15c3-3 requires broker-dealers to account for customer securities on a daily basis and take steps to ensure that customer fully-paid and excess margin securities are held in the control of the broker-dealer free of lien. On a weekly basis, broker-dealers are required to perform a calculation of the amount of customer cash they hold and compare that amount with the amount of cash they have extended to or on behalf of customers for margin loans and short sales. The excess of the amount of money held for customers (if any) must be on deposit in a special reserve bank account for the exclusive benefit of customers in the form of cash or US government securities.

These requirements – along with the broker-dealer net capital rule – are designed to allow a broker-dealer to self-liquidate in an orderly wind-down where customer cash and securities are quickly returned to customers or transferred to a solvent broker-dealer. Broker-dealers that cannot self-liquidate are liquidated by a trustee in a court-supervised proceeding under the Securities Investor Protection Act ("SIPA"). These provisions are designed to restore customer funds and securities quickly and to insulate the securities markets from disruption following the failure of broker-dealers. Generally, under SIPA, customers' cash and securities held by the brokerage firm are returned to customers on a pro rata basis. If sufficient funds and securities are not available to satisfy customer net equity claims, the reserve funds of the Securities Investor Protection Corporation ("SIPC") are used to supplement the distribution, up to a ceiling of $500,000 per customer, including a maximum of $250,000 for cash claims.

In answering the remaining questions:

(1) Please provide details, as appropriate, where the Regime in your jurisdiction applies different treatment or results based on differences in:

a. Categories of Client Assets;

b. Models of trading (e.g., exchange-traded versus over-the-counter).

*c. Categories of clients (*e.g.*, retail versus sophisticated)*

(2) You are requested to provide details of the Regime in your jurisdiction. You are additionally invited to provide information explaining how that Regime is applied in practice, through, e.g.*, informal arrangements between governmental entities.*

Pre-Insolvency

2. Does the regime in your jurisdiction require an Investment Firm to hold special authorization (*i.e.*, a specific form of license or registration) to be permitted to hold Client Assets?

a. If special authorization is required, what requirements (both initial and ongoing) is an Investment Firm required to comply with to hold such authorization?

b. If special authorization is not required, how, if at all, is this activity supervised by a regulator?

Each firm that engages in the business of effecting transactions in securities for others must be registered with the SEC as a broker-dealer. Each broker-dealer is subject to a minimum net capital requirement, which increases if a broker-dealer holds customer accounts. The net capital requirement for broker-dealers is the greater of a fixed-dollar amount or an amount determined using a financial ratio based on either the firm's level of aggregate indebtedness or the amount of the firm's customer debits (e.g., margin loans and money extended on behalf of customers to effect short sales). Broker-dealers that do not receive, directly or indirectly, or hold funds or securities for customers or owe funds or securities to customers must maintain a fixed dollar amount of $5,000.00 in net capital. A broker-dealer that receives, but does not hold, customer securities must maintain a fixed-dollar amount of $50,000.00 in net capital. A broker-dealer that carries customer or broker-dealer accounts and receives or holds funds or securities for those persons must maintain a fixed-dollar amount of $250,000.00 in net capital. However, customers that receive and hold customer funds and securities typically have customer debits that make their financial ratio amount of required net capital much larger than the $250,000 fixed-dollar amount. Thus, the financial ratio amount becomes the minimum requirement. New firms are subject to more stringent capital requirements than firms that have been in the business for more than one year.

The capital levels of a broker-dealer and its compliance at all times with minimum capital requirements and customer segregation requirements is monitored through the filing by the broker-dealer of periodic and annual reports, and through on-site inspections.[1] Compliance with capital levels is regularly monitored by the broker-dealer's designated examining authority.[2] For example FINRA, through initial examinations, examines to see that new broker-dealers have enough capital to survive for a certain period of time without generating revenue. FINRA will also conduct special inquiries of firms that hold customer assets. The SEC may also review a firm's filings or conduct a site inspection. The broker dealer must also provide an audited annual report to the SEC.

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1 *See* 17 CFR 240.17a-5(a).

2 Upon becoming registered as a broker-dealer with the SEC, each broker-dealer is assigned an SRO to be its designated examining authority, or DEA. The DEA is responsible for regular examinations of the broker-dealer as well as oversight of the broker-dealers' activities.

3. Does the Regime in your jurisdiction require that Client Assets be maintained separately from the assets of an Investment Firm? If so, please provide a description of the process by which segregation is accomplished, and of the applicable requirements. Specifically:

a. Must the Client Assets of one client be maintained separately from those of other clients?

i. Are Investment Firms allowed to hold Omnibus Accounts?

ii. What measures are used to protect the Client Assets of each client from losses due to the activities of other clients?

Rule 15c3-3 is designed to ensure that customer securities and monies are segregated from proprietary positions and monies so that if a broker-dealer fails financially, those customer securities and funds would be available to be returned to customers in an orderly wind-down or liquidation administered by a SIPA trustee. The customer securities and funds are not available to satisfy claims of general creditors of the broker-dealer. SEC Rule 15c3-3,[3] commonly called the "Customer Protection Rule," requires that every broker-dealer obtain and maintain possession or control[4] of customer fully paid and excess margin securities, and maintain a reserve account that contains (at least) the net dollar amount of cash the broker-dealer owes to its customers. The SEC's Rules 8c-1 and 15c2-1,[5] commonly called the "Hypothecation Rules," prohibit a broker-dealer from comingling customer securities with its own proprietary securities that are under the same lien. Finally, the Net Capital Rule requires broker-dealers to maintain a minimum amount of capital, which is based upon the nature of the broker-dealer's business and whether the broker-dealer handles customer funds and securities. Those broker-dealers that handle customer funds and securities are required to maintain a higher level of net capital.

Most securities are held at the Depository Trust Companies or a bank that has access to the Federal Reserve Bank of New York. However the bank must agree that the account is held for the benefit of the broker-dealer's customers and not place any lien on the account.

In addition, the net capital and margin rules are designed to build in cushions of capital to protect customers from losses incurred by the broker-dealer. For example, anytime a customer opens a margin account the margin must be done individually and all customer obligations to a broker-dealer must be over collateralized. Thus, even if a customer defaults on a margin call, the account has been over collateralized and losses will not flow to the broker-dealer or other customers.

b. Please describe any requirement that an Investment Firm must reconcile the Client Asset account. For example:

i. How do you calculate the amount of Client Assets that a firm is required to hold in one or more accounts segregated for the benefit of clients?

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3 17 CFR 240.15c3-3.

4 "Control" is defined in Rule 15c3-3(c). 17 CFR 240.15c3-3(c).

5 17 CFR 240.8c-1 and 15c2-1.

A) Are required Client Assets fungible between or within asset classes, or is the Investment Firm required to hold, *e.g.*, the specific assets deposited by the client?

B) How is the reconciliation conducted (*e.g.*, on an aggregate basis, or a client-by-client basis)?

C) If a client has a debit balance (*i.e.*, the client owes the Investment Firm), is such balance deducted in determining the amount the Investment Firm is required to hold?

ii Timing issues:

A) How often is reconciliation required (*e.g.*, daily, weekly, monthly).

B) When is such reconciliation required (*e.g.*, noon of the following business day, the tenth business day of the following month).

C) Is the Investment Firm required to make good any deficiency from their own funds? If so, in what period? Is any payment by the Investment Firm thereby deemed to be Client Money?

iii. Is an Investment Firm permitted or encouraged to maintain any of their own assets in a Client Asset account (*e.g.*, as a "buffer")? If so, are any such assets so transferred then deemed to be Client Assets? Is there a requirement to remove any excess assets?

Broker-dealers are required to make and keep current (as of the end of each business day) ledger accounts itemizing separately each cash and margin account of every customer of the broker-dealer.[6] The ledger should include all purchases, sales, receipts and deliveries of securities and commodities for the account and all debits and credits to such account. Broker-dealers must also make and keep current ledgers reflecting all assets and liabilities, income and expense, and capital accounts.[7]

Broker-dealers must reconcile the Client Asset account with a Reserve Computation. The Reserve Computation is calculated pursuant to a formula set forth in Exhibit A to Rule 15c3-3.[8] Under the formula, a broker-dealer adds up various credit and debit line items. The credit items include cash balances in customer accounts and funds obtained through the use of customer securities. The debit items include monies owed by customers (e.g., from margin lending) and such items as securities borrowed by the broker-dealer to effectuate customer short sales and required margin posted to certain clearing agencies as a consequence of customer securities transactions. If, under the formula, customer credit items exceed customer debit items, the broker-dealer must maintain cash or qualified securities in that net amount in a "Special Reserve Bank Account for the Exclusive Benefit of Customers." This account must be segregated from any other bank account of the broker-dealer. In addition,

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6 17 C.F.R. 240.17a-3(a)(3).

7 17 C.F.R. 240.17a-3(a)(2).

8 17 C.F.R. 240.15c3-3a.

although the Reserve Computation is done on an aggregate basis, broker-dealers are required to keep a stock record that reflects the securities positions of each client.[9]

Generally, a broker-dealer must compute its reserve requirement at least weekly.[10] The weekly computation determines the required minimum balance the broker-dealer must maintain in the reserve account and is made as of the close of the last business day of the week. The required amount to be on deposit in the special reserve bank account is due one hour after the opening of business on the second following business day, normally Tuesday at 10 am. Broker-dealers are subject to a 3% haircut on the debit items, which allows for a buffer in the Reserve account.

c. Can the Investment Firm use Client Assets of one client for meeting obligations of another client? If so, how?

Customer credit balances can be used only to support other customer transactions. Customer margin loans must be over collateralized with cash or highly liquid securities and, therefore, if a customer defaults on an obligation, the broker-dealer should hold collateral in excess of the amount of the customer's obligation to the broker-dealer, normally 25%. This means that a customer default on an obligation to the broker-dealer financed by the use of customer cash should not normally cause the broker-dealer or other customers to suffer any loss. Furthermore, the fact that customer margin loans are over collateralized means that if the broker-dealer fails, the margin loans can be transferred to a solvent broker-dealer for cash or liquidated to an equity and, therefore, any customer cash used to finance the margin loans will be available to be returned to the customers.

d. Are there any restrictions on the ability of the Investment Firm (or other party holding Client Assets) to invest, encumber, rehypothecate, stock-lend, or otherwise deal with, the Client Assets? If so, please describe.

SEC Rule 15c3-3,[11] commonly called the "Customer Protection Rule," requires that every broker-dealer obtain and maintain possession and control of customer fully paid and excess margin securities, and maintain a reserve account that contains (at least) the net dollar amount of cash the broker-dealer owes to its customers. The SEC's Rules 8c-1 and 15c2-1,[12] commonly called the "Hypothecation Rules," prohibit a broker-dealer from comingling customer securities with its own proprietary securities that are under the same lien.

e. What are the requirements, if any, for clearinghouses or other central counterparties to maintain the separate identification of collateral posted by the Investment Firm for its Client Positions?

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9 17 C.F.R. 240.17a-3(a).

10 Broker-dealers holding aggregate customer funds of less than $1 million may make their computations on a monthly basis if certain requirements are met.

11 17 CFR 240.15c3-3.

12 17 CFR 240.8c-1 and 15c2-1.

There is no requirement that a clearinghouse or other central counterparty maintain the separate identification of collateral posted by a broker-dealer for its Client Positions, although the clearinghouse or counterparty must segregate the assets owed to the broker-dealer in bulk. However, the broker-dealer is required to segregate customer securities from general firm securities and the broker-dealer must notify the clearing house regarding what securities relate to customer positions as opposed to firm positions.

4. Are Investment Firms permitted to transfer to, or hold Client Assets in, another jurisdiction? If so, does the Regime in your jurisdiction require Investment Firms to preserve the separate identification of:

a. Client Assets transferred to or located in other jurisdictions?

b. Client Assets that have been transferred to the Investment Firm from other jurisdictions and that have been identified as Client Assets in those jurisdictions?

If so, please provide details of those requirements.

A broker-dealer is deemed to have control over foreign securities if they are in the custody of a foreign depository, foreign clearing agency or foreign custodian bank, which the Commission must deem a satisfactory control location for securities. The foreign entity must agree to hold the securities for the benefit of the broker-dealer's customers and free of all liens. Cash cannot be held at a foreign location.

5. If the Regime in your jurisdiction permits or requires Client Assets to be held by third party custodians:

a. Please describe the requirements, if any, concerning the qualifications of such custodians e.g., licensing, creditworthiness. May the Client Assets be kept with an affiliate of the Investment Firm?

b. Please describe any requirements concerning the custody agreement between intermediary and custodian. In particular, may the custodian be permitted to place a lien, charge or other encumbrance on Client Assets? If so, please explain.

Securities are considered under control of a broker-dealer if they are held in a location that the SEC has deemed to be a good control location. Securities must be held free of all charges, liens, or claims. Good control locations include the following:

- Securities under the custody and control of a clearing corporation or other subsidiary of either a national securities exchange or a registered national securities association or a custodian bank and in compliance with the Hypothecation Rules. In addition, the delivery of the certificates to the broker-dealer cannot require the payment of money or value and the books and records of the broker-dealer must identify the customers entitled to receive

specified quantities or units of the securities that are held for the customers collectively.

- Securities that are carried for the account of any customer by a broker or dealer and are carried in a special omnibus account in the name of such broker or dealer. Such securities are deemed to be under the control of the broker-dealer to the extent that he has instructed such carrying broker-dealer to maintain physical possession or control of the securities free of any charge, lien, or claim of any kind in favor of the carrying broker-dealer or any person claiming through the carrying broker-dealer.

- Securities that are in the custody of a foreign depository, foreign clearing agency, or foreign custodian bank, which the SEC has designated as a satisfactory control location.

- Securities that are in the custody or control of a bank, as defined in the Securities and Exchange Act. The delivery of these securities may not require the payment of money or value and the bank must acknowledge in writing that the securities are not subject to any right, charge, security interest, lien or claim of any kind in favor of the bank or any person claiming through the bank.

- Securities held at any location as the SEC shall designate as adequate for the protection of customer securities.

6. Under what circumstances, if any, is an Investment Firm required to disclose to clients information related to the protection of the client's assets? What is the nature of such required disclosures? How do any such required disclosures apply to Client Assets held in another jurisdiction?

A broker-dealer must send customers monthly and/or quarterly account statements showing their security positions. The industry practice is to send monthly account statements to customers with activity in their accounts during that month. In addition, broker-dealers are required to send a customer a confirmation of each transaction under Rule 10b-10.

7. Under what conditions, if any, may clients choose to waive any of the Client Asset protection requirements applicable in your jurisdiction (also known as "opting out")? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

The segregation requirements discussed above are mandatory for the broker-dealer. Consequently, customers generally may not "opt out" of the protection requirements.

8. Under what circumstances, if any, is an Investment Firm required to notify the regulators, or the market generally, of material changes in their

financial position or ability to continue to carry on business? What is the nature of such required disclosures?

Pursuant to Exchange Act Rule 17a-11 (commonly called the "Early Warning Rule"), a broker-dealer must promptly notify the SEC and its designated examining authority if its net capital level falls below 120% of its required net capital amount, or, if the firm computes its net capital using the alternative method, if the firm's net capital falls below 5% of aggregate debit items (such firms are required to hold net capital equal to 2% of customer debit items). Pursuant to Exchange Act Rule 17a-11, a broker-dealer must promptly notify the SEC's main office and the regional office of the SEC in whose region it resides. Further, the broker-dealer must notify its designated examining authority, and the CFTC, if it is registered therewith. The equity capital of a broker-dealer may not be withdrawn if it falls below the early warning levels.

A broker-dealer also must file an annual audit with the SEC and its designated examining authority under Rule 17a-5(d). If during the course of the audit, the independent public accountant finds material inadequacies that exist in the accounting system, internal accounting control, or procedures for safeguarding securities, the independent public accountant must inform the chief financial officer who must notify the SEC and the designated examining authority within 24 hours. If such chief financial officer fails to notify the SEC and the designated examining authority within 24 hours or the independent public accountant disagrees with statements contained in the notice, the independent public accountant must inform the SEC and the designated examining authority of the material inadequacy within 24 hours thereafter.[13]

If a broker-dealer fails to make a required deposit in its reserve bank account or special account, as required by Rule 15c3-3, the broker-dealer must immediately notify the SEC and its designated examining authority and promptly thereafter confirm such notification in writing.[14]

9. For an Investment Firm whose financial situation is seen to have deteriorated *(e.g.*, capital has fallen below certain thresholds), what actions, if any, may the firm's regulators take to protect Client Assets?

The Exchange Act and the regulations promulgated thereunder prohibit a broker-dealer from continuing to do a securities business if the firm's net capital falls below its required minimum.[15] Further, a broker-dealer is restricted from withdrawing capital if certain parameters have been broken.[16] The Self Regulatory Organizations ("SROs"), i.e. FINRA, also have rules that restrict the activities of a broker-dealer in financial difficulty.[17] The SROs have rules that allow the SRO to direct the intermediary to take specific corrective or prophylactic actions, such as reducing their business.[18] To the extent that it becomes apparent that a broker-dealer is in or is approaching financial difficulty, SEC staff must

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13 17 CFR 240.17-5(h)(2).
14 17 CFR 240.15c3-3(i).
15 15 U.S.C. 78o(c)(3) and 17 CFR 240.15c3-1.
16 17 CFR 240.15c3-1(e)(2).
17 *See e.g.*, NYSE Rule 326(b) and NASD Rule 3130.
18 *Id.*

contact SIPC to inform it of the status of the situation so that it can assess whether it should initiate a liquidation proceeding.[19] If the firm holds customer cash and securities, the goal is to have these accounts transferred to a solvent broker-dealer in an orderly self-liquidation or prior to a liquidation under SIPA.

Post-Insolvency

10. Please describe the process by which an Investment Firm enters the status of "insolvent" or "bankrupt" or the equivalent. For example, is a petition filed by the firm's regulator or some other administrative agency, by creditors of the firm, or otherwise? Is a decree entered by a court? Is this process different from the process applicable to entities that are not Investment Firms?

Although each broker-dealer failure is unique and presents different issues, generally SEC staff will collect as much information as possible before taking any action. Usually, SEC staff and the firm's designated examining authority know that the firm is approaching financial difficulty because the firm has filed telegraphic notice pursuant to Exchange Act Rule 17a-11 or the difficulty was discussed during an examination. SEC staff may collect reports that have been filed by the relevant broker-dealer, contact the broker-dealer's designated examining authority, and, if the firm is an introducing firm, contact the firm's clearing firm. Further, SEC staff may attempt to have an on-site inspection initiated, either by SEC staff or by the staff of the firm's designated examining authority – these examinations may be conducted at any time. To the extent that it becomes apparent that a broker-dealer is in or is approaching financial difficulty, SEC staff must contact SIPC to inform it of the status of the situation so that it can assess whether it should initiate a liquidation proceeding.[20] If the firm holds customer cash and securities, the goal is to have these accounts transferred to a solvent broker-dealer in an orderly self-liquidation or prior to a liquidation under SIPA.

If SIPC determines that any member of SIPC has failed or is in danger of failing to meet its obligations to customers, and is either: insolvent or is unable to meet its obligations as they mature; the subject of a proceeding in which a receiver, trustee, or liquidator for such debtor has been appointed; not in compliance with applicable requirements under the Exchange Act or rules of the SEC or any SRO with respect to financial responsibility or hypothecation of customers' securities; or unable to make such computation as may be necessary to establish compliance with such financial responsibility or hypothecation rules: then SIPC may, upon notice to such member, file an application for a protective decree with any court of competent jurisdiction.[21] If the court issues a protective decree, the court must appoint, as trustee for the liquidation of the business of the debtor and as attorney for the trustee, such persons as SIPC, in its sole discretion, specifies.[22]

Under a SIPA liquidation, customers of a failed brokerage firm get back all securities (such as stocks and bonds) that already are registered in their names or are in the process of

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19 15 U.S.C. 78eee(a)(1).
20 15 U.S.C. 78eee(a)(1).
21 15 U.S.C. 78eee(a)(3).
22 15 U.S.C. 78eee(b)(3).

being registered (i.e., securities certificates in the name of the customer held by the broker-dealer). After this first step, the firm's remaining customer assets are distributed on a pro rata basis with securities and cash shared in proportion to the size of the customer's net equity. If sufficient assets are not available in the firm's customer accounts to satisfy claims within these limits, the reserve funds of SIPC are used to supplement the distribution, up to a ceiling of $500,000 per customer, including a maximum of $250,000 for cash claims. In this way, SIPA seeks to protect investors from the loss of securities or cash left with a failed broker-dealer.

11. Please describe the process by which the Administrative Officer (as defined above), if any, is selected. What qualifications, if any, must an Administrative Officer have? Who selects the Administrative Officer?

As stated above, upon the failure of a broker-dealer, SIPC may, upon notice to such broker-dealer, file an application for a protective decree with any court of competent jurisdiction. If the court issues a protective decree, the court must appoint, as trustee for the liquidation of the business of the debtor and as attorney for the trustee, such persons as SIPC, in its sole discretion, specifies. The only qualification for the trustee under SIPA is that he or she must be disinterested, as that term is defined in SIPA.[23] In certain small liquidations, SIPC itself may be appointed as the trustee.

12. What are the duties of the Administrative Officer?

a. What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?

b. Under what standard (*e.g.*, strict liability, negligence), if any, is the Administrative Officer, pursuant to the Regime in your jurisdiction, subject to personal liability for failure to properly perform his or its duties?

A trustee appointed under SIPA must (1) promptly deliver customer name securities to customers and distribute customer property; (2) sell or transfer offices and other productive units of the business of the debtor; (3) enforce rights of subrogation under SIPA; and (4) liquidate the debtor. The bankruptcy laws of the United States are applicable to the proceeding to the extent they are consistent with SIPA.[24]

Under general bankruptcy law, which is applicable to SIPA proceedings, a trustee may be held personally liable for willful or deliberate violations of his or her duties. A trustee may also be held liable, in his or her official capacity, for acts of negligence, but will not be held liable for mistakes of judgment where discretion is allowed.

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[23] 15 U.S.C. 78eee(b)(3).

[24] 15 U.S.C. 78fff(a).

13. What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?

a. Does the regulator continue to supervise the Investment Firm?

b. How, if at all, is the regulator involved in the process of returning Client Assets?

The SEC oversees SIPC and may, on its own motion, file notice of its appearance in any proceeding brought under SIPA and thereafter participate as a party.[25] In addition, the SEC may apply to any district court of the United States for an order requiring SIPC to initiate a proceeding and commit its funds to protect customers.[26]

14. Does the Regime in your jurisdiction facilitate or encourage the transfer of Client Assets from an Investment Firm which has become bankrupt or insolvent to a solvent Investment Firm?

a. What steps, if any, are prerequisite to accomplishing such a transfer? In general, how long does it take to accomplish those steps?

b. What factors, if any, affect the time period required to accomplish such a transfer?

Whenever feasible, customer accounts are quickly transferred to another operating broker-dealer to facilitate customers' orderly receipt of cash and securities and continuing access to brokerage services. In general, if the books and records of the broker-dealer are in order and customer accounts are properly margined, the trustee likely can promptly transfer the accounts to another broker-dealer in a process known as a bulk transfer. The transfer could take longer depending on the books and records of the broker-dealer and whether the operating systems of the two broker-dealers are compatible. After the transfer, customers may choose to maintain their accounts at the new firm or transfer them to a firm of their choice. If a bulk transfer is not possible, the trustee returns customer securities and cash directly to customers through a claims process.

15. To what extent are clients at risk of, or protected from, having to return Client Assets (or the value thereof) that were distributed to the client prior to the insolvency proceeding?

Under SIPA, if customer property is not sufficient to pay all customers in full, the trustee may recover any property transferred by the debtor which would have been customer property if such a transfer is void or voidable under the Bankruptcy Code. In general, a trustee can recover "preference" actions, which are principal payments made to customers

[25] 15 U.S.C. 78eee(c).
[26] 15 U.S.C. 78ggg(b).

within 90 days of the liquidation. A trustee can also recover for fraudulent transfer actions, which are payments made within two years (or further back, depending on applicable state law) of the bankruptcy filing, including payments for earnings and also payments for principal (unless the recipient can establish an affirmative defense that he/she received the principal payments without knowledge of the broker-dealer's difficulties).

16. To what extent, if at all, does the Regime in your jurisdiction provide compensation to clients from other sources (for example, an investor protection or similar fund) for loss of Client Assets? Please discuss the scope of protections, conditions on such protection, and the limits of compensation (*e.g.*, maximum compensation per client).

Where sufficient assets are not available in the firm's customer accounts to satisfy claims in full, the reserve funds of SIPC are used to supplement the distribution of customer property, up to a ceiling of $500,000 per customer, including a maximum of $250,000 for cash claims.

17. Are there circumstances in which clients are treated differently based on permissions they have granted pre-bankruptcy. *E.g.*, if any re-hypothecation has been entered into (or a 'right-to-use' exercised), please explain the client's position under the Insolvency Regime in such event.

No, customers are not treated differently based on permissions they have granted pre-bankruptcy. Customers cannot waive protections under SIPA.

18. Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?

None, customer assets held by the broker-dealer in another jurisdiction are still protected under SIPA. As explained above, the only assets that can be held in another jurisdiction are foreign securities, and then only under certain circumstances.

19. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?

If a broker-dealer fails to comply with Client Asset protection requirements it is a violation of the Federal securities laws, specifically Rule 15c3-3. Such a firm must immediately cease doing business as a broker-dealer and is in jeopardy of being moved to a

bankruptcy proceeding if it cannot comply with customer protection requirements. Upon the failure of such a broker-dealer all customers are treated the same.

20. If there is a shortfall, *i.e.*, if claims by clients exceed resources dedicated to paying such claims (whether from Client Assets, investor protection fund, or otherwise), how are Client Assets distributed? *E.g.*, is there a pro rata distribution of Client Assets, are there priorities between classes of clients, is there a priority distribution ahead of the distribution of the general estate/distribution to unsecured creditors?

If there is a shortfall in customer property, it is distributed to all customers on a pro rata basis to the extent of their respective net equities (as defined in SIPA).[27]

21. Please explain how claims of clients are ranked in the insolvency process relative to those of other creditors. Does your insolvency regime rank domestic creditors above foreign creditors?

Customer property is allocated first to customers of the debtor, who share pro rata in the customer property, then to SIPC as subrogee for the claims of customers and then for repayment of any advances made pursuant to section 78fff-3(c)(2) of SIPA. Finally, any customer property remaining after allocation becomes part of the general estate of the debtor.[28]

III. Pertinent references

Please provide, for any statutes, regulations, or other authorities or texts that are referred to in your response, electronic copies (in English translation, if available), or URL links to available copies. How might a person outside your jurisdiction most readily get access to such items? Are there treatises that would be useful for obtaining a general understanding of client asset protection in your jurisdiction?

The following are links to the laws discussed here.

Rule 15c3-1: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=4e84cfe5e594d0d270a353ed425ef653&rgn=div8&view=text&node=17:3.0.1.1.1.2.84.287&idno=17

Rule 15c3-3: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=4e84cfe5e594d0d270a353ed425ef653&rgn=div8&view=text&node=17:3.0.1.1.1.2.84.296&idno=17

[27] 15 U.S.C. 78fff-2(c)(1).
[28] 15 U.S.C. 78fff-2(c)(1).

Rule 15c3-3a: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=4e84cfe5e594d0d270a353ed425ef653&rgn=div8&view=text&node=17:3.0.1.1.1.2.84.297&idno=17

Rule 17a-3: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=4e84cfe5e594d0d270a353ed425ef653&rgn=div8&view=text&node=17:3.0.1.1.1.2.94.373&idno=17

Rule 17a-5: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=4e84cfe5e594d0d270a353ed425ef653&rgn=div8&view=text&node=17:3.0.1.1.1.2.94.375&idno=17

Rule 8c-1: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=4e84cfe5e594d0d270a353ed425ef653&rgn=div8&view=text&node=17:3.0.1.1.1.1.56.64&idno=17

Rule 15c2-1: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=4e84cfe5e594d0d270a353ed425ef653&rgn=div8&view=text&node=17:3.0.1.1.1.2.84.278&idno=17

SIPA: http://www.sipc.org/pdf/SIPA_new.pdf

Appendix C Case Studies

Administration of the Assets of Lehman Brothers, Inc. under the Securities Investor Protection Corporation

On September 15, 2008, the U.K. broker-dealer, Lehman Brothers International (Europe) (LBIE), filed for administration. On the same day, the LBIE U.S. parent, Lehman Brothers Holdings, Inc. (LBHI), filed for bankruptcy.

Shortly after the LBHI bankruptcy filing, on September 19, 2008, a district court judge in the Southern District of New York entered an order granting the application of the Securities Investor Protection Corporation (SIPC) for issuance of a protective decree adjudicating that the customers of Lehman Brothers, Inc. (LBI), the U.S. registered broker-dealer/futures commission merchant affiliate of LBHI, were in need of protection afforded by the U.S. Securities Investor Protection Act of 1970 (SIPA). Interestingly, according to LBI staff accountants, LBI held at this time capital in excess of regulatory requirements.

The liquidation has been referred to, and is now being administered under, the auspices of The Honourable James M. Peck, United States Bankruptcy Court for the Southern District of New York (Case No. 08-01420 (JMP) SIPA). The liquidation of LBI is overseen by the Trustee (James W. Giddens) appointed by the United States District Court for the Southern District of New York.

Early in the morning of Saturday, September 20, 2008, Judge Peck approved the transfer of the entirety of LBI's commodity futures business and portions of LBI's securities business. These transfers were effected over the ensuing days, and the customers whose accounts were transferred incurred no losses of customer assets and (with minor exceptions) maintained continuous control over their accounts.

The Trustee also fulfils public duties assigned under SIPA. The Trustee's primary duty is the return of customer property to customers of LBI as defined by the law, while at the same time maximizing the estate for all creditors. In furtherance of the goal of protecting customers, during the period November 12, 2009 – October 26, 2010 (Reporting Period), the Trustee concluded the transfer of more than 110,000 accounts to other broker dealers.[1] Specifically, as of October 26, 2010, the total number of *claims* made against LBI was 124,977. Of those, the vast majority, 110,633 (or 89%), were resolved through simple transfer of customer accounts to other broker-dealers (72,527 to Barclays and 38,106 to Neuberger Berman).[2] Another 14,057 claims were determined through a claims process.

The Trustee's professionals have thus completed reconciling and determining virtually all non-affiliate customer claims. These claims have been asserted by, among others, individuals, pension funds, financial and other institutions, and hedge funds. The claim process includes determining the validity of each claim, the applicability of SIPA, and the claimant's net equity.

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1 See *Trustee's Fourth Interim Report for the Period May 11, 2010 Through October 26, 2010*, In Re Lehman Brothers Inc., Debtor, Case No. 08-01420 (JMP) SIPA (Bankr. S.D.N.Y.) (October 26, 2010).

2 As of October 26, 2010, the Trustee determined all of the 12,233 non-affiliate customer claims, allowing 980, denying 7,302, and denying and reclassifying 3,941 as general creditor claims.

There remain, however, 3561 unresolved customer claims (or 2.8% of total customer claims). In particular, the Trustee has not yet resolved the complex claims filed by LBHI, LBIE, and other affiliates of the global Lehman Brothers enterprise. Collectively these 1,416 affiliate claims assert customer status to some $24 billion.

Drexel Burnham Lambert

Drexel Burnham Lambert (Drexel) was a major Wall Street investment banking firm, which first rose to prominence and then was forced into bankruptcy in February 1990 by its involvement in illegal activities in the junk bond market, driven by Drexel employee Michael Milken. At its height, it was the fifth-largest investment bank in the United States. As a result of the SEC's regulatory program (e.g., capital and customer account segregation requirements), the SEC was able to wind down the operations of Drexel's broker-dealer affiliate without putting the firm or its customers through the time and expense of a liquidation administered by the Securities Investor Protection Corporation (SIPC).

In particular, when Drexel's holding company filed for bankruptcy in 1990, the SEC worked with the Drexel broker-dealer and other regulators to close its securities operations and to transfer remaining customer accounts and securities positions to other broker-dealers. This entire process was completed without any cost to the SIPC fund or the U.S. taxpayer. As more recently stated by former SEC Chairman Richard Breeden, "[w]e froze and then sold the firm's regulated broker dealer, transferring customer funds and accounts to a new owner without loss. Having protected the regulated entity and its customers, we refused to provide assistance to the holding company parent that had a large 'unregulated' portfolio of junk bonds financed by sophisticated investors (including several foreign central banks that were doing gold repos with Drexel's holding company parent). Though there were those who wanted us to bail Drexel out, we forced the holding company into Chapter 11 instead, and let the courts sort out the claims."[3]

[3] Statement of Richard C. Breeden, Former Chairman, U.S. Securities and Exchange Commission, and Chairman, Breeden Capital Management, Before the Senate Committee on Banking, Housing and Urban Affairs (Mar. 26, 2009), available at: http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=b8c90e4c-b0b3-4027-8880-3dc6c3f26ebd.