

# **Recommendations Regarding the Protection of Client Assets**

## **Consultation Report**



**OICU-IOSCO**

**THE BOARD  
OF THE  
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS**

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## Foreword

The International Organization of Securities Commissions' (IOSCO) Board has published this Consultation Report with the aim of outlining principles against which both the industry and regulators can assess the quality of regulation and industry practices concerning client asset protection. Generally, these draft principles reflect a level of common approach and are a practical guide for regulators and the industry. Implementation of the principles may vary from jurisdiction to jurisdiction depending on local conditions and circumstances.

## How to Submit Comments

Comments may be submitted by one of the two following methods **before Monday 25 March COB CET**. To help us process and review your comments more efficiently, please use only one method.

**Important:** All comments will be made available publicly, unless anonymity is specifically requested. Comments will be converted to PDF format and posted on the IOSCO website. Personal identifying information will not be edited from submissions.

### 1. Email

- Send comments to [clientassetprotection@iosco.org](mailto:clientassetprotection@iosco.org) cc. [m.bensalem@iosco.org](mailto:m.bensalem@iosco.org)
- The subject line of your message must indicate *client asset protection*
- If you attach a document, indicate the software used (e.g., WordPerfect, Microsoft WORD, ASCII text, etc) to create the attachment.
- Do NOT submit attachments as HTML, PDF, GIFG, TIFF, PIF, ZIP or EXE files.

### 2. Paper

Send 3 copies of your paper comment letter to:

**Mohamed Ben Salem**  
General Secretariat  
International Organization of Securities Commissions (IOSCO)  
Calle Oquendo 12  
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Spain

Your comment letter should indicate prominently that it is in relation to the Consultation Report on Client Asset Protection.

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## **Introduction**

Events in recent years including the Lehman Brothers and MF Global insolvencies have placed client asset protection regimes in the spotlight, as investors have tried to better understand the potential implications of placing their assets with particular intermediaries and in certain jurisdictions. Regulators have sought to address risks to client assets and determine how to transfer or return client assets in default, resolution or insolvency scenarios. These concerns have led some regulators to consider how they might enhance their supervision of intermediaries holding client assets through clarification of the respective roles of the intermediary and the regulator in protecting client assets.

While client asset protection regimes may vary across jurisdictions, many jurisdictions have rules and regulations governing client assets. It is first and foremost the intermediary's responsibility to ensure compliance with these rules, including through the development of internal systems and controls to monitor compliance. Where the intermediary places client assets with third parties, the intermediary should reconcile its accounts and records with those of the third party. While the intermediary must comply with the client asset protection regimes, the regulator has a role in supervising the intermediary's compliance with the applicable domestic rules and maintaining a regime that promotes effective safeguarding of client assets.

Two possible scenarios may pose regulatory challenges: where a client has knowingly or unknowingly waived or modified the degree of protection applicable to client assets or otherwise opted out of the application of the client asset protection regime (where permitted by law); and where an intermediary has placed or deposited assets in a foreign jurisdiction.<sup>1</sup>

To address the former issue, and to provide greater clarity regarding the status of client assets, documentary requirements should apply. The intermediary should be required to obtain the client's explicit, written consent to any waiver or modification to protection of the client asset regime or to any opting out of the client asset protection regime. Where such a waiver, modification or opt-out is permitted by law, any client consent should be set forth in a separate document that addresses only the provision of the consent. The consent should be affirmative and explicit and should not be "deemed" or "implied". It is important that clients are aware of the possible effects of a waiver or modification of the degree of protection applicable to client assets or opt-out of the application of the client asset protection regime, especially in the context of a default, resolution or insolvency scenario. In addition, the documentation could help clarify the status of client assets at a particular point in time and, if necessary, facilitate return of any client assets in a default, resolution or insolvency scenario.

Where an intermediary has placed or deposited assets in a foreign jurisdiction, the regulator may face further challenges in supervising the intermediary's compliance with the applicable domestic rules. Additional challenges may arise if an intermediary holds client assets in a chain of custody through multiple jurisdictions or places assets with an affiliate in the same group or with a third party regulated, in either case, and if at all, outside the intermediary's home jurisdiction. Where the domestic regulatory

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<sup>1</sup> With respect to an intermediary whose home jurisdiction is an EU member state, references in this report to placing or depositing client assets in a *foreign jurisdiction* should be read as meaning placing or depositing client assets in a jurisdiction outside of the EU.

regime prescribes requirements for client assets placed in foreign jurisdictions, the regulator should consider how to accomplish its supervisory responsibilities.

\* \* \* \* \*

The terms used in the Principles are defined in the Glossary at the end of the report. .

## **Principles**

**Principle 1 – An intermediary should maintain accurate and up-to-date records and accounts of client assets that readily establish the precise nature, amount, location and ownership status of client assets and the clients for whom the client assets are held. The records should also be maintained in such a way that they may be used as an audit trail.**

Means of implementation

1. An intermediary should establish systems and controls for maintaining accurate and up-to-date records of client asset holdings including information specifying the amount, location, and ownership status<sup>2</sup> of client assets.
2. The intermediary's records should be sufficient to permit an external party (such as a regulator, an external auditor, or an insolvency practitioner) to verify the amount, location, ownership status and identity of assets held. Where client assets are held with a third party, records should also include the location and the terms and conditions on which a third party holds the client assets.
3. The intermediary's systems and controls should provide for reconciliations on a regular basis between internal accounts and records in relation to the client assets and those of any third party with whom such client assets are held. In the context of reconciliations between an intermediary and a central securities depository, such reconciliations should take place on a daily basis.
4. The records and accounts should enable an intermediary to, at any time and without delay, specify each client's rights and the intermediary's obligations to each client with respect to client assets.
5. In those jurisdictions where clients may waive, consent to the modification of, or otherwise opt out of any aspect of client asset protection, the intermediary should maintain sufficient records to clearly demonstrate, as applicable, the client's explicit, written and informed consent to the waiver or modification of the protection of client assets or to opting out of the client asset protection regime.
6. Accounts held with a third party for the benefit of clients should be titled in such a way to clearly distinguish assets held for clients from assets held for the intermediary. Where separate accounts at a third party are held for each client, the accounts should be titled in such a way as to clearly distinguish assets held for one client from assets held for any other client or for the intermediary itself.

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<sup>2</sup> An example of ownership status is the existence of liens or other encumbrances that may affect the return of client assets or their value to clients.

**Principle 2 – An intermediary should provide a statement to each client on a regular basis, as well as on request, detailing the client assets held for or on behalf of such client.**

Means of implementation

1. The statement the intermediary provides should be a statement of account or other report to clients showing their asset holdings and money balances as of a reasonably recent date.
2. Where, to the extent permitted by law, the client has waived or modified any aspect of the client asset protection regime, or otherwise opted out of the application of the client asset protection regime, the statement should reflect that fact.
3. Where a client has requested a statement from an intermediary in relation to its assets, the intermediary should respond reasonably promptly to the request.

**Principle 3 – An intermediary should maintain appropriate arrangements to safeguard the clients' rights in client assets and minimise the risk of loss and misuse.<sup>3</sup>**

Means of implementation

1. An intermediary should understand the options, if any, for holding client assets and take into account the levels of client asset protection (both pre- and post-default) in addition to any associated risks.
2. An intermediary should also analyse how certain actions or decisions could materially change the status of the client asset and/or complicate return of the client asset (*e.g.*, if the exercise of a right of re-use or enforcement of a pledge results in a different party succeeding to rights in the client asset). An intermediary may build this understanding through in-house analysis as well as through consultation with professional advisors (*i.e.*, law firms or accountancy firms).
3. Where client assets are placed with a third party (whether in the same jurisdiction or in a foreign jurisdiction), the intermediary should exercise all due skill, care and diligence in the selection and appointment (where applicable), and periodic review of the third party and of the arrangements for safeguarding the client assets, and should consider:
  - (a) The legal requirements or market practices related to the holding of client assets that could adversely affect clients' rights during business as usual and in the event of resolution or insolvency of the intermediary or the third party;
  - (b) The expertise and market reputation of the third party;
  - (c) Protection or lack thereof attendant upon the regulatory status of the third party; and
  - (d) The need for diversification and mitigation of risks, where appropriate, by placing client assets with more than one third party.
4. Where an intermediary places client assets with a third party, the intermediary should, to the extent necessary to achieve compliance with applicable domestic requirements, understand the material effects of the contractual provisions governing that arrangement on the clients' rights in respect of such client assets, including how those contractual provisions would operate in the

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<sup>3</sup> As noted above, these Principles apply to cases where an intermediary has responsibility for safeguarding client assets as opposed to cases where an intermediary does not have responsibility for safeguarding client assets.

jurisdiction where such assets are held, including in the event of the resolution or insolvency of the intermediary, the third party or both.

5. An intermediary should be aware of the effect of liens and other encumbrances on client assets and take appropriate steps to ensure that any such lien or encumbrance is only granted to the extent, if any, permitted by the regulatory regime, including with respect to any requirement for client consent.<sup>4</sup> Each intermediary should consider the best interest of the clients<sup>5</sup> to the extent it has a choice in agreeing to liens or encumbrances.

**Principle 4 – Where an intermediary places or deposits client assets in a foreign jurisdiction, the intermediary should understand and take into account the foreign regime to the extent necessary to achieve compliance with applicable domestic requirements.**

Means of implementation

To the extent the home regime imposes requirements on an intermediary that places or deposits client assets in a foreign jurisdiction, the intermediary may face challenges in ensuring its compliance with such domestic requirements. Accordingly, the intermediary should have sufficient knowledge of the domestic as well as foreign regimes where it places client assets to the extent necessary to ensure such compliance. This means that the intermediary has the responsibility to understand the client asset protection regimes and arrangements in every jurisdiction (including its home jurisdiction) in which client assets are kept, to the extent necessary to ensure compliance with the domestic requirements.

**Principle 5 – An intermediary should ensure that there is clarity and transparency in the disclosure of the relevant client asset protection regime(s) and arrangements and the consequent risks involved.**

Means of implementation

1. Consistent with the requirements of its home jurisdiction, an intermediary should ensure its agreements with clients contain adequate and appropriate information about the arrangements for client asset protection and the ways in which the intermediary holds or deposits different types of client assets and the attendant risks. These disclosures should (i) be appropriate in light of the relationship between the client asset and the client's rights in the asset and (ii) take account of the fact that the ownership status of the client assets may affect the degree of protection.
2. Where client assets are to be held in a foreign jurisdiction and will be subject to the client asset protection and/or insolvency regimes of that foreign (*i.e.*, not home) jurisdiction, the intermediary should inform the clients of that fact and highlight material differences and the

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<sup>4</sup> See Principle 6.

<sup>5</sup> The phrase “best interest of the clients” should not be interpreted to suggest the application of a fiduciary standard beyond the extent required by a relevant jurisdiction. In some common law jurisdictions, certain intermediaries may be subject to the duty to act fairly, honestly and in good faith, while not being technically subject to a fiduciary standard of care.

potential consequences of such differences so the client can make an informed decision concerning its investment.

3. Any required disclosure should be in writing and be prepared in clear, plain, concise and understandable language. Legal or financial jargon not commonly understood should be avoided.
4. Where the intermediary has determined there are material risks of placing client assets in a particular foreign jurisdiction and where those risks cannot be effectively mitigated by the intermediary, the intermediary should clearly and understandably disclose those risks in advance to the clients so that such clients can make informed decisions concerning their investments.

**Principle 6 – Where the regulatory regime permits clients to waive or to modify the degree of protection applicable to client assets or otherwise to opt out of the application of the client asset protection regime, such arrangements should be subject to the following safeguards:**

- (a) The arrangement should only take place with the client’s explicit, written consent.**
- (b) Before such consent is obtained, the intermediary should ensure that the client has been provided with a clear and understandable disclosure of the implications of giving such consent.**
- (c) If such arrangements are limited to particular categories of clients, clear criteria delineating those clients that fall within such categories should be defined.**

Means of implementation

1. Any (a) waiver or modification of any aspect of the client asset protection regime or (b) any opting out of the client asset protection regime should, in either event, be contained in a separate document and be clear and in writing, through whatever technical means, and affirmatively executed by the client.
2. The writing evidencing the client’s consent to the waiver or modification of the protection of client assets or to opting out of the client asset protection regime should effectively communicate to the client the effect of a waiver, modification or opt-out both pre- and post-default. The written client’s consent should be retained by the intermediary and should allow the intermediary to demonstrate clearly what the client agreed to and the client’s confirmation of its understanding of the implications of giving consent. This documentation may help clarify the status of client assets at a particular point in time and, if necessary, facilitate the return of any client assets in a default, resolution or insolvency scenario.
3. To ensure informed consent from the client in relation to a waiver or modification of the protection of client assets or to an opt out of the application of the client asset protection regime, the separate client consent document should contain adequate and appropriate information and, where appropriate, relevant risk disclosures about:
  - (a) The contractual and/or statutory limits, if any, on different types of client assets in respect of which the waiver, modification or opt-out is agreed and a clear explanation of how the limits are calculated;
  - (b) The consequences to the client of such waiver or modification of the protection of client assets or of such opt-out of the application of the client asset protection regime, and the effect on the client’s rights of any exercise of such waiver, modification or opt-out by the intermediary in the ordinary course of business or in the event of a third party’s or

- intermediary's insolvency, and the nature and extent of risks associated with each waiver, modification or opt out, and any investor compensation scheme, where applicable. This should include material risks to the client of having any client assets held in foreign jurisdictions; and
- (c) The client's right to call for redelivery of the assets, where applicable.
4. If a waiver, modification or opt-out of client asset protection is permitted in a jurisdiction, the regulatory regime of that jurisdiction should define criteria to delineate the qualifications of clients who will be permitted to waive or modify the protection applicable to client assets or otherwise to opt out of the client asset protection regime. Any such criteria should be clear. Such jurisdictions should also consider prohibiting specific classes of clients from waiving or modifying the protection applicable to client assets or from opting out of the client asset protection regime where that class of client is judged unlikely to have the knowledge or ability necessary to assess effectively the risks associated with the waiver, modification or opt-out.
  5. Where appropriate, regulatory regimes may consider requiring different levels of disclosure by an intermediary of the consequences of any waiver, modification or opt-out for different types of clients that are commensurate with their respective sophistication and knowledge of financial markets.

**Principle 7 – Regulators should oversee intermediaries' compliance with the applicable domestic requirements to safeguard client assets.**

Means of implementation

1. Regulators should have and use adequate tools to effectively monitor an intermediary's compliance with the domestic client asset protection regime. Such tools may include, among other things, regulatory measures such as:
  - (a) Mandatory reports to the regulator from an intermediary, whether sent on a periodic basis or upon the occurrence of specific events, as to the amount, location, value and ownership status of client assets held, the status of the intermediary's compliance with the applicable requirements and any separate client asset protections that apply where client assets are invested;
  - (b) Mandatory periodic or occurrence-related reports to the regulator from self-regulatory organizations (where applicable) as to the status of the intermediary's compliance with the applicable requirements;
  - (c) Mandatory reports sent to the regulator from independent external auditors, provided at least annually, as to the adequacy of the intermediary's arrangements in safeguarding client assets;
  - (d) Ad-hoc inspection visits to assess the adequacy of the intermediary's arrangements in safeguarding client assets; and
  - (e) The establishment of *whistle-blowing* programs to provide an additional mechanism for the monitoring of an intermediary's compliance.
2. The regulator may decide to use a risk-based approach to supervise its intermediaries' compliance with the applicable domestic client asset protection requirements. Such a risk-based analysis should focus on intermediaries that pose the greatest regulatory concerns and should, where practicable, consider:

- (a) The value of client assets held by the intermediary (as an indication of the impact the insolvency of the intermediary would have on clients and the market);
  - (b) The location of the client assets (as an indication of the impact of concentration risk on that particular intermediary or third party);
  - (c) The prudential/capital health of the intermediary (as an indication of the likelihood of the insolvency of the intermediary); and
  - (d) The status of the intermediary's general governance, systems and control arrangements, regulatory history and complexity of its business (as an indication of potential internal compliance risk posed by the intermediary).
3. The factors referred to in 2 above may also influence the depth of the analysis the regulator conducts with respect to a particular intermediary.
  4. Where a jurisdiction requires intermediaries to meet specific qualifications in order to be considered eligible to place or deposit client assets in foreign jurisdictions, the regulatory regime should define clear criteria to delineate those qualifications.

**Principle 8 – Where an intermediary places or deposits client assets in a foreign jurisdiction, the regulator should, to the extent necessary to perform its supervisory responsibilities concerning applicable domestic requirements, consider information sources that may be available to it, including information provided to it by the intermediaries it regulates and/or assistance from local regulators in the foreign jurisdiction.**

#### Means of implementation

1. Regulators should use available information sources in performing their supervisory responsibilities with respect to intermediaries placing or depositing client assets in foreign jurisdictions.
2. Intermediaries
  - (a) Where the regulator has the power to require this, it may obtain from an intermediary information on the operation of the client asset regime in the foreign jurisdiction (or, where relevant, jurisdictions) where the intermediary places or deposits client assets, and may require such intermediary to demonstrate that it has complied with any applicable client communication requirements.
  - (b) Where a regulator has the power to request information regarding the amount, location, value and ownership status of client assets, it should request such information from regulated intermediaries to the extent necessary to perform its supervisory responsibilities.
3. Cooperation with other regulators
  - (a) Regulators should endeavour to respond to requests from foreign regulators regarding their client asset protection regime and/or insolvency regime, as far as the request falls within their remit. The local regulator may be in a better position to outline the standards in its jurisdiction and to explain how the client asset protection regime works generally as well as in default scenarios.
  - (b) Regulators should consider seeking assistance from the local regulator to obtain information concerning how the foreign client asset protection regime operates. The

- local regulator may have access to better information and records than the home regulator and, in some cases, may be able to verify the location of client assets (*e.g.*, where permitted by applicable law or regulation, by cross-checking records or through on-site inspections).
- (c) Regulators should also consider whether there are adequate mechanisms in place to promote information sharing between jurisdictions whether through pre-existing workstreams (*e.g.*, the IOSCO survey on client asset protection regimes) or in response to ad hoc requests from individual regulators. In particular, regulators should consider whether existing memoranda of understanding (MOUs) are sufficient to provide for information sharing or whether further MOUs or side letters are required.
  - (d) Regulators should consider any confidentiality and/or data protection issues that may prevent information sharing (especially in a cross-border context). Regulators should consider whether existing MOUs (including side letters) cover, or new memoranda of understanding should be agreed to address confidentiality or other concerns.
  - (e) To the extent consistent with any confidentiality and/or data protection rules, the regulator should be able to share information with respect to a particular intermediary or particular client asset as necessary. This could include, where permitted by applicable law or regulation, verifying the existence of particular assets or the holdings of a particular intermediary if necessary (*e.g.*, through an on-site inspection or by cross-checking records) and/or sharing information about the intermediary's record of compliance with client asset protection rules.

(f)

## **Glossary**

**Client asset protection regime** – the statutes, regulations, rules or other legally binding requirements of a jurisdiction (including, where applicable, of a self-regulatory organisation) in relation to protection of client assets and any associated rights.

**Client assets** – assets (or an analogous term) in respect of which the intermediary has an obligation (either contractual or regulatory) to safeguard for its clients, including, to the extent appropriate, client positions, client securities and money (including margin money) held by an intermediary for and on behalf of a client.

**Client positions** – contractual rights arising from transactions entered into by an intermediary on behalf of its clients, including mark to market accruals arising from the change in value of futures and options positions.

**Client securities** – securities, bonds, notes, shares and other similar instruments held for or on behalf of a client, including fully paid securities and margin securities.

**Fully paid securities** – securities for which a client has fully paid, and which are free from further pledges and encumbrances.

**Intermediary** – a securities firm (including a derivatives firm) that is subject to supervision by a regulatory authority.

**Margin securities** – securities purchased in part with money a customer has borrowed from the intermediary.

**Regulators** – regulatory authority responsible for the supervision of intermediaries' compliance with the applicable client asset protection regime including, where applicable, self-regulatory organisations acting in a supervisory capacity.

**Third party** – a party with whom client assets are placed by the intermediary (such as a bank, central counterparty or other entity).

Appendix A - 2013 Client Asset Protection Questionnaire Summary

	Australia	Brazil	Canada	France
<i>Context Questions</i>				
<p><b>How does your jurisdiction define the term "client assets"?</b></p>	<p>Not specifically defined. Client Assets are comprised of both Client Money and Client Property.</p> <p>Client Money is money paid to an Investment Firm in connection with a financial service that has been provided, or that will or may be provided, to a person (the client); or a financial product held by a person (the client); and is paid by the client; or by a person acting on behalf of the client; or to the Investment Firm in the Firm's capacity as a person acting on behalf of the client. There are exclusions from this definition.</p> <p>Client Property is property other than money (for example, share certificates) that is given to an Investment Firm in connection with a financial service that has been provided, or that will or may be provided, to a person (the client); or a financial product held by a person (the client); and the property is given by the client; or by a person acting on behalf of the client or for the client; or for the benefit of the client; or the Investment Firm is accountable for the property.</p> <p>Exclusions from client property include property that is given as security for a standard margin lending facility.</p>	<p>- "Client Money": sometimes treated as a general obligation of the Investment Firm</p> <p>- "Securities" and "Positions"- segregated from the pool of assets of the Investment Firm at the custodian level.</p> <p>Margins placed by Clients as collateral for derivatives positions are also segregated, and can be transferred to other Investment Firms at will or in case of insolvency. On the other hand, margins placed as collateral in loans granted by the Investment Firm to purchase Equities are not segregated from the pool of assets of the Investment Firm.</p> <p>-Client Assets categorized as "Securities" can be divided in two major groups: (1) equities, corporate bonds/commercial papers, shares of mutual funds and all derivatives, and (2) government bonds, currency spot and time/demand deposits.</p>	<p>Assets include cash, securities and certain other property such as segregated insurance funds. The definition of security also includes a commodity futures contract and commodity futures options as defined under the Ontario Futures Act.</p>	<p>"Client Assets" means "financial instruments" and "client money".</p> <p>"Financial instruments" include financial securities and financial contracts.</p> <p>"Financial securities" include equity securities, debt securities and units or shares in undertakings for collective investment.</p> <p>"Financial contracts" are those included on a list issued by decree.</p> <p>"Client money" includes "fund received from the public" and funds received by investment firms for the purpose of financial transactions.</p>

Appendix A - 2013 Client Asset Protection Questionnaire Summary

	Australia	Brazil	Canada	France
<p><b>What is the nature of a client's ownership rights with respect to its client assets placed with an investment firm?</b></p>	<p><b>Client Money</b>                      -No reference to ownership rights in Act                      -Act imposes fiduciary obligations on an Investment Firm in favor of the client with respect to Client Money in certain circumstances.</p> <p><b>Client Property</b>                      -No reference to ownership rights in Act                      -Act imposes a fiduciary obligation on an Investment Firm to hold the Client Property in trust for the benefit of the person who is entitled to it.</p>	<p>Clients retain ownership rights over assets placed with an Investment Firm. The only exception is money: in case of a shortfall or insolvency, the client holds only a claim against the Investment Firm in relation to cash deposited, since it would be treated as a general obligation of the Firm ranked pari passu with other unsecured creditors.</p>	<p>The client has full ownership interest for any unencumbered cash maintained in its investment account with the member firm (cash in the account due to short selling is excluded). It also has full ownership interest over the securities which have been fully paid for. These securities will be required to be put in segregation and be shown as such on the client's statement of account. Provincial Securities Acts require those firms acting as custodians to hold these securities in a separate location without lien or charge. This protects customers by preventing the member firm from using these securities for other purposes.</p> <p>Fully paid for securities can also be held in safekeeping where the member firm acts as the client's custodian, similar to a bank safety deposit box. A written agreement needs to be in place between the member firm and the client and these securities will be shown as held in safekeeping on the client's monthly statement of account.</p> <p>If the client has a margin account, a proper margin agreement needs to be signed between the member firm and the client. This margin agreement protects the firm for financing customer purchases. This agreement gives the firm the legal right to place a lien on securities not fully paid for and to use these unpaid securities as collateral to finance the position. If the client fails to meet a margin call, the member firm may liquidate the security in the account and apply the proceeds to satisfy the client's indebtedness. The client will gain back full ownership over the securities when it is fully paid for.</p>	<p>The client retains ownership rights over "financial instruments" held by a custody account-keeper in a securities account.</p> <p>The "financial instruments" must be strictly identified on an individual account basis. The custody account-keeper is not permitted to use the securities without the client's express consent.</p> <p>The "financial instruments" are materialized in an entry on the client's account. There is a presumption that the "financial instruments" are owned by the client under whose name the account is maintained.</p>

Appendix A - 2013 Client Asset Protection Questionnaire Summary

	<b>Australia</b>	<b>Brazil</b>	<b>Canada</b>	<b>France</b>
<b>How does your jurisdiction define the term "client"?</b>	<p><b>Client</b>                      Person who has been, may be or will be provided with, a financial service or who holds the financial product, in relation to:                      (a) money paid to the Investment Firm in connection with such financial service or financial product (but not necessarily paid by the client);                      (b) property is given to the Investment Firm in connection with such financial service or financial product (but not necessarily by the client).                      -Retail clients and wholesale clients (in effect, wholesale clients are sophisticated investors) are treated the same.</p> <p><b>Australian Securities Exchange 24 Market Participants</b>                      -Client: any person, partnership or Corporation on behalf of whom the market participant enters, acquires or disposes of a futures contract or option contract; or on whose behalf the market participant proposes to enter, acquire or dispose of a futures contract or options contract; or from whom the market participants accepts instructions to do so.                      -For futures contracts traded on ASX- client is defined to mean a person on behalf of whom the market participant deals, or from whom the market participant accepts instructions to deal, in futures contracts.</p>	<p>"Clients" are natural persons or legal entities that hold accounts at Investment Firms. Brazil follows a Custodial Regime, therefore the relationship between the Investment Firm and its clients with respect to Client Assets is primarily a custody arrangement under civil law.</p>	<p>Any individual or entity that opens an account with the member firm and for which services are rendered is considered a client.</p>	<p>Client is not defined in French legislation. It is understood in line with the MiFID definition: client means any natural or legal person to whom the investment firm provides investment and/or ancillary services.</p> <p>There is a distinction between professional and non-professional customers.</p> <p>Professional customers are customers who possess the experience, knowledge and skills to make investment decisions and evaluate the risks incurred. Professional customers may elect to be treated as non-professional customers.</p> <p>Non-professional customers are all other customers.</p> <p>There is also a concept of a "qualified investors" - an individual or entity possessing the expertise and resources required to apprehend the risks inherent in transactions in financial instruments.</p> <p>For FMIs, the following terms are used rather than client: participants and indirect participants.</p> <p>For CCPs, EMIR refers to clearing members and clients.</p>
<b>Pre-Insolvency Questions</b>				

Appendix A - 2013 Client Asset Protection Questionnaire Summary

	Australia	Brazil	Canada	France
<b>Does the Regime require the Client Assets of each client to be placed in an individual account?</b>	No. An Investment Firm may hold Client Assets in an Omnibus Account or in an individual account. Client money may be co-mingled.	Securities and Positions: Yes (at the custodian level.)  Cash: No. Even though cash balances for each client are updated on an ongoing basis and are readily available for consultation, the aggregate cash amount deposited by clients is held at the Investment Firm's account.	(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 <i>OR</i> (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 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) <i>Client Money</i> . No. Furthermore, only banks (not investment firms) are allowed to hold client money. Investment firms must either deposit client money in a bank or use such money to purchase qualifying money market funds. Where client money has been deposited, investment firms must reconcile their own accounts and the register of the entity where the money is deposited. The investment firm must also report to the ACP on a quarterly basis and provide clients with this information.  (iii) <i>Client Securities</i> . Yes. In addition, investment firms must keep accurate records and accounts as necessary to enable them to at any time and without delay distinguish assets held for one client from assets held for other clients and from their own financial instruments. These records must be reconciled periodically. If a custody account-keeper uses the services of an agent, it must ensure that the same segregation is made on the agent's books.
<b>How often does the Regime require the Investment Firm to reconcile its books and records with its segregation requirement?</b>	(i) <i>Investment Firms that are Members of the Australian Securities Exchange ("ASX"), Chi-X and ASX 24</i> . 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) <i>Investment Firms that are not Members of ASX, Chi-X and ASX 24</i> . There is no express requirement for reconciliation under the Act although an Investment Firm is required to have adequate risk management systems. Effective accounting and reconciliation processes are considered fundamental to this requirement.	There are no specific rules that apply to book reconciliation, but the best practice is to reconcile cash positions by the end of the relevant business day. Reconciliation is applicable only to cash deposited at the Investment Firm, since "securities" and "positions" are held in individual accounts at the custodian level.	(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.	Regarding client funds and client securities, reconciliation is required to be conducted regularly (e.g. on a daily basis).  Client funds may be reconciled on an aggregate basis.  For client securities, investment service providers must also conduct periodic reconciliations between internal accounts and third party records.

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	<b>Australia</b>	<b>Brazil</b>	<b>Canada</b>	<b>France</b>
<b>Does the Regime permit the Investment Firm to temporarily hold less Client Assets than the amount specified in the segregation requirement?</b>	<p>(i) <i>Investment Firms that are Members of ASX, Chi-X or ASX 24</i> . No, an Investment Firm must notify ASX, Chi-X or ASX within two (2) business days if reconciliation reveals deficiency in Client Assets.</p> <p>(ii) <i>Investment Firms that are not Members of ASX, Chi-X or ASX</i>. The Act regulates payments in and payments out of the client money account. It does not regulate the determination of the segregation requirement nor if the Investment Firm holds Client Assets that meet a segregation requirement.</p>	<p>Segregation requirements are not necessary in the Brazilian jurisdiction since Client Assets are held in individual accounts at the custodian level, thus out of reach of the Investment Firm. The only exception is cash, see above.</p>	<p>Yes, if the Investment Firm does not knowingly cause such a deficiency.</p> <p>If an Investment Firm discovers a deficiency in segregated Securities, then it must compensate for such deficiency by the next business day.</p> <p>If an Investment Firm discovers a deficiency in "free credit balance" then it must "expeditiously take the most appropriate action to rectify the deficiency."</p>	<p>No.</p>
<b>If a client has a debit balance, does the Regime permit the Investment Firm to deduct such balance in determining its segregation requirement? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?</b>	<p>The Act regulates payments in and payments out of the client money statutory trust account. It does not specify how to determine what balance should be held.</p>	<p>Segregation requirements are not applicable in the brazilian jurisdiction, see above.</p>	<p>In Canada, client credit balances are permitted to be used by the Member in its operations up to a threshold. Client credit balances exceeding the threshold are required to be segregated. If a client has a debit balance it is required to provide collateral to secure the debit balance. If the client does not, the firm is required to take a charge against capital for any shortfall.</p>	<p>No. The accounts receivable (debit balance) of a customer cannot be deducted from the credits. One client's net debt balance does not reduce the firm's obligations with respect to the required funds to be held on deposit for net credit balances of other clients. Moreover, regarding securities, a securities account is not permitted to have a debit balance.</p>

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	<b>Australia</b>	<b>Brazil</b>	<b>Canada</b>	<b>France</b>
<b>Does the Regime permit the Investment Firm to treat different types of Client Assets (i.e., cash and securities) as fungible?</b>	No. The Act does not deal with this issue specifically. However, in practice Client Assets are fungible within Client Money and Client Property classes respectively.	Client Assets are not fungible between or within asset classes.	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 assets are fungible, in particular fully dematerialised securities.
<b>Does the Regime permit the Investment Firm to maintain its own assets in the Client Account as a "buffer" against violating segregation requirements?</b>	An Investment Firm is not permitted to deposit proprietary funds into a client money account by way of buffer or otherwise. An Investment Firm has one month to withdraw fees and commissions that have accumulated in the CSA to avoid violating the segregation requirements.	No such rules exist regarding buffer assets. Segregation requirements are not applicable in the Brazilian jurisdiction, see above.	(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.

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	Australia	Brazil	Canada	France
<b>Does the Regime permit the Investment Firm to encumber, re-hypothecate, or otherwise use Client Assets?</b>	Yes to the extent there is no prohibition against rehypothecation under the Act however the encumbering or use of Client Assets is subject to restriction generally. For Client Money (but not Client Money that is used by the Investment Firm for margining), the Act provides for protection from attachment, execution or similar process in certain circumstances. There are also limitations on the permitted withdrawal, use or investment of Client Money eg a Firm may include authorisations and directions in its client agreement so that the withdrawal amounts to making a payment to or in accordance with the written direction of a person entitled to the money and therefore is a permitted withdrawal under the Act. Further, in relation to derivatives and dealings in derivatives, the Act also allows the Firm to use both Client Money and Client Property for meeting its obligations in connection with margining, guaranteeing, securing, transferring, adjusting or settling dealings in derivatives. The protection provisions for Client Property are less extensive. Generally the Act requires that Client Property be only dealt with in accordance with the safe custody, registration and security arrangements under the Regulations, the terms and conditions agreed with the client and any subsequent instructions of the client.	No.	(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.	Yes.  (i) An Investment Firm must deposit client funds in a bank or may invest client funds in "qualifying money market funds." It may not use client funds in any other manner.  (ii) An Investment Firm may use financial instruments for securities financing with client consent. Retail clients must give such consent in writing.  If financial instruments are being held on an omnibus basis, then the Investment Firm may use such Securities for securities financing only if:  (a) all relevant clients have consented or  (b) the Investment Firm implements systems and controls to easily differentiate between those clients that have consented and those that have not.  (iii) the custody account-keeper may not make use of any financial instrument / attached rights in custody nor transfer title without the express consent of the holder.
<b>How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?</b>	Client Money: The Act does not address ownership rights. -If an Investment Firm has the client's consent and authority to withdraw Client Money from the client money account and use it or invest it under the client agreement, and the exercise of those rights is not prohibited under the Act, whilst the Investment Firm remains solvent and holds the AFSL, a client's rights would be limited to those arising out of the client agreement with the Investment Firm.  In the case of the Investment Firm's insolvency, the Act provides for a priority of payments to those persons entitled to the money held in the account.  Client Property: The Act does not contain a prohibition against re-hypothecation but if the Investment Firm exercises its right to use Client Property in this way, it may result in transfer of title to the Client Property to the Investment Firm.	-Does not have laws or regulations concerning rights of use or re-hypothecation of client assets. -Rights of use and re-hypothecation are not feasible, since assets posted as collateral by the client are kept in individual accounts, out of reach of the Investment Firm for its own use as collateral on proprietary positions or on positions entered into by other clients.	If the client securities are not fully paid for, there is no ownership right over these unpaid securities. If the client has a margin account, a proper margin agreement needs to be signed between the member firm and the client. This margin agreement protects the firm for financing customer purchases. This agreement gives the firm the legal right to place a lien on securities not fully paid for and to use these unpaid securities as collateral to finance the position. If the client fails to meet a margin call, the member firm may liquidate the security in the account and apply the proceeds to satisfy the client's indebtedness. The client will gain back full ownership over the securities when it is fully paid for. The client's consent over the use by the Dealer member to do financing transaction with the unpaid securities comes in the form of the client signing the margin account agreement.	Where the client has agreed to grant a "right of use" to an investment service provider in respect of pledged assets (or where ownership has passed from the client to the investment service provider) and where this right has been exercised by the investment services provider, the client has lost his ownership right in the asset.  If the investment service provider failed, the client would be treated as an ordinary creditor.  It should be noted that this is applicable where assets have been pledged or where ownership has been transferred to the investment service provider (i.g. not where assets have been temporarily ceded as collateral).

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<b>How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?</b>	<p>(i) Client Money - the consent is usually in writing by including appropriate terms in the client agreement.</p> <p>(ii) Client Property – regulation 7.8.07(8) requires a written notice to be given to the client by the Investment Bank which identifies the property and states that the Firm proposes to deposit the Client Property as security for a loan or advance to the Firm. It is noted that section 984B requires that Client Property be dealt with subject to the terms and conditions on which the Client Property was given to the Investment Firm and to any subsequent instructions given by the client.</p> <p>ASX24 market participants. Prior to the commencement of trading for a Client, an Investment Firm must have in force, a duly signed agreement with that client containing the minimum terms. An</p>	See above	The client's consent over the use by the Dealer member to do financing transaction with the unpaid securities comes in the form of the client signing the margin account agreement.	Through express prior consent. In the case of a retail consent, this must be in writing.
<b>How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (i.e., established by statute or regulation, established by prior judicial decision)</b>	<p>With respect to the nature of a client's ownership rights and client's beneficial interest, see above.</p> <p>Rehypothecation of Client Assets is not regulated by the Act.</p> <p>Client Money - It is possible a client would pursue an action against the Investment Firm for recovery of the amount due to it under or in connection with the terms of the client agreement and related transactions and services. The Act does provide for priority of payments in those cases where the balance of the client money statutory trust account is insufficient to meet investor claims and the Investment Firm has become insolvent or has ceased to trade.</p> <p>Client Property - Any hypothecation of the Client Property to the Investment Firm would be addressed under the terms of the client agreement or related document. Depending on the facts of the case, if the Investment Firm had re-hypothecated Client Property without consent and without such default, it is possible the client would pursue a claim against the Investment Firm for recovery of the Client Property in specie, seek compensation for the loss of the Client Asset or seek to recover the Client Asset from third parties holding the Client Asset under the re-hypothecation.</p>	See above	The Dealer member cannot do financing transactions with unpaid securities without having in place a proper margin account agreement signed by the client. All client fully paid and excess margin securities are required to be segregated. The Dealer member is not permitted to use them as they are the custodian of these assets (Criminal Code of Canada 322(1)). If in violation of the above rule, the Dealer member used or re-hypothecated a client's asset they are still considered the assets of the client. If the Dealer member could not fulfill its custodial responsibilities because it is insolvent, the client can submit a claim against the compensation fund.	Where the client has not consented to re-use by the investment firm, the client retains his rights in the securities (and would retain a right of restitution in respect of the securities). However, should the firm become insolvent, the client will lose his ownership rights and become an unsecured creditor of the firm.
<b>Does the Regime permit the Investment Firm to hold Client Assets with a third-party affiliate?</b>	Yes. In addition, if an Investment Firm is a bank, it may choose to hold Client Assets itself.	Yes.	Yes, provided that the third party affiliate also qualifies as an acceptable securities location.	<p>Yes subject to the custody account-keeper ensuring that the assets of its customers are segregated from its own assets on the books of any CSD of which it is a member.</p> <p>Where the third party is located outside the EEA, and where holding of financial instruments is not regulated in that jurisdiction, certain conditions must be met to place the client assets with that third party.</p>

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	Australia	Brazil	Canada	France
<p><b>Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)? If so, what protections are applicable to the Foreign Investment Firm’s Client Assets? What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets? What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?</b></p>	<p>This question has been interpreted as asking if an Investment Firm in Australia can commingle its Client Money with that of a Foreign Investment Firm in the same Omnibus Account. The Investment Firm must pay Client Money into a client money statutory trust account that complies with the requirements of the Act. The Act places restrictions on what money may be deposited into an account, otherwise known as the client money account. Client Money of a Foreign Investment Firm is not permitted to be paid into and therefore commingled in a client money account.</p> <p>Subsequent to paying Client Money into the client money account, provided the client has authorized and consented to it, Client Money may be withdrawn and paid into another account. This account may be an Omnibus Account that could also hold money from foreign clients.</p> <p>No statutory protections apply to Client Assets that have been subsequently deposited into an Omnibus Account with the client’s consent and authority.</p> <p>Regulation in the foreign jurisdiction may dictate what steps the Foreign Investment Firm must take, if any.</p> <p><u>ASX 24 market participants.</u></p> <p>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.</p> <p>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</p>	<p>There are no specific rules regarding this issue; the general rule is that the final beneficial owner must be identifiable at all times.</p> <p>Local omnibus accounts are an exception to the rule, as explained before. Protections applicable to Foreign Investment Firms’ Client Assets held at omnibus accounts are the same applicable to Local Investment Firms’ Client Assets. There is a high degree of protection since Client Assets (securities and positions) are always segregated, at the custodian level, from the Investment Firm’s Assets and from assets belonging to other Clients.</p> <p>No further steps must be taken by the foreign Investment Firm to secure such protections.</p> <p>Currently there are no laws or CVM instructions concerning reduction in protections (waiver of rights).</p>	<p>Yes, Foreign Investment Firms are allowed to open an omnibus account with an IIROC Dealer member. However, there is no Canadian Investor Protection Fund protection afforded to investment firms, and its customers, dealing with an IIROC Dealer member on an omnibus basis.</p>	<p>Regarding financial instruments, omnibus accounts are not allowed in France. The principle is that all accounts are individually titled (except at CSD level and at other intermediary levels that do not confer ownership rights). If a non-French bank/investment firm holding client securities asks a French bank/investment firm to hold them on its behalf, the French entity will open a dedicated account for the securities of the clients of the foreign entity (the account will not contain the securities of anyone else). On request, the French entity will open a dedicated account for each of the clients of the non-French entity. This will enhance the level of protection but will be more costly.</p> <p>Regarding client money, see also the answers to Question 3 above.</p>
<p><b>Does the Regime permit clients to waive or otherwise reduce or vary any of the Client Asset protection requirements?</b></p>	<p>There is no specific mechanism for clients to opt out of or waive the Client Asset protection provisions under the Act or ASIC market integrity rules. However, certain practices can have the effect that the Investment Firm is holding may not be subject to the client money protection provisions.</p>	<p>No.</p>	<p>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.</p>	<p>No. However, because an Investment Firm is permitted, with client consent, to 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.</p>

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	<b>Australia</b>	<b>Brazil</b>	<b>Canada</b>	<b>France</b>
<b>Under the Regime, what actions may the Regulator take to protect the Clients Assets of an Investment Firm in distress?</b>	<p>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.</p> <p>The regulator may also apply to the court for interim freezing orders.</p>	<p>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.</p>	<p>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 Membership. In general, such suspension would lead to the initiation of insolvency proceedings against the Investment Firm.</p>	<p>Client money held by an investment firm, as well as client financial instruments held by a bank or investment firm do not form part of the assets of the entity. They are not subject to the insolvency procedure or actions to be undertaken by ACP with respect to the financial situation of the investment firm.</p>

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	Australia	Brazil	Canada	France
<p><b>Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically, does the Investment Firm report where client assets are held? Does the Investment Firm or depository report the protections applicable to such client assets? Does the Investment Firm or depository report the amount of assets that are held? In each case, are such reports provided on request or periodically? If periodically, with what frequency?</b></p>	<p>In relation to reporting breaches of the Client Asset Protection Provisions, the Act requires the Investment Firm that has breached or is likely to breach its AFSL obligations (including the obligation to ensure the Firm has available adequate resources to provide the financial services covered by the licence) to notify ASIC as soon as practicable and in any event within ten business days after it becomes aware of the breach or likely breach where that breach or likely breach is significant.</p> <p>ASX 24 market participants: ASX 24 market participants who hold client money are required to report the nature of Client Assets held on a monthly and annual basis. They report the amount of Client Assets held and the nature of the client's investment. The client funds reconciliation is submitted on a monthly basis, one month after the calendar month to which the reconciliation relates.</p>	<p>Reporting on Client Assets by Investment Firms is required only in cases of administrative investigation (by the Market Authority or by the SROs) or by court order. Nevertheless both the exchange (BM&amp;FBovespa) and trade repositories (OTC organized markets like CETIP or BM&amp;FBovespa) report all derivative open interest positions on a daily basis to the Market Authority (CVM).</p>	<p>There is no report required to be filed concerning where client assets are held. However, under Rule 200 for minimum books and records, the Dealer member is required to maintain at all times a securities record reflecting for each security all long and short positions carried for the Dealer Member's account or for the account of customers, showing the location of all securities long and the offsetting position to all securities short and in all cases the name or designation of the account in which each position is carried.</p> <p>As per Rule 29.1, each Dealer member shall include on the front of each confirmation and account statement sent to a customer the CIPF official symbol, and shall also include in legible print on each confirmation and account statement sent to as customer the CIPF official explanatory statement which reads: "Customers' accounts are protected by the Canadian Investor Protection Fund within specified limits. A brochure describing the nature and limits of coverage is available upon request".</p> <p>Client net equity is reported on Schedule 10 of Form 1 on a monthly basis. Client net equity is defined as the total value of cash, securities and other acceptable property owed to the client by the Dealer member less the value of cash, securities, and other acceptable property owned by the Client to the Dealer member. However, there is no reporting for the amount of securities held at custodians.</p> <p>Securities records would be provided on request during regular field examinations. As for the filing of the audited Form 1 in which client net equity is indicated, this is produced annually.</p>	<p>Credit institutions must report to the ACP regarding the global amount of client funds held. They must also report to the Deposit Guarantee Scheme in respect of eligible deposits.</p> <p>Investment firms must ensure its statutory auditor reports to ACP annually outlining the adequacy of measures taken to comply with client money requirements and quarterly regarding quantitative information relating to the amount of client money to be segregated.</p> <p>Custody account-keepers must report to the AMF at least annually on the adequacy of measures taken to comply with provisions on safeguarding client financial instruments.</p> <p>Custody account-keepers must also give additional disclosure to ACP, on a quarterly basis, including information on the amounts of client money to be segregated and amounts of financial instruments eligible for the Investor Compensation Scheme.</p>

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	<b>Australia</b>	<b>Brazil</b>	<b>Canada</b>	<b>France</b>
<p><b>What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify where Client Assets are held, the amount of Client Assets held at a depository, and the safeguards applicable to Client Assets held at a depository?</b></p>	<p>ASIC conducts proactive and reactive surveillance of Investment Firms for their compliance with Australia's financial services laws. This will include a requirement that the Investment Firm provide documentary evidence of its compliance such as bank statements where Client Money is held in a foreign jurisdiction.</p> <p><b>ASX 24 market participants.</b></p> <ul style="list-style-type: none"> <li>- Must perform a daily reconciliation of client funds by 7pm the next business day. The reconciliation requires the ASX 24 Market Participant reconcile the liability owed to the client against the money held in the clients' segregated account.</li> <li>-Required to notify ASIC, within 2 business days if the reconciliation has not been performed, or if there is a deficit (total deposit is less than third party Client Money) or the Market Participant is unable to reconcile its clients' segregated account.</li> <li>-Required to submit its monthly reconciliation of client funds to ASIC by the last business day of the calendar month following the calendar month to which the reconciliation relates. ASIC reviews the client funds reconciliation to ensure it contains the required disclosure and is completed in a timely manner.</li> <li>-Must prepare and give to ASIC, an annual declaration for clients' funds. This requires an independent audit of the client monies procedures and controls.</li> </ul> <p>ASIC performs ad hoc inspection of ASX 24, ASX and Chi-X market participant's Client Funds Reconciliations against supporting records to verify that client money is held in accounts designated as clients' segregated account and to determine the nature of any investment.</p>	<p>In all examinations, inspections and audits performed by either CVM or Self-Regulatory Organizations, Investment Firms are assessed for compliance with asset segregation rules.</p>	<ul style="list-style-type: none"> <li>-Regular field examinations performed by Financial &amp; Operations Compliance personnel</li> <li>-Ensure that custodians meet the definition of acceptable securities locations.</li> <li>-Review custody agreements in place between the Dealer member and the custodian to ensure minimum regulatory provisions.</li> <li>-Select a sample to review monthly position reconciliations for evidence of the Dealer member's review and approval.</li> <li>-Test to ensure adequate capital has been provided for unresolved differences over 20 business days.</li> </ul> <p>For client assets held at a depository, during regular field examinations, tests are done on the securities record and custodians' reconciliations are reviewed to verify the amount of client assets held. Moreover, to verify the safeguards applicable to client assets, during regular field examinations, new custodial agreement are looked at to ensure the minimum regulatory provisions are included. There are also tests conducted on the segregation of securities.</p>	<p>Both ACP and AMF undertake inspections regarding client assets. Custody account-keepers and the French CSD (Euroclear France) are subject to periodic inspections.</p>

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	<b>Australia</b>	<b>Brazil</b>	<b>Canada</b>	<b>France</b>
<b>Where an Investment Firm based in a foreign jurisdiction (a "Foreign Investment Firm") deposits Client Assets (i.e., of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify the amount and/or value of such Client Assets, and the protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?</b>	This will depend on the basis the foreign regulator claims jurisdiction over the Foreign Investment Firm and the relevance of the Client Assets to that issue. However, it may be possible for the foreign regulator to seek ASIC's assistance under the co-operative arrangements between them to share information. Further, certain information is public pursuant to the disclosure and reporting obligations of public companies in Australia.	In these cases, general rules concerning the exchange of information between jurisdictions for enforcement purposes would apply (e.g. MMoU).	The foreign regulator could request from the Foreign Investment Firm to consult the monthly statement of account received from the Dealer member. This monthly statement will show the detailed securities of all the clients comingled into one account opened under the Foreign Investment Firm's name.  There is no CIPF protection afforded to Foreign Investment Firms, and its customers, dealing with an IROC Dealer member on an omnibus basis.	Requests are handled pursuant to the applicable Memorandum of Understanding.
<i>Post-Insolvency Questions</i>				

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	<b>Australia</b>	<b>Brazil</b>	<b>Canada</b>	<b>France</b>
<b>Under the Regime, how does an Investment Firm enter the status of "insolvent," "bankrupt," or the equivalent?</b>	<p>In general, either the Investment Firm or its creditors may file a petition for liquidation (<i>i.e.</i>, court liquidation, creditors' voluntary liquidation, and members' voluntary liquidation). Only the Investment Firm may file a petition for reorganization (<i>i.e.</i>, voluntary administration).</p> <p>The Corporations Act 2001 apply to Investment Firms just like any other company.</p>	<p>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.</p>	<p>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.</p> <p>Part XII of the Canadian Bankruptcy and Insolvency Act is specific to Canadian Securities Firms.</p>	<p>Either the Investment Firm or the ACP may request the appointment of a provisional administrator. The ACP's opinion is required for initiation of a judicial reorganisation and liquidation procedure.</p>
<b>Under the Regime, what is the process of appointing an Administrative Officer?</b>	<p>(i) <i>Court Liquidation</i> . In general, the court would appoint the Administrative Officer from a list of qualified practitioners.</p> <p>(ii) <i>Members' Voluntary Liquidation</i> . The directors of the Investment Firm would choose the Administrative Officer, although members may resolve to appoint an alternative.</p> <p>(iii) <i>Creditors' Voluntary Liquidation</i> . The directors of the Investment Firm would choose the Administrative Officer, although creditors may resolve to appoint an alternative.</p> <p>(iv) <i>Voluntary Administration</i> . The party seeking to place the Investment Firm into administration would choose the Administrative Officer.</p> <p>In cases (ii), (iii), and (iv), the Administrative Officer would be a Registered Liquidator with the regulator, subject to educational, personal, and practice requirements.</p>	<p>The regulator selects the Administrative Officer, who usually is a current or retired employee of the regulator, with relevant experience.</p>	<p>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.</p>	<p>The ACP selects the Administrative Officer in a provisional administration and appoints the liquidator in a judicial reorganisation and liquidation procedure.</p>

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	<b>Australia</b>	<b>Brazil</b>	<b>Canada</b>	<b>France</b>
<b>What guidance is available to such Administrative Officer?</b>	<p>Statute (<i>i.e.</i> , 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.</p> <p>There is no guidance specific to Investment Firms.</p>	<p>Statute (<i>i.e.</i> , Law n. 6.024)</p>	<p>Statute (<i>i.e.</i> , Part XII and Part V of the Canadian Bankruptcy and Insolvency Act); The engagement agreement between CIPF and the Trustee; CIPF Insolvency Procedures Manual; CIPF direction</p>	<p>The provisional administrator must comply with its judicial mission (assistance, supervision and administration) and the legal and contractual obligations as a manager at the head of the firm.</p>
<b>What is the standard of liability for such Administrative Officer?</b>	<p>Liability for negligence.</p>	<p>Negligence.</p>	<p>Liability for gross negligence or willful misconduct.</p>	<p>Strict liability for misconduct.</p>

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	<b>Australia</b>	<b>Brazil</b>	<b>Canada</b>	<b>France</b>
<b>How is the regulator involved in the insolvency of an Investment Firm, including in the return of Client Assets?</b>	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.	IIROC is not involved in the insolvency of the Investment Firm. Rather, CIPF assumes responsibility for administering such insolvency.	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.

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	<b>Australia</b>	<b>Brazil</b>	<b>Canada</b>	<b>France</b>
<b>What are the requirements, if any, governing the segregation and treatment of Client Assets during the insolvency of an Investment Firm?</b>	Client Money is to be paid as follows: (a) the first payment is of money that has been paid into the account in error; (b) 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; (c) the next payment is payment to each person who is entitled to be paid money from the client money account; (d) 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 (e) 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 licensee.	There are no specific rules on that matter. General segregation rules apply during the insolvency of an Investment Firm.	None officially but in practice, same as going concern.	<u>Insolvency of a Custody account-keeper</u> The Monetary and Financial Code provides that the resolution authority verifies that the securities held by the central depository on the custody account-keeper's account are sufficient to satisfy the custody account-keeper's obligations.  Where securities are insufficient, the resolution authority may conduct a proportional distribution of the securities.  The remaining securities will be brought into resolution proceedings.  The account holders may ask for the transfer of securities to an account held by another custody account-keeper.
<b>Does the Regime facilitate or encourage the transfer of Client Assets from an insolvent Investment Firm to a solvent Investment Firm?</b>	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. If the Firm is a bank, specific legislation allows for the transfer of part or all of the bank's business to another bank either voluntarily or compulsorily (making it possible to transfer the assets of an insolvent bank to a solvent bank).	Yes, with client consent and authorization from the administrative officer.	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.	The Regime does not provide an overarching arrangement for the transfer of Client Assets. Work is being conducted on this issue.
<b>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?</b>	No, because the Investment Firm holds Client Assets in trust.	Only if Client Assets are inappropriately distributed.	Only if distributions of Client Assets were complicated by conflicts of interest or inside information.	Yes. The honouring of any prior claim to clients before the beginning of an insolvency procedure is prohibited. In principle, this distribution would be null and void. This would be the case in the event of fraud.

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	<b>Australia</b>	<b>Brazil</b>	<b>Canada</b>	<b>France</b>
<b>Does the Regime have a scheme to compensate clients for losses suffered due to the insolvency of the Investment Firm?</b>	<p>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).</p> <p>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.</p>	<p>Yes. There is a deposit guarantee scheme (FGC) that applies to deposits in some financial institutions, namely banks, savings and loans and financial institutions in the real estate segment. Maximum coverage is set at R\$70,000 per person, per financial institution/conglomerate (approximately USD 35,000)</p>	<p>Yes, up to CDN\$1 million (approximately USD\$991,000).</p> <p>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.</p>	<p>Yes, limited to €70,000 (approximately US\$93,000). The guarantee applies to all of the same investor's assets with the same guarantee scheme member institution, irrespective of the number of accounts and location (in France or in the EEA).</p> <p>Securities deposited by credit institutions, investment firms, insurance undertakings, collective investment schemes, pension organizations and funds are excluded from the guarantee.</p>
<b>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?</b>	<p>Yes. Please see above for specific practices that may cause Client Assets to lose protection if the Investment Firm experiences insolvency.</p>	<p>There is no difference in treatment since no such permissions are feasible.</p>	<p>No, because segregation requirements do not vary based on client permission pre-insolvency.</p>	<p>(i) Yes. For client funds held by a credit institution or where funds are held as collateral subject to a right of reuse, the financial firm may use the client funds. Where client funds are held by investment firms, however, investment firms are not permitted to use client funds (except for qualifying money market funds which may invest in money market instruments).</p> <p>(ii) No, with respect to client Securities (unless the client has agreed to grant the investment firm a right of re-use).</p>
<b>If there is a shortfall (i.e., client claims exceed Client Assets), then how does the Regime allocate such loss?</b>	<p>(i) <i>Client Money</i>. <i>Pro rata</i> distribution, with clients becoming unsecured creditors with respect to the shortfall.</p> <p>(ii) <i>Client Securities</i>. 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.</p> <p>If the Administrative Officer cannot perform the abovementioned tracing, then clients would share <i>pro rata</i> each pool of Client Assets of the same type as that they deposited.</p>	<p>In case of a shortfall, claims on Client Money deposited at the Investment Firm rank <i>pro rata</i> with other unsecured creditors and would be allocated <i>pro rata</i>. No shortfall is expected relative to other assets, since they are segregated at the custodian level. In other words, comprehensive asset recovery in relation to amount claimed is the norm for securities held in a CSD. Cash deposited at the Investment Firm (or placed as collateral in loans granted by the Investment Firm to purchase Equities) are not segregated from the pool of assets of the Investment Firm, and recovery will depend on the recovery ratios applicable to all unsecured creditors</p>	<p><i>Pro rata</i>. "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."</p>	<p><i>Pro rata</i>.</p>

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	Germany	Hong Kong	India	Italy
<i>Context Questions</i>				
<b>How does your jurisdiction define the term "client assets"?</b>	<p>(i) In Germany, there is no general legal definition of the term "client assets" or an analogous term thereof.</p> <p>(ii) To give an idea of the scope, however, the Safe Custody Act ("DepotG") applies to shares, 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.</p>	<p>"Client assets" means client securities and collateral and client money.</p> <p>In relation to an Investment Firm, "client securities" means any securities (other than securities collateral) (i) received or held by or on behalf of the Investment Firm; or (ii) received or held by or on behalf of any corporation which is in a controlling entity relationship with the Investment Firm, which are so received or held on behalf of a client of the Investment Firm or in which a client of the Investment Firm has a legal or equitable interest.</p> <p>In relation to an Investment Firm, "client collateral" means any securities or property (other than securities or money) deposited with, or otherwise provided by or on behalf of a client of the Investment Firm to, the Investment Firm; or any other intermediary or person, which are so deposited or provided (i) as security for the provision by the Investment Firm of financial accommodation, or (ii) to facilitate the provision by the Investment Firm of financial accommodation under an arrangement that confers on the Investment Firm a collateral interest in the securities or property.</p> <p>In relation to an Investment Firm, "client money" means any money (i) received or held by or on behalf of the Investment Firm; or (ii) received or held by or on behalf of any corporation which is in a controlling entity relationship with the Investment Firm, which is so received or held on behalf of a client of the Investment Firm or in which a client of the Investment Firm has a legal or equitable interest, and includes any accretions thereto whether as capital or income.</p>	<p>"Client assets" means funds, securities and positions held on behalf of client by a investment firm.</p>	<p>"Client Assets" include both client financial instruments and client funds (i.e. client money).</p> <p>The term financial instruments is interpreted in accordance with MiFID.</p>

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<p><b>What is the nature of a client's ownership rights with respect to its client assets placed with an investment firm?</b></p>	<p>(i) Clients retain full ownership rights over their client assets (other than client money, in respect of which they retain a claim on their client money).</p> <p>(ii) In respect of settling a securities transaction in Germany where the securities are eligible for collective safe custody with the German central depository (Clearstream Banking AG), the Bank will be required to provide the customer with co-ownership of these collective securities deposits (section 6 (1) DepotG).</p> <p>(iii) In case of insolvency of the depository, the depositor is entitled to claim segregation and the return of the securities and the securities will not form part of the insolvency assets (section 47 German Insolvency Code (Insolvenzverordnung - InsO) of the investment firm.</p> <p>(iv) Where 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 depository, the depositor is also entitled to claim segregation.</p> <p>(v) Investment funds which are managed by a management company are asset pools without legal personality. Pursuant to section 30 para. 1 sentence 1 InvG, the investment fund may be held by the investors in direct co-ownership (co-ownership solution) or through the management company acting as owner (trust solution).</p> <p>(vi) A creation of a sub-custody arrangement outside the German jurisdiction by the German Custodian is only permissible in case the</p>	<p>Sections 4 and 5 of the Client Money Rules and the Client Securities Rules respectively require the Investment Firm to ensure that client assets which are received or held in Hong Kong 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 remain subject to a trust in favour of the client.</p>	<p>The investment firms are required to settle the funds and securities of the clients within 24 hours of the pay out received from the stock exchanges. In case the shares/funds of the clients are held in the books of investment firms based on their consent, the same is required to be held in the fiduciary capacity on behalf of the client.</p>	<p>There are two scenarios: where client assets are held by an investment firm and where client assets are held by an investment firm that is a bank.</p> <p><u>Investment Firm that is not a bank</u> Clients retain full ownership rights (i.e. not merely a claim) over client assets (including client money).</p> <p><u>Investment Firm that is a bank</u> In this scenario, clients retain full ownership rights over client assets other than client money. For client money, the client retains a claim since the bank would acquire ownership of the client money placed with them.</p>

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	Germany	Hong Kong	India	Italy
<b>How does your jurisdiction define the term "client"?</b>	<p>(i) In Germany, there is no general legal definition of the term "client" or an analogous term thereof. The statutes offer some perspective on how the term might be used.</p> <p>(ii) The German Securities Trading Act (Wertpapierhandelsgesetz – WpHG) at section 31a WpHG defines "clients" as all natural or legal persons, an investment firm is bringing its investment service to.</p> <p>(iii) The Safe Custody Act (DepotG) applies to retail and institutional investors, though neither term is defined.</p> <p>(iv) Also the German Investment Act (InvG) does not distinguish between retail or professional clients, there are no legal definitions.</p>	<p>Under the SFO, "client", in relation to an intermediary (means a licensed corporation or a registered institution), means a person for whom the intermediary ("first intermediary") provides a service the provision of which constitutes a regulated activity. "Client" includes another intermediary that deposits securities, money or any property as collateral with the first intermediary and, in connection with a leveraged foreign exchange contract, does not include a recognized counterparty.</p> <p>"Licensed corporation" means a corporation which is granted a licence under section 116 or 117 of the SFO. "Registered institution" means an authorized financial institution which is registered under section 119 of the SFO, e.g. a bank. While the authority over licensed corporations lies with the SFC, the oversight of registered institutions is delegated to the Hong Kong Monetary Authority ("HKMA") in connection with supervision, complaints handling and carrying out investigations and regulated under the SFO and the Banking Ordinance (Chapter 155 of the Laws of Hong Kong). Registered institutions are subject to the provisions of the SFO (including its subsidiary legislation) in the same way as licensed corporations with respect to protection of client assets. However, to avoid regulatory overlap, registered institutions are not subject to the Client Money Rules as it is not appropriate for registered institutions to segregate client money from the other deposits which they maintains in the course of their banking business.</p>	<p>A client is one who is registered with the investment firm for the purpose of dealing in the securities. Further, there are no exclusions as on date in the definition of terms.</p>	<p>Client means any natural or legal person to whom an investment firm provides investment and/or ancillary services (this definition tracks the client definition in MiFID).</p> <p>There is also a distinction between "retail client" and "professional client".</p> <p>Retail client is a client who is neither a professional nor a qualified counterparty.</p> <p>Professional client is a client that possess experience, knowledge and expertise to make its own investment decisions and to assess properly the risks. The characterisation can be presumed for some entities, expressly indicated or assessed on request.</p> <p>A qualified counterparty are customers to whom order execution and/or own account trading and/or receipt and transmission of orders services are provided.</p>
<b>Pre-Insolvency Questions</b>				

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	Germany	Hong Kong	India	Italy
<b>Does the Regime require the Client Assets of each client to be placed in an individual account?</b>	<p>The regime in Germany generally requires that client assets be maintained separately from the assets of an investment firm.</p> <p>(i) Customers may waive this restriction.</p> <p>(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.</p> <p>(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.</p>	<p>No. An Investment Firm may hold Client Assets in an omnibus account or an individual account.</p>	<p>Yes.</p>	<p>(i) Yes, investment firms are required to hold Client Assets in individual accounts separately from their own assets and from the assets of other clients.</p> <p>(ii) The regime is "true asset segregation" since financial instruments held by banks and financial instruments and funds held by investment firms other than banks are treated as separate and segregated assets (i.e. creditors of the investment firm cannot take action in respect of those assets).</p> <p>(iii) Client money can only be held through duly authorized banks - investment firms other than banks must open a third party omnibus account with a bank / central bank within one day of receipt. This third party account must be separate from the accounts where the investment firm deposits its own assets.</p> <p>(iv) Investment firms may sub-deposit financial instruments in an omnibus account with a third party where a client consents to this (for professional clients, oral agreement is sufficient).</p> <p>(v) The Investment Firm must comply with special recordkeeping requirements and have the ability to identify, at any point in time, the Client Assets (including positions) of each client.</p> <p>(vi) In addition, commingling of Client Assets is criminally sanctioned.</p>
<b>How often does the Regime require the Investment Firm to reconcile its books and records with its segregation requirement?</b>	<p>The depository is required to issue a securities account statement at least once a year. These statements are normally sent to the clients in the first month of the year.</p> <p>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 trading 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.</p>	<p>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).</p> <p>An Investment Firm must calculate the amount of Client Assets owed to each client, but may reconcile such amount to bank statements or custodian statements on an aggregate basis.</p>	<p>Client accounts are required to be reconciled on a continuous basis at the choice of the clients and at least once in a month or quarter, as per the choice of the client.</p>	<p>An Investment Firm is required to perform reconciliation (a) for each client and (b) in aggregate with respect to each asset class.</p> <p>Reconciliation on a client by client basis is carried out regularly, depending on the frequency and volume of executed transactions.</p> <p>In respect of financial instruments, investment firms must check within one day from the date of registration, that the balance of the customer account at the central depository coincides with the balance in their internal customer account records.</p> <p>On a regular basis, an Investment Firm must also reconcile its internal accounts of Client Assets with the records of any custodian or sub-custodian records holding those Client Assets.</p>

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	<b>Germany</b>	<b>Hong Kong</b>	<b>India</b>	<b>Italy</b>
<b>Does the Regime permit the Investment Firm to temporarily hold less Client Assets than the amount specified in the segregation requirement?</b>	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, 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. The amount (and type) of assets must correspond exactly with the amount of Client Assets deposited with the Investment Firm.  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.
<b>If a client has a debit balance, does the Regime permit the Investment Firm to deduct such balance in determining its segregation requirement? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?</b>	(i) In the scope of the DepotG there are no specific requirements regarding this issue. Investment firms include 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) One client's net debit balance does not reduce the investment firm's obligations with respect to the total required funds on deposit for net credit balances of other 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 in the calculation of the amount of Client Assets that a firm is required to segregate.	Yes, but one client's net debit balances do not reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients.	No. An Investment Firm cannot offset credit and debit balances across different clients. Also, investment firms are prohibited from using the assets of one client to cover margins or transactions of other clients.

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	Germany	Hong Kong	India	Italy
Does the Regime permit the Investment Firm to treat different types of Client Assets (i.e., cash and securities) as fungible?	<p>No.</p> <p>(i) Client Money is not fungible with client Securities.</p> <p>(ii) In general, an Investment Firm "is required to hold the specific securities deposited by the clients." However:</p> <p>(a) The safekeeper can be authorized to take possession of securities or assign the property to a third party, section 13 (1) DepotG. Thereupon the safekeeper is only bound to return securities of the same kind. The authorization must be given expressly and in writing for the several depositing transaction. The authorization has to reflect that by the exercise of the authorization the property assigns to the safekeeper or a third party and that the depositor only has an in personam claim of delivery a certain kind and amount of securities, section 13 (1) sentence 2 DepotG. From the time the safekeeper exercises his right of taking possession of securities or assigning the property to a third party, the regulations of chapter 1. DepotG do no longer apply, section 13 (2) DepotG.</p> <p>(b) 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.</p> <p>(c) 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 protection.</p> <p>(d) Pursuant to the DepotG a client (depositor) is generally the owner</p>	No.	Yes, client assets are fungible between or within asset classes.	No. Cash is fungible. Financial instruments having the same ISIN code are fungible among themselves. Paper-based financial instruments are not fungible assets.
Does the Regime permit the Investment Firm to maintain its own assets in the Client Account as a "buffer" against violating segregation requirements?	No. An Investment Firm is not permitted to commingle proprietary assets with client Securities in individual segregated accounts or omnibus segregated accounts.	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.	No. Client Assets must be kept separate from own assets.

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	Germany	Hong Kong	India	Italy
<p><b>Does the Regime permit the Investment Firm to encumber, re-hypothecate, or otherwise use Client Assets?</b></p>	<p>Yes.</p> <p>(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.</p> <p>(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.</p> <p>(iii) 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.</p> <p>(iv) Finally, the safekeeper can be authorized to take possession of securities or assign the property to a third party, section 13 (1) DepotG. Thereupon the safekeeper is only bound to return securities of the same kind. Where the safekeeper exercises his right of taking possession of securities or assigning the property to a third party, the regulations of chapter 1. DepotG do no longer apply, section 13 (2) DepotG.</p> <p><i>With respect to investment funds under the scope of the Common</i></p>	<p>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.</p>	<p>No, in India, client assets cannot be used or re-hypothecated by an investment firm.</p>	<p>No, unless the following conditions are met:</p> <p>(i) For financial instruments, the client must give written consent. For client money, the client must give specific consent.</p> <p>(ii) Retail clients must give any such consents (for financial instruments or money) in written form.</p> <p>(iii) For financial instruments held in an omnibus account, the investment firm cannot use the financial instruments unless one of the following conditions is met:</p> <p>(a) each client whose financial instruments are held together in the omnibus account has given prior express consent (prior express consent is not required from a professional client).</p> <p>(b) the investment firm has systems and controls in place to ensure only financial instruments belonging to clients who have given prior express consent are so used. Special recordkeeping requirements must be complied with.</p>
<p><b>How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?</b></p>	<p>(i) The affect or the change on the ownership's rights depend on the situation given.</p> <p>(ii) From the time the safekeeper exercises his right to which the depositor has authorized him (section 13 (1) DepotG, see for details response to question 3. b. i. A) and 3. d) of taking possession of securities or assigning the property to a third party, the regulations of chapter 1. DepotG do no longer apply, section 13 (2) DepotG. By assigning the property to a third party, the client loses his ownership rights over the assigned asset.</p> <p>(iii) Securities lending according to section 54 InvG is an example for using assets of a fund. However, the words "lending", "loan" or "borrower" are in some ways misleading as the transaction is in fact an absolute transfer of title against an undertaking to return equivalent securities.</p>	<p>If a client has granted the Investment Firm the right to use or re-hypothecate his assets, the ownership rights of the client over its assets would be subject to the terms and conditions of the client's grant. The court may (a) characterise a security interest with a right of re-hypothecation as being a title transfer arrangement; or (b) interpret such a security interest as having an implied right for the Investment Firm to acquire full legal and beneficial interest automatically upon a disposal (and a corresponding obligation on the Investment Firm to return equivalent securities in due course).</p> <p>If the court characterizes a security interest with a right of re-hypothecation as a title transfer arrangement, the client has no proprietary interest in the collateral, but merely a conditional contractual right against the Investment Firm for re-delivery of assets. If the court interprets such a security interest as having an implied right for the Investment Firm to acquire full interest upon a disposal, the client is the beneficial owner of the assets delivered as collateral.</p>	<p>In India, clients assets cannot be used or re- hypothecated by an investment firm.</p>	<p>All client assets belong to the client, regardless of whether any "right of use" is exercised by the investment firm.</p>

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<b>How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?</b>	The investment firm needs an express and written authorization. Further requirements may be applicable depending on the specific authorization (i.e. if it is in respect of a collective depository, or if it is an authorization to take possession of securities or assign property to a third party, or in respect of investment funds).	A client's consent should be in writing, in one-off direction or standing authority. A standing authority shall specify a validity period not exceeding 12 months and may be renewed upon expiry.	In India, clients assets cannot be used or re- hypothecated by an investment firm.	For retail clients, consent must be in writing and the relevant client agreement should indicate the counterparties, transaction type and obligations of the parties.  For other clients, written consent is required for use of financial instruments and specific consent for use of funds.
<b>How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (i.e., established by statute or regulation, established by prior judicial decision)</b>	This question concerns civil law matters and is not within BaFin's remit.	If a client does not grant the Investment Firm any right to use or re-hypothecate his assets, according to sections 4 and 5 of the Client Money Rules and the Client Securities Rules respectively, the Investment Firm is required to hold the client assets in a segregated account which is designated as a trust account or client account. These assets so segregated remain subject to a trust in favour of the client. If the Investment Firm uses or re-hypothecates the client assets without the client's consent, the client would, in principle, have the right to trace and recover his assets. This conclusion is based on a line of authorities including C.A. Pacific Securities Limited (HCCW 36-37/98) and Re Diplock [1948] Ch. 465.  If the Investment Firm, in breach of the relevant statute, rule or regulation, uses or re-hypothecates its client assets without such client's consent, the Investment Firm would have criminal liability on conviction. But it does not affect the client's right to its assets. The client could commence a civil action to trace and recover his assets which were held by the Investment Firm in trust for him. If there is a shortfall of client assets, the client who does not recover all his assets can apply to the court to wind up the Investment Firm and he will rank as an unsecured creditor in the liquidation in respect of the shortfall.  The SEC has established an Investor Compensation Fund to provide a	In India, clients assets cannot be used or re- hypothecated by an investment firm.	All client assets belong to the client, regardless of whether any "right of use" is exercised by the investment firm.
<b>Does the Regime permit the Investment Firm to hold Client Assets with a third-party affiliate?</b>	Yes.	Yes.	No. In the case of institutional clients, the assets may be maintained with the independent custodians registered with SEBI.	Yes, provided that the client has given his consent (in written form if he is a retail). Investment Firms must keep separate identification of the Client Assets held with a third party. The financial instruments must be held with the third party in an account opened in the name of the Investment Firm indicating that the assets belong to its clients. This client account shall be kept separately from the ones where the Investment Firm deposits its own assets. Investment Firms must keep

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<p><b>Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions ("Foreign Investment Firms") in an Omnibus Account (that includes Client Assets from domestic clients)? If so, what protections are applicable to the Foreign Investment Firm's Client Assets? What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets? What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?</b></p>	<p>(i) Within the scope of the DepotG there is no distinction between client assets from domestic clients and client assets belonging to foreign clients.</p> <p>(ii) To the Foreign Investment Firm's Client Assets the same protections are applicable as to domestic Investment Firm's Client Assets.</p> <p>(iii) There is no need to take any steps for Foreign Investment Firms to secure such protections for its Clients Assets. If German law, i. e. DepotG and Depot-Bek., applies to the custody agreement, the foreign customers benefit from the same protections as a domestic customer.</p> <p>(iv) Neither clients nor Foreign Investment Firms can reduce such protections.</p>	<p>Yes, an Investment Firm in our jurisdiction is permitted to hold Client Assets of Foreign Investment Firm in an Omnibus Account together with other client assets. Such Client Assets are entitled to the same protection as that conferred on other client assets received or held by the Investment Firm in Hong Kong.</p> <p>The Foreign Investment Firm which holds its Client Assets with the Investment Firm is subject to the same Client Asset protection requirements as other clients of the Investment Firm. Clients of an Investment Firm are not permitted to waive any of the Client Asset protection requirements.</p>	<p>No.</p>	<p>Yes, provided that all the conditions described under the previous response are met, as well as the followings: (a) where the activity of safekeeping financial instruments is subject to regulation and supervision, the Investment Firm must deposit the client assets with a sub-custodian subject to such regulation; or (b) where the activity is not regulated, the investment firm may deposit the client assets provided that: (I) the deposit is necessary in view of the financial instrument / service provided or (II) the professional client has consented in writing.</p>
<p><b>Does the Regime permit clients to waive or otherwise reduce or vary any of the Client Asset protection requirements?</b></p>	<p>No. However, a client may consent to pledging or assigning its securities under certain circumstances or passing full title to Securities to the Investment Firm or the third-party depository. In some circumstances, such Securities would cease to be Client Assets, and would no longer be subject to protection.</p> <p>In addition according to section 34a (1) of the Securities Trading Act (WpHG), the following waive of rights is possible:</p> <p>(i) Investment services enterprises which have no authorization to conduct deposit business within the meaning of section 1 (1) sentence 2 no. 1 of the Banking Act (KWG) shall without undue delay segregate client money held in safe custody, which they accept in connection with an investment service or ancillary service, from the money of the enterprise and from other clients' money in a trustee account with credit institutions, enterprises within the meaning of section 53b (1) sentence 1 of the Banking Act or comparable institutions domiciled in a third country and authorized to conduct</p>	<p>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.</p>	<p>No.</p>	<p>No, clients cannot opt out of the protection regime but clients may consent to the investment firm's "right of use" and sub-custody of assets.</p>

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<b>Under the Regime, what actions may the Regulator take to protect the Clients Assets of an Investment Firm in distress?</b>	<p>(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.</p> <p>(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.</p> <p>(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.</p> <p>(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.</p>	<p>The regulator may: (i) suspend or condition the licence 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.</p>	<p>Regulation 16 of the SEBI (stock Brokers and Sub-brokers) Regulations, 1992 requires that a minimum 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 and financials of investment firm is closely monitored by the stock 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.</p>	<p>(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.</p> <p>(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).</p>

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	Germany	Hong Kong	India	Italy
<p><b>Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically, does the Investment Firm report where client assets are held? Does the Investment Firm or depository report the protections applicable to such client assets? Does the Investment Firm or depository report the amount of assets that are held? In each case, are such reports provided on request or periodically? If periodically, with what frequency?</b></p>	<p>(i) According to section 44 InvG the management company must present an annual report for each fund as at the end of each fiscal year.</p> <p>(ii) According to section 44 para. 5 InvG the auditor must submit the annual report on the auditing of the fund without undue delay after conclusion of the audit to the Federal Supervisory Authority.</p> <p>(iii) There is no special regulation in the DepotG.</p> <p>(iv) According to section 36 German Securities Trading Act (WpHG) there is a yearly audit of responsibilities with respect to the security deposit business of financial firms. There is no special reporting of information and data on the holding of client assets to the BaFin mentioned in the WpHG.</p> <p>(v) Moreover, all credit institutions in Germany have to declare on their balance sheet any liabilities with regard to their customers (section 21 para. 2 Kreditinstituts-Rechnungslegungsverordnung –RechKredV).</p> <p>(vi) Section 44 InvG does not require the firm to report where client assets are held nor reporting the protections applicable to client assets.</p> <p>(vii) According to section 44 (1) no. 1 InvG the value of the fund must be stated and these reports are provided annually.</p>	<p>Yes. Investment Firms are required to report in the analysis of client assets in the financial returns how much client money and client securities are held by it and the amount of client funds segregated and distribution of the client securities by the locations specified in the financial returns, e.g. banks, clearing house, other investment firms. For client securities held in other locations, Investment Firms are required to specify the locations and purposes of the dispositions.</p> <p>An Investment Firm is required to notify the SFC in writing upon becoming aware that it does not comply with sections 4(4) (provision for a written confirmation of the renewal of the standing authority to client), 5 (requirement for deposit or registration of client securities and securities collateral) or 10(1) (limitations on the treatment of client securities and securities collateral) of the Client Securities Rules and sections 4(1) or (4) (requirement for designation of segregated account and payment of client money into segregated account) or 5(1) (requirement for payment of client money out of segregated accounts) of the Client Money Rules within one business day thereafter.</p> <p>Section 56 of the Securities and Futures (Financial Resources) Rules (Chapter 571N of the Laws of Hong Kong) requires an Investment Firm to submit financial returns, which include an analysis of client assets, to the SFC on a monthly basis.</p> <p>In addition, under section 156 of the SFO and the Securities and Futures (Accounts and Audit) Rules (Chapter 571P of the Laws of Hong Kong), an Investment Firm is required to submit to the SFC on an annual basis, financial returns, which include an analysis of client assets, made up to the last day of each financial year together with an auditor's opinion as to, among other things, whether the financial returns so submitted are correctly compiled from the records of the Investment Firm.</p>	<p>Yes, the reports are provided both periodically and on request.</p>	<p>The investment firm must report to the regulator about client assets, distinguishing whether financial instruments are held at the firm itself or have been deposited with custodians or sub-custodians (and if so, the type of custodian and where the custodian is located).</p> <p>The investment firm must also report to the regulator about client money and where it is held (i.e. with the investment firm itself if authorised or with another entity).</p> <p>Data is divided by investment service.</p> <p>Finally, the investment firm must report on its exposure to the third party with whom the client assets are deposited (i.e. credit risk information).</p>

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<p><b>What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify where Client Assets are held, the amount of Client Assets held at a depository, and the safeguards applicable to Client Assets held at a depository?</b></p>	<p>Annual audits must be made independent accountants according to §§ 29 KWG, 36 WpHG and §§ 56 – 59 Prüfberichtsverordnung (PrüfBV).</p>	<p>Under sections 153 and 156 of the SFO and the Securities and Futures (Accounts and Audit) Rules, an Investment Firm is required to appoint an auditor to conduct annual audit and review on its controls and compliance with the Client Money Rules and the Client Securities Rules and submit an auditor’s report to the SFC. The auditor’s report shall contain the auditor’s opinion as to, among other things, (a) whether each of the financial returns (including an analysis of client assets) made up to the last day of each financial year is correctly compiled from the records of the Investment Firm; (b) whether the Investment Firm had systems of control in place that were adequate to ensure compliance with the Client Money Rules and the Client Securities Rules during the financial year; and (c) whether the Investment Firm has complied with the Client Money Rules and the Client Securities Rules during the financial year.</p> <p>Under sections 159 and 160 of the SFO, the SFC may appoint an auditor to examine and audit the accounts and records of an Investment Firm in certain circumstances, e.g. upon receiving an auditor report on a matter that, in the opinion of the auditor, constitutes on the part of the Investment Firm a failure to comply with the prescribed requirements under the Client Money Rules and the Client Securities Rules. The SFC has the authority under section 180 of the SFO to conduct onsite inspection on Investment Firms and their associated entities and require the production of records and documents from Investment Firms and their associated entities, and make inquiries concerning such records and documents in order to ascertain whether such firms are or have been complying with specified requirements, including those relating to client assets.</p>	<p>The audits of regulatory requirements of client's assets are carried out by investment firm through an independent auditor on an half yearly basis. Further, Self-Regulatory Organizations conducts annual inspections to verify the same. Inspections are also conducted by regulator which are risk based.</p>	<p>The Bank of Italy and the Regulator may required data, documentation, information or records from the investment firm.</p> <p>They also carry out on-site inspections and investigations, as well as all exercise all the investogatory powers provided by law.</p>

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	Germany	Hong Kong	India	Italy
<p><b>Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (i.e., of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify the amount and/or value of such Client Assets, and the protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?</b></p>	<p>(i) The law applicable to custodian agreements is, at present, not harmonized by the EU. The Commission works on a respective Directive, which is expected to be consulted in 2013. Therefore a foreign supervisor may only use MiFID rules, Art. 32 MiFID.</p> <p>(ii) According to MiFID and § 3 Abs. 1 Satz 2 DepotG a branch office of a foreign EU custodian, if it is regarded as investment firm, is supervised by BaFin. The home supervisor of the foreign custodian may cooperate with BaFin according to MiFID rules.</p> <p>(iii) In case of a third country custodian and supervisor cooperation is possible on the basis of a bilateral or multilateral administrative cooperation agreement between supervisors.</p>	<p>The SFC is a signatory to the IOSCO MMoU (Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information) which facilitates information exchange and mutual assistance between securities regulators.. Moreover, the SFC has entered into a number of bilateral MoUs and other written cooperative arrangements with securities regulators outside Hong Kong.</p>	<p>Omnibus accounts cannot be opened in India.</p> <p>Regulation 17 of SEBI (Stock Broker and Sub-Brokers) Regulations, 1992 and SEBI circular SMD/SED/CIR/93/23321 dated November 18, 1993 states that 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.</p> <p>Foreign regulators can approach Indian regulators for accessing/verifying the details mentioned in (a) and (b) in terms of IOSCO MOU, if any entered between the countries.</p>	<p>The regulator can exercise all of its powers on behalf of a foreign regulator, upon request, in order to provide international cooperation, including gathering information and documents or carrying out investigations and on-site inspections.</p>
<i>Post-Insolvency Questions</i>				

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<p><b>Under the Regime, how does an Investment Firm enter the status of "insolvent," "bankrupt," or the equivalent?</b></p>	<p>The directors of the insolvent investment firm have the obligation to inform the regulator if the investment firm becomes insolvent. Only the regulator may file a petition for insolvency with the relevant district court.</p>	<p>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.</p> <p>The Investment Firm, its shareholders or its creditors may also petition for winding-up of the firm, like any other company.</p>	<p>An investment firm is declared a "defaulter" by the stock exchange.</p>	<p>(i) The Ministry of economy and 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 Economy and Finance may initiate such proceedings even if the Investment Firm is not insolvent.</p> <p>(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.</p> <p>(b) An Investment Firm may enter into compulsory administrative liquidation (withdrawal of authorization and winding up of the firm) if (i) the regulator or the Bank of Italy finds (a) the administrative irregularities or legal violations exceptionally serious or (b) the 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.</p> <p>(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 a company.</p>
<p><b>Under the Regime, what is the process of appointing an Administrative Officer?</b></p>	<p>The court appoints - after hearing the regulator - the insolvency administrator, who must "be independent and possess adequate experience."</p>	<p>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 sector insolvency practitioners. The court may also appoint a liquidator at the time of making the winding up order.</p> <p>If the Investment Firm's shareholders or creditors petition, they nominate.</p>	<p>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.</p>	<p>The Bank of Italy appoints the Administrative Officer in a special administration or a compulsory administrative liquidation.</p>

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	<b>Germany</b>	<b>Hong Kong</b>	<b>India</b>	<b>Italy</b>
<b>What guidance is available to such Administrative Officer?</b>	The duties of the Administrative Officer are set out in the German Insolvency Code (InsO).	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. .	Statute ( <i>i.e.</i> , 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.
<b>What is the standard of liability for such Administrative Officer?</b>	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	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.	Personal liability for failure to follow directions from the Bank of Italy. Civil law actions against the Administrative Officer is subject to the Bank of Italy prior authorization.

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	<b>Germany</b>	<b>Hong Kong</b>	<b>India</b>	<b>Italy</b>
<b>How is the regulator involved in the insolvency of an Investment Firm, including in the return of Client Assets?</b>	<p>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.</p> <p>BaFin is not involved in the process of return of client assets.</p>	<p>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.</p>	<p>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.</p>	<p>The Bank of Italy continues to supervise the Investment Firm, and will direct the special administration or the compulsory administrative liquidation.</p> <p>The Bank of Italy shall supervise the return of Client Assets in accordance with the law. The Bank of Italy also approves the allotment plan for distribution of client assets.</p>

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	Germany	Hong Kong	India	Italy
<b>What are the requirements, if any, governing the segregation and treatment of Client Assets during the insolvency of an Investment Firm?</b>	<p>(i) In the insolvency process of the safekeeper, there will be a clearing method between the depositors that have entrusted securities or parts of a collective deposit to the safekeeper, who has pledged those securities or parts of a collective deposit in accordance with section 12 (2) DepotG to his pledge, section 33 DepotG.</p> <p>(ii) 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).</p> <p>(iii) In case of insolvency of the depository, 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).</p> <p>(iv) 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 depository, the depositor is also entitled to claim segregation.</p>	An Investment Firm must still comply with the segregation and treatment of Client Assets as required under the Client Money Rules and the Client Securities Rules during the insolvency of an Investment Firm.		During the insolvency of an investment firm, segregation must be maintained, regardless of the measures the Administrative Officers adopts for winding-up purposes (transfer of assets and liabilities or continuation of the exercise of the undertaking).
<b>Does the Regime facilitate or encourage the transfer of Client Assets from an insolvent Investment Firm to a solvent Investment Firm?</b>	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.	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.	Yes, the Bank of Italy must authorize the transfer of Client Assets and agree the transfer with the oversight committee. 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>i.e.</i> , notification of clients) are streamlined.
<b>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?</b>	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.	There does not appear to be such a risk.	There are no such requirements.	No, because Client Assets belong to clients and not to the Investment Firm.

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	Germany	Hong Kong	India	Italy
<b>Does the Regime have a scheme to compensate clients for losses suffered due to the insolvency of the Investment Firm?</b>	<p>Yes, a client may be able to claim compensation under any of several protection schemes in Germany which compensate certain clients in case of insolvency of a financial institution:</p> <ul style="list-style-type: none"> <li>- 2 Statutory Deposit Guarantee Schemes (DGS)</li> <li>- 2 Voluntary DGS and</li> <li>- 1 Statutory Investor Compensation Scheme.</li> </ul> <p>All schemes pay compensation independently from insolvency proceedings and hereby accelerate the transfer of value to clients.</p> <p><u>Statutory DGS:</u></p> <p>(i) The statutory protection for deposits with credit institutions is governed by the provisions of the Deposit Guarantee and Investor Compensation Act (Einlagensicherungs- and Anlegerentschädigungsgesetz – EAEG) which expresses the minimum scope of harmonisation according to the EU Directive on Deposit Guarantee Schemes (94/19/EC). All deposit taking credit institutions with their registered offices in Germany are mandatory.</p>	<p>Yes, for retail investors only. Limited to HK\$150,000 (approximately US\$ 19,000).</p>	<p>In case of stock exchanges, they have set up investor protection funds to compensate the investors subject to certain limits.</p> <p>Further, SEBI vide circular dated October 28,2004 has provided for the Investor Protection Fund /Customer Protection Fund at the stock exchanges as a mechanism to compensate the clients in case of default.</p>	<p>Yes, for retail investors only. Limited to €20,000 (approximately US\$26,000).</p>
<b>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?</b>	<p>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.</p>	<p>Generally, permissions granted by clients pre-bankruptcy would not have impact on the client’s position except that the return of client assets that have been re-hypothecated or lent to a third party by the Investment Firm pre-bankruptcy may be subject to fulfillment by the Investment Firm of its liabilities to the third party.</p>	<p>It depends on facts and circumstances of each case.</p>	<p>No. If there is a shortfall in Client Assets, then all clients claims will be satisfied pro rata and for the remaining amounts, rank as unsecured creditors.</p>
<b>If there is a shortfall (i.e., client claims exceed Client Assets), then how does the Regime allocate such loss?</b>	<p>(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).</p> <p>(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.</p>	<p>If the Administrative Officer could trace the shortfall to a specific client, then that client would have to bear the loss whereas the remaining clients would receive the Securities and Client Money that they deposited with the Investment Firm.</p> <p>If the Administrative Officer cannot perform the abovementioned tracing, then clients would share <i>pari passu</i> each pool of Client Assets of the same type (same stock line in the case of securities) as that they deposited.</p>	<p>The assets are distributed pro rata.</p>	<p><i>Pro rata.</i></p>

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	Japan	Korea	Mexico	Netherlands AFM
<i>Context Questions</i>				
<b>How does your jurisdiction define the term "client assets"?</b>	<p>Paragraph 3 of Article 79-20 of the Financial Instruments and Exchange Act (FIEA) defines the assets of "general customers" which are entitled to receive compensation by Investor Protection Fund as follows.</p> <ul style="list-style-type: none"> <li>• Money or securities which are deposited by general customers for transactions of exchange-traded securities derivatives or for margin transactions.</li> <li>• Money or securities which are deposited by general customers for transactions of securities.</li> </ul>	<p>Client assets are defined as follows: any financial investment product or money that has been deposited into the client's investment account as a result of trading through a financial investment business entity.</p>	<p>(i) There is no specific definition for client assets.</p> <p>(ii) The definition of securities can be used as an analogous term:</p> <p>Securities, shares, stocks, debentures, bonds, warrants, certificates, promissory notes, bills of exchange and other negotiable instruments, or unnamed nominees, whether registered or not in the registry, which may circulate in the securities markets that referred to herein, which are issued in series or in mass and represent the social capital of a corporation, an aliquot of a good or participation in a credit union or any credit right individual, in terms of national legislation or applicable foreign.</p>	<p>Under Dutch law, client assets are money and financial instruments.</p> <p>Financial Instrument is defined in Article 4, section 1 (17) of the Directive 2004/39/EC of The European Parliament and of the Council of 21 April 2004 on markets in financial instruments (MiFID).</p>

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<p><b>What is the nature of a client's ownership rights with respect to its client assets placed with an investment firm?</b></p>	<p>Placing client assets with the investment firm itself will not change the nature of client's ownership, which remains in the client.</p>	<p>(i) Client assets remain the sole property of the client.</p> <p>(ii) Client deposits are deposited in a financial securities company.</p> <p>(ii) Client securities are deposited in Korea Securities Depository.</p>	<p>Clients keep all the rights and benefits from the assets placed within the investment firm.</p>	<p>Client assets placed with an investment firm constitutes a deposit of securities into a Wge pool.</p> <p>The client's ownership right is replaced with a right of co-ownership in the "community of property" (gemeenschap) of the Wge pool.</p> <p>For Dutch financial instruments admitted to the system of securities custody of the Dutch Securities Giro Transfer and Administration Act (Wge), there is a three-tier structure, created by Wge that is applicable:</p> <p>(i) The top of the pyramid is formed by the so-called 'giro pool' (girodepot), which is administered by the CSD. The CSD's participants are co-owners in the pool, in proportion to the securities of the same kind which they administer. There is a different pool for each issue of securities and as many (giro) pools exist as there are securities admitted to the system.</p> <p>(ii) The second tier of the period consists of the securities that are administered by the participants - so-called 'participant pools' (verzameldepots).</p> <p>(iii) investors are co-owners of these pools, in proportion to the securities to which they are entitled. They form the third and last tier of the Wge pyramid.</p> <p>For securities that are not eligible for the Wge system and securities that are located abroad, there is the VABEF system of 'simplified administration and custody of securities'.</p> <p>(i) Ownership of securities is transferred to a depository, a special purpose vehicle that is separate from the institution with which</p>

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	Japan	Korea	Mexico	Netherlands AFM
<b>How does your jurisdiction define the term "client"?</b>	Paragraph 1 of Article 79-20 of the FIEA defines "general customers" which are entitled to receive compensation by Investor Protection Fund in case of insolvency of investment firms. This excludes sovereigns, local governments and qualified institutional investors with adequate experience and knowledge of investment.	<p>Clients are counterparties to a financial investment business entity in respect of a transaction in respect of a financial investment product. (Financial Services and Capital Markets Act (FSCMA))</p> <p>"Client" is split into two categories:                      (i) "professional investor"; and                      (ii) "ordinary investor".</p> <p>A "professional investor" covers both:                      (i) an investor who has the ability to take risks accompanying the investment due to its expertise in relation to financial investment instruments, the scale of assets it owns; and                      (ii) any of the following:                      (a) the state;                      (b) the Bank of Korea;                      (c) financial institutions specified by Presidential Decree;                      (d) stock-listed corporations, provided that trading in OTC derivatives with a financial investment business entity shall be limited to cases where an investor notifies the financial investment business entity in writing of its willingness to be treated as a professional investor; and                      (e) other persons specified by Presidential Decree.</p> <p>"Ordinary investor" means any investor other than professional investors.</p>	<p>Clients are defined in 3 categories: qualified, institutional and general public investor.</p> <p>Qualified investor: the person who usually has the income, assets or the qualitative characteristics that have been established by general provisions of the National Banking and Securities Commission (the Commission).</p> <p>Institutional investor: the person considered as such pursuant to federal laws, financial institutions, including when acting as trustees under trusts under the laws (considered as institutional investors).</p> <p>Public investor: persons that do not fall into the other categories.</p>	The Dutch system (Article 1.1. FSA) does not use the term "client" (as used in Article 1, section 10 MiFID), but uses the term 'Consumer' which means any natural person, not acting in business or by profession, to whom an investment firm provides investment services.
<b>Pre-Insolvency Questions</b>				

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Does the Regime require the Client Assets of each client to be placed in an individual account?	<p>No, but client assets deposited to an investment firm (where the firm provides securities transactions, exchange-traded derivatives or margin intermediary services) should be segregated from the firm's own assets.</p> <p>Assets must be held in a way which enables the investment firm to identify each client's assets.</p>	<p>Yes, each client's assets must be maintained separately from those of other clients and of the investment firm itself. The assets are maintained according to each client's customer account.</p> <p>Client deposits must be identified and kept as client assets. Client securities must be kept in the Korea Securities Depository and identified as the client's securities.</p> <p>Omnibus accounts are permitted where there is an asset whose valuation is less than 100,000 won and in respect of which there have not been any trades, deposit or withdrawal within six months may be separately maintained in an omnibus account.</p>	<p>No. An Investment Firm may hold Client Assets in an omnibus account or an individual account.</p> <p>Client assets must be maintained separately from other clients or the investment firm's own assets.</p> <p>Pursuant to Mexican securities law, the client assets must be registered in different accounts from the investment firm's assets account in an authorised deposit securities institute.</p>	<p>Yes.</p> <p>Investment Firms which are not credit institutions are not directly allowed to hold Client Assets. The moneys and financial instruments belonging to a client and to which the services of the investment firm pertain are held on one or more accounts at a credit institution in name of the client.</p> <p>A written agreement can be entered between the investment firm (offering execution or asset management services) and client that contains the following provisions:</p> <ul style="list-style-type: none"> <li>(i) client money and financial instruments are held in one or more accounts in the client's name at a bank;</li> <li>(ii) crediting and debiting the instruments account will take place on a DVP basis vis-a-vis the client account administering the money;</li> <li>(iii) the investment firm is solely authorized to transfer client money and financial instruments if this is deemed necessary for conducting the investment services for the client.</li> </ul> <p>Investment firms which are credit institutions comply with the requirement to protect client assets by entering into an agreement stipulating that the client account in financial instruments is only credited or debited against the money client account. Financial instruments must either be held and managed in accordance with the Securites Bank Giro Transactions Act or held by a depositary meeting certain requirements.</p> <p>Investment Firms are allowed to hold Client Assets in omnibus accounts in the Netherlands.</p>
How often does the Regime require the Investment Firm to reconcile its books and records with its segregation requirement?	Daily, on a client by client basis.	On a regular basis as part of internal controls. Actual timing can differ based on the entity's internal control standards.	Daily, generally by the end of the next business day.	<p>Article 165, paragraph 1, sub c of the Besluit Gedragstoezicht Financiële Ondernemingen (i.e. review on a regular basis) contains the timing requirements for reconciliation.</p> <p>All investment firms also have a legal duty to review on a regular basis whether the money and financial instruments of clients, held by third parties, is consistent with the investment firm's administrative records.</p>

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Does the Regime permit the Investment Firm to temporarily hold less Client Assets than the amount specified in the segregation requirement?	No.	No, financial investment business entities must maintain proprietary property, trust accounts and client accounts separately. Accounting of each of the assets is completed separately as well.	No, a deficiency in client assets is considered a violation in our Securities Law	Due to the system described above, this should not be possible.
If a client has a debit balance, does the Regime permit the Investment Firm to deduct such balance in determining its segregation requirement? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?	Yes.	Client assets and client liabilities are separately calculated, each in aggregate (i.e. client liabilities will not be deducted from such client's assets).  Similarly, the net debit balance is not reduced from the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients.	Only with cash - there is a netting process between debit and credit money balances. A debit balance could not be deducted from the total amount required to hold on deposit by the Investment Firm for net credit balances of other clients.	All investment firms also have a legal duty to review on a regular basis whether the money and financial instruments of clients, held by third parties, is consistent with the investment firm's administrative records.

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	<b>Japan</b>	<b>Korea</b>	<b>Mexico</b>	<b>Netherlands AFM</b>
<b>Does the Regime permit the Investment Firm to treat different types of Client Assets (i.e., cash and securities) as fungible?</b>	No, investment firms must hold the specific assets deposited by each client.	No. The investment firm must hold the specific assets deposited by the 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, All investment firms also have a legal duty to review on a regular basis whether the money and financial instruments of clients, held by third parties, is consistent with the investment firm's administrative records.
<b>Does the Regime permit the Investment Firm to maintain its own assets in the Client Account as a "buffer" against violating segregation requirements?</b>	No.	No, the financial investment business entity's own assets are prohibited from being transferred to a client's account.	No.	An investment firm is not permitted to maintain any of its own assets in a client asset account.

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	<b>Japan</b>	<b>Korea</b>	<b>Mexico</b>	<b>Netherlands AFM</b>
<b>Does the Regime permit the Investment Firm to encumber, re-hypothecate, or otherwise use Client Assets?</b>	Yes, with client consent.	With the client's consent the financial investment business entity may have the right to use the entrusted securities of its client or to provide such securities as collateral.	Yes, with client consent.	In the opinion of the AFM, the re-hypothecation of client assets by the credit institution is in principle not allowed, unless: (a) the client has explicitly authorized this (in a separate client agreement); (b) the risks have been disclosed to the client; and (c) the investment firm has provided sufficient safeguards to protect the client assets pursuant to Dutch rules on client asset protection.
<b>How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?</b>	The ownership rights will move to an investment firm.	There is no change to the client's ownership rights.	Unless otherwise agreed, the investor keeps all ownership rights and benefits over its client assets, when the Investment Firm re-hypothecates or uses with his consent.	In an insolvency context where the third party exercising its pledge over the rehypothecated client assets, the client would not receive its assets. In most cases this risk does not arise due to the wording in the general conditions of services relating to financial instruments as agreed between the credit institution and its clients.

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<b>How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?</b>	<p>The client's written consent is required and the document which proves the consent should be delivered to the client.</p> <p>In addition, the document evidencing the client's consent should be retained in records pursuant to Article 46-2 of the FIEA and Article 157 of the Cabinet Office Ordinance on Financial Instruments Business, etc. (Cabinet Office Ordinance)</p>	<p>The investment firm must receive prior comprehensive consent from its client.</p>	<p>Through the performance of a contract.</p> <p>The investment firm must retain the contract as a part of its records for clients.</p>	<p>Explicit authorization in a separate client agreement.</p>
<b>How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (i.e., established by statute or regulation, established by prior judicial decision)</b>	<p>If the firm goes bankrupt and the client's assets have been re-used or re-hypothecated by the firm, the client would lose the right of recovery over their assets.</p>	<p>The investment firm is prohibited from using or re-hypothecating client assets without the client's consent. To do so without consent is prohibited by law.</p> <p>Use or re-hypothecation of client's assets without the client's consent may constitute as embezzlement or misappropriation. The person/firm will be subject to not more than 10 years of imprisonment or a penalty not exceeding KRW 30,000,000 (about USD27,000) . Civil remedy may be also available to the client for the amount of the assets that have been used or re-hypothecated, attorney's fees, etc.</p>	<p>Investment firms are forbidden by law from disposing of client's resources or assets for purposes other than as ordered by the client or contracted with him. The violation of this implies a penalty of five to fifteen years in prison, but if the Investment Firm compensates the damage caused to the client, there are significant reductions in the penalties outlined above.</p>	<p>In an insolvency context where the third party exercising its pledge over the rehypothecated client assets, the client would not receive its assets. The client will be treated as a general creditor under bankruptcy law. In case of unauthorized re-hypothecation, the client would have a claim against the Investment Firm for unauthorised use of its assets in violation of the agreement as stipulated by law.</p>
<b>Does the Regime permit the Investment Firm to hold Client Assets with a third-party affiliate?</b>	<p>Yes, we do not have any specific prohibition about it.</p>	<p>Client's securities can only be held by the KSD; no third party custodians are allowed to hold such assets.</p> <p>Client deposits must be held:                      (i) in a financial securities company; or                      (ii) in an entity that runs a financial investment business concurrently and is among one of the following entities:</p>	<p>Yes.</p> <p>The entity must be a commercial bank or investment firm that acts as a custodian and to have an agreement with a depository institution. A foreign entity should be a financial intermediary licensed or registered in their jurisdiction.</p>	<p>Yes, client assets may be held by third party custodians and with affiliates subject to certain conditions.</p> <p>Where an investment firm holds client assets with a third party, the investment firm must act carefully in relation to selection and appointment of the third party (including periodic reviews of the third party)</p>

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<p><b>Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)? If so, what protections are applicable to the Foreign Investment Firm’s Client Assets? What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets? What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?</b></p>	<p>Yes. However, client assets must be held in a way which enables the investment firm to identify each client's assets. In addition, the client assets are subject to compensation by Investment Protection Fund up to 10 million yen.</p>	<p>Securities received from trading foreign securities through a financial investment entity must be held in a foreign depository appointed by the Korea Securities Depository (such foreign depository must be among the foreign depositories designated and publicly notified by the Financial Services Commission).</p> <p>To protect such clients, foreign depositories which can hold these assets are restricted to a depository that is established to perform the similar functions of KSD and which is under the regulatory supervision of the foreign jurisdiction’s government or regulatory authority.</p>	<p>There must be the same level of protection as the level afforded any assets deposited in the Investment Firm.</p>	<p>Investment firms are permitted to hold Client Assets deposited in an Omnibus Account, including Client Assets deposited by Investment firms in other jurisdictions and Client Assets of domestic clients.</p> <p>A distinction can be made between:                      (i) assets that are kept in a Dutch ‘giro’ pool, administered at the CSD; and                      (ii) assets that are kept in foreign countries (at (subcustodians).</p> <p>In both cases there are two options for holding the assets:                      (i) the system of the Dutch Securities Giro Transfer and Administration Act (Wge); and                      (ii) the system of a depository.</p> <p>Foreign assets may be kept within the Dutch Securities Giro Transfer and Administration Act (Wge).</p> <p>Since further requirements would be applicable to the foreign assets, the more common method is to use the depository system.</p> <p>The Dutch rules do not differ in protection for foreign clients and domestic clients.</p>
<p><b>Does the Regime permit clients to waive or otherwise reduce or vary any of the Client Asset protection requirements?</b></p>	<p>Yes.</p>	<p>Client asset protection laws and regulations cannot be waived. They remain applicable to all clients.</p>	<p>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.</p>	<p>No. Clients have no option to differ the amount of protection received.</p>

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<p><b>Under the Regime, what actions may the Regulator take to protect the Clients Assets of an Investment Firm in distress?</b></p>	<p>If the net assets of an investment firm fall to less than 50 million yen, the FSA may:</p> <p>(i) rescind the firm's registration or authorization; or</p> <p>(ii) order suspension of all or part of its business by specifying a period not exceeding six months.</p> <p>Where the capital-to-risk ratio of an investment firm is less than 100 percent, if the FSA finds it necessary and appropriate for the public interest or protection of investors, it may order the suspension of all or part of its business by specifying a period not exceeding three months, within the limit necessary. If the capital-to-risk ratio continues to be less than 100 percent after the deadline and is not likely to recover, the FSA may rescind the registration of the firm.</p>	<p>Pursuant to the Act on the Structural Improvement of Financial Industry Art 10., regulators may make timely corrective measures.</p> <p>Where a financial institution fails to meet standards listed in Article 10(2) such as its equity ratio failing to meet specified standards, the Financial Services Commission shall recommend, request or order the financial institution to furnish an implementation plan to prevent insolvency or order the financial institution or the executives of such financial institution to take the following measures:</p> <p>(i) admonition, warning, reprimand or salary reduction in relation to the financial institution concerned and its executives and employees;</p> <p>(ii) Capital increase or capital deduction, disposal of property holdings or reduction in stores and downsizing;</p> <p>(iii) Ban on acquisition of high-risk assets, such as non-fulfillment of obligations or price fluctuations, or restriction on the receipts at exorbitantly high interest;</p> <p>(iv) Suspension of executives' performance of duties or appointment of management supervisors acting for executives' duties;</p> <p>(v) Amortization or consolidation of stocks;</p> <p>(vi) Suspension of all or part of business;</p> <p>(vii) Merger or third-party takeover of the financial institution concerned;</p>	<p>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.</p>	<p>The AFM may, on notice by the investment firm or the Dutch Central Bank take action where an investment firm's financial situation has deteriorated.</p> <p>(i) The AFM may require an investment firm to adhere to particular requirements;</p> <p>(ii) the Dutch Central Bank may issue an instruction to a financial institution if it detects problems that could affect the equity capital, solvency or liquidity of a financial enterprise.</p> <p>Under certain circumstances, the AFM (or DNB) may appoint one or more persons as Administrative Officer if the investment firm has failed to comply with instructions or if the problems could adversely affect operation of the financial enterprise, or jeopardize the interests of clients (with the exception of professional investors).</p>

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	Japan	Korea	Mexico	Netherlands AFM
<p><b>Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically, does the Investment Firm report where client assets are held? Does the Investment Firm or depository report the protections applicable to such client assets? Does the Investment Firm or depository report the amount of assets that are held? In each case, are such reports provided on request or periodically? If periodically, with what frequency?</b></p>	<p>Under Article 56-2 of the FIEA, financial firms can be required:</p> <p>(i) to report data when the regulator orders them to report or</p> <p>(ii) submit any information or documents concerning their business operation or property to the regulator when the regulator finds it necessary to do so for the purpose of protecting the public interest or investors.</p>	<p>(i) Unless an exception applies, client assets are held in KSD and/or financial securities companies. The investment firm does not report the protections applicable to client assets since protection of client assets is mandated by laws and regulations.</p> <p>(ii) The investment firm will report the amount of client assets held. Financial investment entities are required to submit a business report (including the total amount of client assets held by the investment firm/depository) to the regulators (FSC/FSS).</p> <p>(iii) Such reports are submitted periodically – monthly and quarterly.</p>	<p>(i) In México there is only one institution performing depository activities namely S.D. Indeval, S.A. de C.V., Institución para el Depósito de Valores (INDEVAL).</p> <p>(ii) Investment Firms must confirm that all securities are effectively deposited in INDEVAL. Also, they must inform the depository institution about the transactions held during the day.</p> <p>(iii) Investment Firms will always be responsible for the transactions performed by their clients.</p> <p>(iv) Investment Firms must send to the National Banking and Securities Commission a list with all the allocations of transactions carried out. The list must be sent in the day of their liquidation.</p> <p>(v) Indeval, Mexico's Depository Institute, must send every day to the National Banking and Securities Commission, the data base that includes the assets that are held.</p>	<p>(i) Credit institutions holding client assets are required send external audit reports (an assurance rapport) to the Dutch Authority for the Financial Markets annually.</p> <p>(ii) The report will address, inter alia, protection of clients assets.</p> <p>(iii) The report is completed on an abstract basis, and therefore it does include specific information about the number of client assets that are held.</p> <p>(iv) The report is proof that the credit institution is on top of client asset protection issues.</p> <p>(v) The external auditor assesses whether the business operations are designed and implemented in accordance with client protection rules.</p>

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	Japan	Korea	Mexico	Netherlands AFM
<p><b>What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify where Client Assets are held, the amount of Client Assets held at a depository, and the safeguards applicable to Client Assets held at a depository?</b></p>	<p>The Securities and Exchange Surveillance Commission (SESC), an inspection and investigation arm of the FSA, checks firms' management of client assets in its examination.</p> <p>Under Paragraph 3, Article 43-2 of the FIEA, an investment firm is subject to an external audit regarding the segregation of client's assets.</p>	<p>Regulators may inspect and examine the business and operation of the KSD and any financial securities companies.</p>	<p>(i) There is only one institution performing depository activities in México, the S.D. Indeval, S.A. de C.V., Institución para el Depósito de Valores (INDEVAL). Therefore there is no need to verify where client assets are held.</p> <p>(ii) Surveillance visits are performed in order to verify the infrastructure and internal controls of the Depository Institute.</p> <p>(iii) The National Banking and Securities Commission has internal procedures to make sure that investor deposits correspond to the Investment Firm's statements.</p> <p>(iv) CNBV's responsibility of supervision is carried out through surveillance activities and preventive and corrective measures, such as requiring information from INDEVAL for examinations and to verify if transactions carried out by Investment Firms and credit institutions satisfy the legal framework.</p>	<p>The protection of clients assets falls within the AFM's authority.</p> <p>AFM requires each investment firm to complete self-assessments disclosing information regarding protection of client assets.</p> <p>AFM acts on a risk-oriented basis, focusing on investment firms which also act as credit institutions since these firms hold client assets for other investment firms as well as their own clients.</p> <p>The following points are addressed in any investigation:</p> <p>(i) How the assets are held – whether the firm acts in accordance with the Securities Bank Giro Transactions Act or uses a depository. If so, does this depository meet the additional requirements (i.e. no additional activities are allowed other than holding the assets);</p> <p>(ii) Does the credit institution comply with the requirement to protect the assets from clients by concluding client agreements stipulating that the financial instruments account of the client held with the credit institution is only credited or debited, if the amount to be received or paid pursuant to the financial instruments note is simultaneously debited or credited to the designated money account of the client;</p> <p>(iii) Does the credit institution possess an adequate administration such that the amount of individual assets can be related to individual clients;</p> <p>(iv) does the bank distinguish between professional clients (non-depot clients, or clients who do can give orders without holding the actual securities) and non-professional clients (depot clients, clients who cannot give orders when they do not possess the actual securities).</p>

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	Japan	Korea	Mexico	Netherlands AFM
<p><b>Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (i.e., of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify the amount and/or value of such Client Assets, and the protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?</b></p>	<p>(i) Pursuant to the applicable memorandum of understanding, the foreign regulator could request information from the domestic regulator.</p> <p>(ii) By law the FSA can share information with overseas regulators, and it has entered into arrangements of cross-border supervisory cooperation with a number of countries.</p> <p>(iii) The FSA is also a signatory of IOSCO MMOU, which covers enforcement cooperation.</p> <p>(iv) Regardless of existing agreements, as long as equivalence of confidentiality obligation is assured, confidential information can be provided by the FSA.</p>	<p>The FSC/FSS is a signatory of IOSCO MMoU and as such the foreign regulator can obtain information in accordance with the provisions set out in the MMoU.</p>	<p>(i) Based on the MOUs that have been signed, the foreign regulators may ask us for information regarding the amount and/or value of client assets, that information is requested to the Mexican Investment Firms and then provided to the foreign regulator to perform the verifications they consider appropriate.</p> <p>(ii) The surveillance activities carried out by this Commission are of general application, so there is no distinction based on the clients’ origin, such as the segregation assets from the ones that the Investment Firm owns, reconciling them from those deposited in Indeval, and the bans about operating client assets for different purposes from the authorized by them.</p>	<p>Chapter 1.3.2 of the Act on Financial Supervision covers cooperation and exchange of confidential information with other EU supervisory authorities:</p> <p>(i) a supervisor from another Member State can verify the data or information needed for its supervisory role after informing the AFM;</p> <p>(ii) the supervisor of the other Member State can ask AFM to verify data or information needed for its supervisory role in an on-site inspection. The AFM will do so or will invite the other authority to make the verification;</p> <p>(iii) the AFM may only refuse the request on a limited number of grounds (such as where granting the request is against Dutch sovereignty/public order; the existence of pending legal procedures or a final verdict for the same facts and in relation to the same entity).</p> <p>Chapter 1.3.3 of the Act on Financial Supervision covers the cooperation with non-EU supervisory authorities for the exchange of confidential information:</p> <p>(i) Provision of confidential information is only permitted if equivalent safeguards exist in the non-EU jurisdiction with regard to confidentiality and the provision of information fits within the scope of supervisory tasks by the non-EU authority.</p>
<i>Post-Insolvency Questions</i>				

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	Japan	Korea	Mexico	Netherlands AFM
<p><b>Under the Regime, how does an Investment Firm enter the status of "insolvent," "bankrupt," or the equivalent?</b></p>	<p>We have Civil Rehabilitation Act, Corporate Reorganization Act and Bankruptcy Act.</p> <p>Pursuant to process under the Bankruptcy Act, the regulator, could file for bankruptcy of a firm. In addition, the firm itself, a firm's creditors and the directors could file for bankruptcy.</p>	<p>The process by which a financial investment business entity becomes "insolvent" or "bankrupt" is the same as that of a non-financial investment company.</p> <p>Once a petition is filed the court will determine whether or not the entity satisfies the requirements to enter into such status and a court decree will be issued accordingly.</p>	<p>An Investment Firm may become subject to bankruptcy proceedings in two ways:</p> <p>(i) <i>Administrative Intervention</i>. 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.</p> <p>(ii) <i>Liquidation</i>. 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.</p>	<p>Bankruptcy (faillissement) can be petitioned for by:</p> <p>(i) one or more of the creditors (including foreign creditors) of the debtor (involuntary filing);</p> <p>(ii) by the debtor himself (voluntary filing), or</p> <p>(iii) in the exceptional case the public interest requires it, by the public prosecutor.</p> <p>If a petition for bankruptcy is granted by the district court, the district court will appoint a bankruptcy trustee/Administrative Officer (curator) and one of the members of the courts as a supervisory judge (rechter-commissaris).</p> <p>A bankruptcy proceeding can also be opened following a suspension of payments proceeding or a debt rescheduling scheme.</p> <p>(i) suspension of payments (surséance van betalen), whereby the debtor is given temporary relief against its creditors in order to reorganise and continue its business. During the period of suspension of payments the debtor's business will be managed by the debtor and a court appointed administrator jointly; and</p> <p>(ii) debt rescheduling scheme (schuldsanering) – the debtor's assets are liquidated for the benefit of his creditors and the debtor must make a maximum effort to generate funds to repay his creditors in a period of three years, with the objective to give the debtor the possibility of a 'fresh start'; this category is only applicable to natural persons.</p>
<p><b>Under the Regime, what is the process of appointing an Administrative Officer?</b></p>	<p>The court selects the Administrative Officer for bankruptcy proceedings.</p>	<p>The court appoints the administrative officer. There are no specific qualification requirements for the administrative officer.</p> <p>After a lawyer/counselor is appointed, the financial investment business entity may appoint a financial expert recommended by the Financial Services Commission.</p>	<p>(i) <i>Administrative Intervention</i>. The regulator may designate the inspector-manager from a list of qualified individuals supplied by self-regulatory organizations. For this designation, the CNBV Chairman may propose to the Board of Governors, the declaration of an intervention of the Investment firm and the designation of the person who takes over the administration of the intermediary concerned.</p> <p>(ii) <i>Liquidation</i>. The shareholders or creditors of the Investment Firm may appoint a liquidator, which may be vetoed by the Ministry of Finance. It is up to the shareholders or creditors of the Investment firm the appointment of the Administrative Officer, which may be vetoed by the Ministry of Finance when it considers that doesn't have sufficient technical quality, reputation and credit history for the satisfactory performance of his duties, or committed serious or repeated violations of the regulation, in which case the appointment of the liquidator may be held by credit institutions, brokerage houses, in the Federal Service Administration Property Disposal, or in individuals or companies that have experience in liquidation of financial institutions.</p>	<p>(i) The Administrative Officer (curator) is appointed by the district court.</p> <p>(ii) The Administrative Officer is usually a member of the local bar (i.e. lawyer).</p> <p>(iii) The Administrative Officer acts under the general supervision of the supervisory judge.</p> <p>(iv) Some Dutch regional courts have established guidelines for the appointment as Administrative Officer by which it is determined whether a lawyer can be placed on the list of eligible Administrative Officers in bankruptcy (curatorlijst) subject to certain requirements.</p> <p>(v) The court has the power to dismiss the Administrative Officer at the request of the supervisory judge, a creditor or a debtor.</p>

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	Japan	Korea	Mexico	Netherlands AFM
<b>What guidance is available to such Administrative Officer?</b>	An administrator should perform his/her duties with due care of a prudent manager. (Paragraph 1, Article 85 of Bankruptcy Act) We do not have specific guidelines for clarifying this duty of diligence.	Not applicable.	Statute; direction from the regulator with respect to administrative intervention; guidance from the Ministry of Finance with respect to liquidation.	<p>The Administrative Officer is subject to the supervision of the supervisory judge.</p> <p>For certain acts, the Administrative Officer needs the authorisation of the supervisory judge such as:</p> <ul style="list-style-type: none"> <li>(i) conducting legal proceedings;</li> <li>(ii) terminating employment and rental contracts; and</li> <li>(iii) realisation of assets by private contract.</li> </ul> <p>In certain cases the supervisory judge can, at the request of the debtor or a creditor, order the Administrative Officer to perform a specific act or to refrain from performing an intended act.</p> <p>A working group of supervisory-judges in bankruptcy (RECOFA) has established some guidelines on bankruptcy and suspension of payment. These guidelines should ensure that the transparency of the activities of the Administrative Officer is increased.</p>
<b>What is the standard of liability for such Administrative Officer?</b>	When an administrator fails to fulfill the duty of diligence, he or she will be liable for compensation of damages under the Paragraph 2 of the Bankruptcy Act.	A breach of duty may lead to the administrative officer being jointly liable for any losses or harm caused by such breach.	Full personal liability.	<p>An Administrative Officer in bankruptcy can be personally liable to a third party who has suffered a loss due to the Administrative Officer's conduct in that capacity.</p> <p><i>This could occur if the Administrative Officer acted contrary to the</i></p>

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	Japan	Korea	Mexico	Netherlands AFM
<p><b>How is the regulator involved in the insolvency of an Investment Firm, including in the return of Client Assets?</b></p>	<p>When there are concerns about an investment firm's ability to pay, the FSA will: issue a business improvement order, with which we require the firm for smooth return of its client assets together with rescinding a registration of an investment firm or issuing a business suspension order.</p> <p>For example, when Lehman Brothers Holdings Inc., the parent company of Lehman Brothers Japan Inc. went bankrupt, the FSA issued business improvement order of which the details are as follows.</p> <p>(i) Get hold of information on its investors and their assets deposited precisely.</p> <p>(ii) Preserve assets deposited by investors and not use up its property unreasonably.</p> <p>(iii) Take full measures for investor protection with considering fair treatment among investors.</p> <p>(iv) Try to keep every investors informed appropriately about the retention of deposited assets, and consider appropriate actions for investors.</p>	<p>Any bankrupt/insolvent entity is solely under the supervision of the bankruptcy court. The bankrupt/insolvent financial investment business entity may be required to notify or submit statements to the Financial Services Commission.</p>	<p>(i) <i>Administrative Intervention</i>. The Commission is involved in transfer / delivery of assets or cash to clients and the agenda established by the Administrative Officer (and approved by the judge) taking into account the Ministry of Finance's opinion.</p> <p>(ii) <i>Liquidation</i>. The Commission is involved with transfer / deliver of assets or cash to the clients and the timetable to consider any applicable sanctions.</p>	<p><u>Confidential Data</u></p> <p>The Netherlands Authority for the Financial Markets (AFM) may supply confidential data or information obtained in the performance of its duties under the Financial Supervision Act to a judge, an administrator and a trustee where a financial undertaking has been declared bankrupt.</p> <p>Certain limitations exist:</p> <p>(i) confidential information cannot be provided if contrary to the interests that the Financial Supervision Act seeks to protect;</p> <p>(ii) confidential information cannot be provided if the information is obtained from another supervisor or a foreign regulator and that supervisor or regulator disagrees with to provide the information.</p> <p><u>Documentation</u></p> <p>The AFM may make documents available in order to help Administrative Officers within bankruptcy proceedings.</p> <p><u>Withdrawal of Authorisation</u></p> <p>The AFM may facilitate an Administrative Officer's request to withdraw the license of a bankrupt Investment Firm.</p> <p>In its decision to withdraw a license of an Investment Firm, the AFM may also stipulate that the financial enterprise must wind up its business, either fully or in part, within a period to be specified by the AFM. After withdrawal of the license withdrawal, the AFM (in principle) does not continue to supervise the Investment Firm.</p> <p><u>Return of Client Assets</u></p> <p>The AFM is basically not involved in the process of returning client assets. However, as stated above, the AFM supervises compliance</p>

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	Japan	Korea	Mexico	Netherlands AFM
<b>What are the requirements, if any, governing the segregation and treatment of Client Assets during the insolvency of an Investment Firm?</b>	<p>When there are concerns about inability to pay of an investment firm, the FSA will:</p> <p>(i) issue a business improvement order for client protection and rescind the investment firm's registration or</p> <p>(ii) issue a business suspension order.</p> <p>The FSA will supervise the firm in order to check whether the firm meets the request stated in the order.</p>	<p>Unless there is priority ownership (collateral, etc.) among the relevant assets or a particular law or regulation provides for the segregation of the assets, client assets may be mixed with other assets.</p>	<p>Administrative Intervention: The regulator would supervise the inspector-manager, including any efforts that the inspector-manager makes to transfer Client Assets.</p> <p>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.</p>	<p>During insolvency, the Administrative Officer is charged with the administration and liquidation of the entity's estate and may take any necessary action to preserve the estate.</p>
<b>Does the Regime facilitate or encourage the transfer of Client Assets from an insolvent Investment Firm to a solvent Investment Firm?</b>	No.	Not applicable.	Yes.	<p>The transfer of assets from a bankrupt/insolvent investment firm to a solvent investment firm is not common practice within the Netherlands.</p> <p>For derivatives the local Central Counter Party, LCH Clearnet S.A., has certain rules that allow porting under French law.</p> <p>If a transfer needed to take place, AFM believes such a transfer should be accomplished quickly because of the margins paid by the various parties that are involved and the obligation to provide (more) margin could be raised significantly during the day.</p>
<b>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?</b>	<p>When there are concerns about inability to pay of an investment firm, the FSA will:</p> <p>(i) issue a business improvement order for client protection and rescind the investment firm's registration or</p> <p>(ii) issue a business suspension order.</p> <p>(Article 52 of FIEA)</p> <p>Through such order, the FSA will ask the firm to preserve assets deposited by investors and not use its property unreasonably.</p>	<p>Client assets that were lawfully returned are not subject to an avoidance power.</p>	<p>Clients are protected only because they are first with other creditors (and to the extent they have documents to show their positions in investments).</p>	<p>Clients could be at risk of having to return client assets as in case of actio pauliana.</p> <p>The Administrative Officer has the power to invoke the actio pauliana if the rights of recourse on the debtor's assets have been prejudiced by legal acts performed by the debtor without obligation.</p>

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	Japan	Korea	Mexico	Netherlands AFM
<b>Does the Regime have a scheme to compensate clients for losses suffered due to the insolvency of the Investment Firm?</b>	The Investor Protection Fund is a protection scheme which will compensate the client assets in case of insolvency of the firm.	The investment firm is required to separately deposit assets in an amount equal to the client's deposit in the investment firm. The Korea Deposit Insurance Corporation provides protection to client's deposits up to KRW 50 million won.	No.	<p><u>Deposit Guarantee Scheme</u></p> <p>(i) The Dutch Central Bank (DNB) fully guarantees 100,000 euro of savings per account holder per bank.</p> <p>(ii) For joint accounts held by two people, this refund applies per person.</p> <p>(iii) To be eligible for this refund, the deposit scheme does have to apply to your bank.</p> <p>(iv) Banks established in the Netherlands which have a licence from the DNB are covered by the deposit guarantee scheme.</p> <p>(v) Banks which are established in the European Union, Norway, Iceland or Lichtenstein and which operate in the Netherlands from a branch are covered by the deposit guarantee scheme of their country of origin.</p> <p><u>Investor compensation scheme</u></p> <p>(i) The investor compensation scheme protects private individuals and "small" businesses which, on the grounds of an investment service, have entrusted money or financial instruments (for example</p>
<b>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?</b>	Yes. If a client permits an investment firm to use its assets, those assets will be categorized into the general creditors' claims to the firm in case of insolvency of the firm. If not, as client's assets are segregated, they should be returned to the original owner, a client.	Not applicable.	No, our regime doesn't treat clients differently.	<p>(i) In case of bankruptcy the re-hypothecation of a client's financial instruments to a third party could result in the client not receiving anything where a third party has exercised its peldge in respect of rehypothecated lcient assets.</p> <p>(ii) In most cases this risk does not appear due to the wording contained in the general conditions of services relating to financial instruments agreed between the credit institution and its clients.</p>
<b>If there is a shortfall (i.e., client claims exceed Client Assets), then how does the Regime allocate such loss?</b>	<p>(i) Clients' assets should be returned to the clients separately from creditors' claims in case of insolvency of an investment firm - the right of recovery will not be affected by the insolvency of the firm and remains in the clients under Article 62 of Bankruptcy Act.</p> <p>(ii) If clients' assets are not secured due to the firm's failure of compliance with the segregation requirement, the loss will be compensated by Investor Protection Fund up to 10 million yen and the rest will be treated equally to general creditors' claims.</p>	Unless the client did not set its priority among other creditors, the assets are distributed pro-rata.	<p>Administrative Officer can call a bankruptcy procedure.</p> <p>There is a priority of clients and then unsecured or subordinated creditors.</p>	If there is a shortfall, there is a pro rata distribution of Client Assets.

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Context Questions	Pakistan	Poland	Romania	Singapore
<p><b>How does your jurisdiction define the term "client assets"?</b></p>	<p>(i) Client assets is not defined.</p> <p>(ii) Client securities and client cash are the terms generally used to refer to "client assets".</p> <p>(iii) The term "client assets" is used in the Stock Exchange General Regulations which address segregation of client assets by brokers and investment firms.</p> <p>(iv) Securities includes:</p> <ul style="list-style-type: none"> <li>(i) stocks;</li> <li>(ii) transferable shares;</li> <li>(iii) scrips;</li> <li>(iv) Modaraba Certificates</li> <li>(iv) notes;</li> <li>(v) debentures;</li> <li>(vi) debenture stock;</li> <li>(vii) participation term certificates;</li> <li>(viii) bonds;</li> <li>(ix) investment contracts;</li> <li>(x) forward and futures contract;</li> <li>(xi) pre-organization certificates or subscriptions;</li> <li>(xii) any interest or instrument commonly known as a "security" and any certificate of deposit for, certificate of interest or participation in, temporary or interim certificate for, receipt for, or any warrant or right to subscribe to or purchase any of the foregoing;</li> <li>(xiii) any Government security as defined in the Securities Act 1920;</li> <li>(xiv) and any bonus entitlement voucher issued by the State Bank of Pakistan in accordance with any scheme announced by the Commission.</li> </ul>	<p>There is no legal definition of client assets. Client asset are composed of the account of financial instruments and the client funds.</p>	<p>"Client assets" are not defined per se. Client assets would include money (funds) and financial instruments belonging to the client.</p> <p>Financial instruments means those instruments specified in Section C of Annex I of the Directive 2004/39/EC on markets in financial instruments (MiFID), as implemented in the Romanian legislation.</p>	<p>Section 103A of the SFA read together with regulation 15 of the SFR provides for the definition of Customer money and Customer assets. For the purposes of this survey, we have used the term "Client money" and "Client assets" to reflect "Customer money" and "Customer assets" respectively.</p> <p>Client money refers to money received from, or on account of the client in respect of the regulated activities under the Singapore Securities and Futures Act ["SFA"] or in the course of business of the Investment Firm, but does not include certain money, such as, money which is to be used to reduce the amount owed by the client to the Investment Firm and money which is to be used to defray the investment firm's brokerage and other proper charges.</p> <p>Client assets means securities and assets (other than money), including Government securities and certificates of deposits, that are beneficially owned by a customer of the Investment Firm.</p>

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	Pakistan	Poland	Romania	Singapore
<p><b>What is the nature of a client's ownership rights with respect to its client assets placed with an investment firm?</b></p>	<p>(i) Clients retain full ownership rights over cash placed with the investment firm and client securities.</p> <p>(ii) Client securities are registered in the client's name by the Investment Firm.</p>	<p>(i) The issue of ownership rights is not per se defined.</p> <p>(ii) The ownership rights with respect to client assets are guaranteed by the Act on Trading in Financial Instruments and the appropriate decrees of the Ministry of Finance. The client asset is an ownership of a client and an investment firm is not allowed to use it on its own account or on the account of the third party. However in case of securities financing transaction concluded by investment firm the use of client asset is possible but it requires a written consent of client or the person who is empowered to the asset.</p>	<p>(i) Generally, clients retain beneficial ownership over client assets at all times and are protected in the case of insolvency of an investment firm.</p> <p>(ii) For example, the creditors of an intermediary (i.e. investment firm or credit institution) may not use the investor's assets, including in an insolvency. Investor assets remain exempt from enforcement by seizure against a broker that has commenced foreclosure proceedings.</p> <p>(iii) The intermediary itself may not use a client's financial instruments for own account trading or for another client's account unless the client gives prior, written consent.</p> <p>A client's funds can be used to perform transactions on their own only by credit institutions.</p> <p>There are exceptions to this general rule:</p> <p>(i) Where the client has transferred assets (money and assets) to the investment firm under full title transfer collateral agreements, the client will not retain beneficial ownership;</p> <p>(ii) Where there has been written consent from a client, an intermediary may be able to use the client's financial instruments.</p>	<p>The moneys and assets in the trust account and custody account, respectively, are held on trust by the Investment Firm for its clients.</p>

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	Pakistan	Poland	Romania	Singapore
How does your jurisdiction define the term "client"?	<p>(i) Client is not defined but "investor" and "sub-account holder" are roughly analogous terms.</p> <p>(ii) Investor means a person, not being the Investment Firm, his agent or representative, who has purchased or sold any of the securities listed on the exchange.</p> <p>(iii) Sub-account holder is defined as follows: a person in whose name a sub-account is opened and maintained by an investment firm with a central depository and is operated by such investment firm.</p>	<p>The term Client is defined under the decree of the Ministry of Finance on the terms and conditions of providing investment services.</p> <p>It is defined as: (...) an individual, legal person or an entity which does not legal personality which has concluded with investment firm an agreement for conducting of the investment services. The category of Client are also defined in the Act on trading in Financial instruments. The categorisation reflects the client categories as mentioned in MIFID Directive i.e professional client, retail clients and eligible counterparty.</p>	<p>There is a general definition of client and two categories of client:</p> <p>(i) client – any natural or legal person to whom an S.S.I.F. provides investment and/or ancillary services;</p> <p>(ii) professional client – any client meeting the criteria laid down in Annex no. 8;</p> <p>(ii) retail client – the client who is not a professional client.</p> <p>Professional clients are clients with the experience, knowledge and ability to take investment decisions and assess any risk involved. Examples of professional clients include entities authorised and regulated to operate in financial markets such as credit institutions, investment firms, insurance companies, UCITs, investment managers, pension funds, traders, institutional investors, governments and supranational institutions. (Annex no. 8 of the CNVM Regulation no. 32/2006).</p>	<p>Under the SFA, for the purposes of Client assets, "customer" refers to (i) a person on whose behalf the Investment Firm carries on or will carry on any Regulated Activities; or (ii) any other person with whom the Investment Firm, as principal enters or will enter into transactions for the sale or purchase of securities or futures contracts, or in connection with leveraged foreign exchange trading. For the purposes of this survey, we have used the term "Client" to reflect "Customer".</p> <p>However, "Client" does not include:</p> <p>(a) the Investment Firm in carrying out any regulated activity for its own account;</p> <p>(b) an officer, an employee or a representative of the Investment Firm; or</p> <p>(c) a related corporation of the Investment Firm with respect to an account belonging to and maintained wholly for the benefit of that related corporation.</p>
Pre-Insolvency Questions				

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	<b>Pakistan</b>	<b>Poland</b>	<b>Romania</b>	<b>Singapore</b>
<b>Does the Regime require the Client Assets of each client to be placed in an individual account?</b>	<p>(i) Yes, investment firms must maintain client assets in separate sub-accounts (with one sub-account for each investor).</p> <p>(ii) Sub-accounts are part of the investment firm’s main account but are in the name of the sub-account holder (the client).</p> <p>(iii) There is a record of the sub-account holder’s title (the client) to the book-entry securities;</p> <p>(iv) The sub-account securities are segregated – this is reflected in the client's account statement;</p> <p>(v) Segregation should protect the client from the Investment Firm using client securities for other purposes;</p> <p>Clause 18 of the terms and conditions of a standardized account opening form provide that the Investment Firm should:</p> <p>(i) ensure protection for the sub-account holder (i.e. the client) in respect of rights to dividend shares, bonus shares, right shares, etc.; and</p> <p>(ii) not do anything that could harm the sub-account holder's (i.e. the client) interests in the securities.</p> <p>Investment Firms are not permitted to hold or maintain omnibus accounts.</p>	<p>(i) Yes. Client assets of one client must be maintained separately from those of other clients.</p> <p>(ii) Furthermore, the investment firm is not allowed to use client funds and/or client financial instruments for its own account or the account of other clients.</p> <p>(iii) This rule is also applicable if the investment firm provides custodian services.</p>	<p>No. Investment firms may hold client assets in omnibus accounts.</p> <p>Records must be kept to allow the investment firm to identify, at any time and without delay, an individual client’s assets from other client assets and from the investment firm’s own assets.</p>	<p>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.</p>
<b>How often does the Regime require the Investment Firm to reconcile its books and records with its segregation requirement?</b>	<p>Reconciliation is conducted on a client by client basis by the investment firm at the end of the day.</p> <p>A daily transaction statement is provided to each client, reflecting their trades.</p> <p>A client can also access their trading information via an SMS alert system provided by the Central Depository Company of Pakistan Limited (CDC) and/or the UIN Information System of the National Clearing Company of Pakistan Limited (NCCPL).</p> <p>A quarterly statement is also sent to all sub-account holders showing the number of book-entry securities entered in the sub-account as of the end of the quarter.</p> <p>Each Account Holder (i.e. investment firm) shall, for each Business Day, verify the activity that took place that Business Day with reference to any handling of book-entry securities entered in any holding and shall immediately report in writing any concerns to the CDC by the end of the next succeeding Business Day.</p>		<p>Participants in the central depository system must conduct daily reconciliation of all the customer sub-accounts and the participant’s house account. For financial instruments, CSD participants must conduct daily reconciliation between information in their back-office systems with information registered in the CSD system by the end of the settlement day.</p> <p>Intermediaries are required to conduct daily reconciliation of funds or financial instruments holdings registered in each client account and in its own account by verifying amounts between obligations and the funds and/or financial instruments holdings recorded in the accounts. Intermediaries must record balances of clients accounts, including the settlement date, in the IT system.</p>	<p>Daily computation and reconciliation of the Client moneys and Client assets maintained in trust and custody accounts is required of the investment firm conducting regulated activities in respect of trading in futures contracts and in respect of leveraged foreign exchange trading.</p>

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	Pakistan	Poland	Romania	Singapore
Does the Regime permit the Investment Firm to temporarily hold less Client Assets than the amount specified in the segregation requirement?	Not addressed.		No. Client money that an investment firm is required to hold in bank accounts should exceed the sum of: (i) positive individual client balances; and (ii) additional margined transaction requirements.  The investment firm must offset the sum of negative individual client balances.	No.
If a client has a debit balance, does the Regime permit the Investment Firm to deduct such balance in determining its segregation requirement? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?	One client's net debit balances does not reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients. Investment Firm of each stock exchange is required to maintain minimum net capital balance at all times and this requirement is used to determine the maximum allowable exposure limit under the Risk Management Regulations of the respective stock exchange. While computing net capital balance, debit balance of a client is not netted off with credit balance of another client. The onus of collecting debts from its clients is delegated to the investment firm itself.		The investment firm must hold sufficient funds to offset the sum of negative individual client balances. The total required funds on deposit for client net credit balances cannot be reduced with one client's net balances.	The amount that the Investment Firm is required to hold as client moneys/assets excludes the amount that is owed by the Client to the Investment Firm including amounts used to defray the investment firm's brokerage and other proper charges.

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	Pakistan	Poland	Romania	Singapore
Does the Regime permit the Investment Firm to treat different types of Client Assets (i.e., cash and securities) as fungible?	There are no requirements in relation to holding/calculating a particular amount/type of assets by the Investment Firm.		No. Client money is fungible. Client financial instruments are also fungible within asset classes (i.e. an ordinary share will not have an identification number).	Client money which is deposited in an omnibus account would be fungible amongst all clients of the investment Firm. As for Client assets, the Investment Firm is required to hold specific assets deposited by the client.
Does the Regime permit the Investment Firm to maintain its own assets in the Client Account as a "buffer" against violating segregation requirements?	No.		Yes, where the total in the bank accounts less the total positive individual client balances is positive, then the investment firm will hold client money plus some of its own money - the amount held in the client account must exceed the total of negative individual client balances.	Yes. An investment firm may advance its own funds to a Client's trust account to prevent the client's trust account from being under-margined or under funded or to ensure the continued maintenance of the trust account.  The investment firm may reimburse itself of the advance and interest/returns from such moneys as long as the reimbursement does not result in the account being under-margined or under funded.

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	<b>Pakistan</b>	<b>Poland</b>	<b>Romania</b>	<b>Singapore</b>
<b>Does the Regime permit the Investment Firm to encumber, re-hypothecate, or otherwise use Client Assets?</b>	The investment firm is restricted from investing, lending, pledging, handling or otherwise using client assets unless the client provides written authorization in the standardized account opening form allowing the investment firm to pledge/handle the client's assets in favor of the stock exchange against the client's exposure.	The investment firm generally cannot use (i.e. invest, encumber) client assets (client funds). With prior written consent (in respect of retail clients) or explicit consent (in respect of professional clients), a client's financial instruments may be used by the investment firm. These transactions are mentioned in art. 2, point 10 of Commission Regulation 1287/2006.	Where the client has given preliminary written consent, client financial instruments may be used by an intermediary, investment firm or credit institution to guarantee own account transactions or transactions for other clients. Client funds can be used to guarantee own account transactions by credit institutions who are registered as intermediaries in the CDNVM Register.  The agreement shall cover each transaction.	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"].  For instance, an Investment Firm must obtain the client's written consent to lend out Client securities or arrange for a custodian to lend out Client securities. The Investment Firm must also enter into an agreement with the Client, in which the terms and conditions for securities lending are set out and disclosed to the Client.  The Investment Firm may mortgage, charge, pledge or hypothecate Client assets if and only if the claims to which the Client assets are subject as a result of such mortgage, charge, pledge or hypothecation do not exceed the aggregate amounts owed by the Clients to the Investment Firm, and the claim to which each Client assets are subject does not exceed the amount owed by the Client to the Investment Firm.
<b>How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?</b>	The client retains beneficial ownership over the pledged securities but the client will not be able to freely transfer or move the pledged securities as the securities will be in a pledge account.		(i) Where a client consents to full title transfer of its assets and the firm exercises its rights to take full ownership of assets, the assets will not be subject to the client asset regime for the period during which the firm exercises full ownership rights.  (ii) If a firm fails during this period, the client would rank as a general creditor of the firm in relation to those assets.  (iii) In a security financial collateral arrangement, the client retains beneficial interest in th assets until the condition in the agreement allowing the firm to exercise its security is met.	As hypothecation of Client assets is subject to an agreement between the Investment Firm and its Client, the rights of the Client will depend on the terms and conditions of his agreement with the Investment Firm.

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<b>How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?</b>	The client's provides its consent in writing through signing a specific authorization or the standardized account opening form.	In case of securities financing transaction investment firm may use client asset when the client give prior written consent - retail Client or explicit Consent - Professional Client	Pursuant to a standard contract and accompanying additional terms.  Additional terms would include the following: (i) introduction of the selling order into the trading system in case of application of the prevalidation mechanism of the financial instruments; (ii) information on the settlement date in accordance with the settlement term, in case of the mechanism without prevalidation of the financial instruments;  For a securities lending transaction or guarantee, a standard lending contract in accordance with GMSLA will be used.	In respect of the lending of Client securities, the Investment Firm must explain the risks involved to the Client and obtain the Client's written consent. The Investment Firm is also required to disclose the terms and conditions of the loan arrangement to the Client.
<b>How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (i.e., established by statute or regulation, established by prior judicial decision)</b>	This would be prohibited. If an investment firm or broker is found non-compliant, sanctions such as fines and penalties could be applicable.  The CDC Act 1997 provides that an investment firm may not create a pledge over any book-entry securities entered in any sub-accounts maintained under the account with the central depository without the authorization of the relevant sub-account holder.		If a firm takes full ownership over client assets and uses them without client consent, the client asset regime should continue to apply to those assets. If the firm used the assets as its own the client/insolvency practitioner may attempt a tracing exercise.  Intermediaries authorised to provide investment services and management companies which manage individual investment portfolios, must be members of the Investment Compensation Fund.  The purpose of the Fund is to compensate investors, in compliance with the conditions set out in the Capital Market Law (Law no. 297/2004, with the following amendments) and with C.N.V.M. regulations, if Fund members fail to return the funds and/or the financial instruments owed by or belonging to investors, which have been held on their behalf for providing investment services or managing individual investment portfolios.  "Investor" refers to any person which has entrusted a Fund member with funds or financial instruments in order to provide investment services.  <del>Compensation from the Fund may be available to investors under</del>	If the Investment Firm uses Client assets without the Client's consent or where such use is not in accordance with the requirements of the SFA, the ownership of such Client assets (which should have been held in trust in favour of the Client under the requirements of the SFA) would rightfully be traced to the Client.
<b>Does the Regime permit the Investment Firm to hold Client Assets with a third-party affiliate?</b>	Foreign investors may open a Special Convertible Rupee Account with any designated bank to trade in securities quoted on stock exchanges in Pakistan. An investor could also open separate sub-accounts with designated banks for custody of securities in dematerialized form. Any bank with a minimum short term credit rating of A3 (pursuant to Banking Companies Ordinance 1962) may apply for admission as a custodian clearing member with NCCPI	Yes.  (i) There is a special category of the custodian banks which under art. 119 of the act on trading in financial instruments are allowed to provide custodian services after obtaining special permission granted by Polish Financial Supervision Authority.	An investment firm may deposit a client's financial instrmnts in an account opened with a third party.  In selecting the third party the investment firm must: (i) act with professional diligence in selecting the third party (including periodic review of the third party); (ii) take into account the market reputation and experience of the	Yes.  Client moneys/assets may be kept with an affiliate if the affiliate itself is a specified financial institution (namely a bank, merchant bank or finance company licensed in Singapore).

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<p><b>Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)? If so, what protections are applicable to the Foreign Investment Firm’s Client Assets? What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets? What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?</b></p>	<p>Not applicable.</p>		<p>As regard client assets protections rules there is no differentiation in the Romanian legislation between client assets held for domestic or overseas clients.</p>	<p>Investment Firms in Singapore are required to hold the Client moneys/assets of Foreign Investment Firms in trust, and are permitted to hold them in omnibus accounts with other Client moneys/Client assets.</p> <p>The regulatory requirements and protection under the SFA/SFR similarly applies to Client moneys/assets of Foreign Investment Firms.</p>
<p><b>Does the Regime permit clients to waive or otherwise reduce or vary any of the Client Asset protection requirements?</b></p>	<p>No waiver is possible since the terms and conditions of account opening are standardized for all participants and clients.</p>	<p>There is no existing regulation on this point.</p>	<p>No, clients may not waive or reduce any of the client asset protections.</p>	<p>In general, the SFA and the SFR do not provide for any situation or condition under which Clients may waive the requirements.</p>

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<b>Under the Regime, what actions may the Regulator take to protect the Clients Assets of an Investment Firm in distress?</b>	<p>Where the Net Capital Balance of an investment firm falls below the Rs. 2.5 million threshold, the investment firm's membership to carry out brokerage business will be suspended and remain suspended until the net capital balance is increased.</p> <p>The SECP may also suspend registration of an investment firm where its financial position has deteriorated such that the SECP is of the opinion its continuing in the securities business would not be in the interest of investors.</p>	<p>There is a few possibilities:</p> <p>(i) the regulator is able to limit or to ban the activities of the investment firm when investment firm does not meet the financial provisions regarding the conducting of investment services.</p> <p>(ii) in some circumstances there is also possible to block the of the account of investment firm under art. 39 of the act on capital market supervision dated on 29 July 2005.</p>	<p>The CNVM can take the following actions:</p> <p>(i) require the firm to raise new capital,  (ii) require the firm to return client assets,  (iii) apply the following sanctions:  (a) warning;  (b) fine;  (c) complementary sanctions include:  (I) suspension of authorisation;  (II) withdrawal of authorisation;  (III) temporary prohibition from carrying our certain activities and services to enforce trustee in bankruptcy procedures if it has acknowledged that an authorised entity is about to become insolvent or if any of the entity's administrators, executive directors or auditors are guilty of:  (A) breaching the provisions of this law or the regulations issued by CNVM which has caused or may cause significant damages or which jeopardises the functioning of the capital markets;  (B) breaching any condition or restriction laid down in the authorisation;  (C) inadequate management of financial instruments and funds belonging to investors.</p> <p>The CNVM may also determine that the entity should be wound up</p>	<p>MAS may take actions such as requiring the Investment Firm to transfer all or a portion of any Client's positions, collateral, assets and accounts to another capital markets services ["CMS"] licensee and imposing conditions and restrictions on the operation of the Investment Firm.</p>

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<p><b>Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically, does the Investment Firm report where client assets are held? Does the Investment Firm or depository report the protections applicable to such client assets? Does the Investment Firm or depository report the amount of assets that are held? In each case, are such reports provided on request or periodically? If periodically, with what frequency?</b></p>	<p>No though the regulator retains the authority to request information at any point in time.</p>	<p>(i) The information concerning client assets is required under information decree of the Ministry of Finance.</p> <p>(ii) The scope of the information is referring to the amount of the client assets and the number of the account of the client. It is submitted monthly.</p> <p>(iii) The information reported does not include where client assets are held. There is strictly limited number of category of institutions where client assets (client money) can be deposited.</p> <p>(iv) On an annual basis there is submitted a report on the way of execution requirements on protections on client assets. It is provided by an independent auditors which evaluate to a standard of completion regarding protection of client assets.</p> <p>(v) The investment firm or depository does report the amount of assets that are held.</p>	<p>During enforcement proceedings, the investment firm must present account statements to the CNVM stating where client money is held including any records of client accounts.</p>	<p>An Investment Firm which is the holder of a CMS licence must report on a quarterly basis, the amount of money segregated in a trust account. The information to be reported includes the amount and location of segregated funds.</p>

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<p><b>What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify where Client Assets are held, the amount of Client Assets held at a depository, and the safeguards applicable to Client Assets held at a depository?</b></p>	<p>The stock exchange – SRO monitors investment firm compliance with client asset protection requirements through its audits.</p> <p>The SECP also inspects investment firms to ensure compliance with the client asset protection regime.</p> <p>Inspection checks include:</p> <ul style="list-style-type: none"> <li>(i) Checking orders that have been placed by the Client from telephonic recording or other media;</li> <li>(ii) Order confirmation has been issued to him within 24 hours;</li> <li>(iii) Pledge have been marked from Client’s CDC Account;</li> <li>(iv) Mark to Marked margins have been deposited by the Clients from “Clients’ Margin Bank Account;</li> <li>(v) Margin call has been initiated in writing; Settlement has been taken place into Client’s CDC Account and/or Client Bank Account;</li> <li>(v) Contract Name has been issued in the name of client and not the agent.</li> </ul> <p>Chapter 13 of the CDC Regulation mentions that, if any information is required by CDC from an investment firm or where the CDC is required to inspect the Records of any investment firm, the CDC may, by notice, require such investment firm to provide such information or, as the case may be, permit CDC to inspect any records.</p>	<p>Desk-based inspections and on-site inspections take place.</p>	<p>For client funds, the audited entity must provide account statements issued by the bank where the firm has its accounts. This is compared to the firm’s balance sheet.</p> <p>For financial instruments, the audited entity must provide account statements issued by the custodian bank.</p> <p>CNVM also receives periodical external and internal auditor reports as well as compliance department reports.</p> <p>CNVM may:</p> <ul style="list-style-type: none"> <li>(i) verify the mode of fulfilling the legal and statutory attributions and obligations of managers, directors, chief executive officers, as well as of other persons linked to the activity of the regulated or supervised entities;</li> <li>(ii) conduct controls at the premises of the entities regulated and supervised by CNVM;</li> <li>(iii) speak with any person in connection with the activities conducted by the entities regulated and supervised by CNVM.</li> </ul>	<p>MAS has the power to inspect the books of an Investment Firm who is the holder of a CMS licence under the SFA. In addition, as part of the annual auditors’ report, the external auditor of an Investment Firm who is the holder of a CMS licence is required to confirm, inter alia that the licensee has complied with the trust account requirements under the SFA and maintained proper records in relation to the safe custody of Client securities and Client assets.</p>

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<p><b>Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (i.e., of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify the amount and/or value of such Client Assets, and the protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?</b></p>	<p>Not applicable.</p>	<p>The foreign regulator can request information from the Polish regulator provided that there is some suitable MOU on exchange of information between the regulators.</p>	<p>Pursuant to art. 56 to 63 of the Directive 2004/39/EC are applicable, as they have been implemented in the CNVM Regulation no. 32/2006, with the following amendments (title VI).</p>	<p>The foreign regulator may request assistance from the MAS and MAS may respond to the request subject to the satisfaction of conditions set out in the SFA.</p> <p>The foreign regulator may also inspect the books of the CMS licensee, subject to satisfaction of the conditions set out in the SFA.</p>
<i>Post-Insolvency Questions</i>				

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<p><b>Under the Regime, how does an Investment Firm enter the status of "insolvent," "bankrupt," or the equivalent?</b></p>	<p>This process for insolvency of an investment firm is different from the process used for other entities.</p> <p>The investment firm initially goes through the process of default as referred in the Default Management Regulations of the Exchange.</p> <p>Under the Default Management Regulations a Default Management Committee is constituted by the relevant stock exchange.</p> <p>The Committee recovers all moneys, securities and other assets due or deliverable to the defaulter by any other Member (in respect of any transactions), securities and/or cash/bank guarantee remained unutilized with NCCPL after squaring-up initiated, membership card and office(s) within the Exchange premises, if any, in the control of the Exchange.</p> <p>After the assets of the investment firm are liquidated and distributed, the Investment Firm can still be taken up for winding up, under Part XI of the Companies Ordinance 1984. The said winding up may be done either: (i) by the Court; (ii) on a voluntary basis; or (iii) subject to the supervision of the Court.</p>		<p>There is a two step process:</p> <p>(i) trustee in bankruptcy procedures; and</p> <p>(ii) winding up / bankruptcy proceedings.</p> <p>CNVM will enforce trustee in bankruptcy procedures where an entity is about to become insolvent or where any of the entity's administrators, executive directors or auditors are guilty of:</p> <p>(i) breaching the provisions of the law or regulations issued by CNVM which have caused or may cause significant damages or which jeopardises functioning of the capital market;</p> <p>(ii) breaching any condition or restriction laid down in the authorisation;</p> <p>(iii) inadequate management of financial instruments and funds belonging to investors.</p> <p>Where there is a significant problem, CNVM may require the dissolution of the authorised entity's board.</p> <p>If CNVM determines, based on the trustee's report, that the authorised entity has not recovered, authorization will be withdrawn and the CNVM may commence winding up procedures for the entity or direct the competent court to open legal reorganization and bankruptcy proceedings.</p> <p>"insolvency" covers the following scenarios:</p> <p>(i) an entity's inability to pay due debts by using own funds;</p> <p>(ii) the withdrawal of the authorisation of regulated entity, in accordance with the law and CNVM regulations as a result of the inability of the authorised entity under special trustee in bankruptcy proceedings to recover financially.</p>	<p>(i) The provisions of the Singapore Companies Act (Cap. 50) ["CA"] apply to all companies in Singapore (unless expressly excluded), including Investment Firms. Our responses for the purpose of the survey focus on the requirements under the CA and on the processes of liquidation and judicial management.</p> <p>Judicial Management</p> <p>(ii) The petition for judicial management of a company can be filed by the company or its creditors.</p> <p>A judicial manager attempts to rehabilitate the company or preserve all or part of the business of the company, if this better serves the creditors.</p> <p>Winding up</p> <p>(iii) A petition for winding up of the company can be filed by the company, its creditors or the company's judicial manager.</p>
<p><b>Under the Regime, what is the process of appointing an Administrative Officer?</b></p>	<p>There is no concept of an Administrative Officer during insolvency or when a member of stock exchange defaults.</p> <p>When a firm is required to file for winding up under provisions of the Companies Ordinance 1984, a liquidator is appointed by the Court, from amongst persons recommended by the Commission (a panel of persons from whom it shall appoint a provisional manager or official liquidator of a company ordered to be wound up by the Court).</p> <p>In case of the voluntary winding up of an investment firm, a liquidator is appointed by the company in general meeting.</p>		<p>In respect of trustee in bankruptcy procedures, the trustee will be a natural or legal person appointed by CNVM.</p> <p>In respect of a legal reorganization and bankruptcy proceedings, the trustee shall be appointed by the tribunal (with CNVM's approval).</p> <p>In a winding up, the trustee shall be appointed by CNVM.</p>	<p><u>Judicial management:</u></p> <p>(i) An application for a judicial management order should be made to the Singapore Court. In the application, the applicant shall nominate a public accountant, who is not the auditor of the company, to act as its judicial manager.</p> <p>(ii) The Singapore Court may reject the nomination of the applicant and appoint another person in his stead.</p> <p>(iii) The Minister in charge of the CA 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.</p> <p>(iv) Where a person is appointed by the Singapore Court or nominated by the Minister to act as a judicial manager that person need not be a public accountant.</p> <p><u>Winding up:</u></p>

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What guidance is available to such Administrative Officer?	Not applicable.		For trustee in bankruptcy procedures, the trustee shall establish measures for the preservation of the assets and the collection of claims to the interest of the investors and of other creditors.	<p><u>Judicial management:</u></p> <p>(i) 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.</p> <p>(ii) He is also required to submit a statement of proposals on the management of the company within 60 days of the judicial management order.</p> <p><u>Winding up:</u></p> <p>(i) The liquidator shall use his discretion in the management of the affairs and property of the company and the distribution of its assets.</p> <p>(ii) The powers and duties of the liquidator are expressly provided in the CA.</p> <p>(iii) 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.</p>
What is the standard of liability for such Administrative Officer?	None.		Full personal liability.	<p><u>Judicial management:</u></p> <p>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</p>

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<p><b>How is the regulator involved in the insolvency of an Investment Firm, including in the return of Client Assets?</b></p>	<p>The relevant stock exchange nominates eligible candidates to be part of the Default Management Committee.</p> <p>Once the Committee is formed, they are in charge of liquidating and disposing the insolvent member's assets and then distributing those assets amongst clearing houses, exchanges, members and clients.</p> <p>The Default Management Regulation Stipulates that "while disposing of the collaterals, in the form of margin eligible securities, cash and/or bank guarantee, of clients of a Member kept as margin, the Exchange shall have the absolute discretion to liquidate such collateral in preference to others to meet the obligations of Exchange/NCCPL".</p> <p>Upon receipt of copy of NCCPL Final Notice, the Exchange shall serve a final notice to the suspended Member calling upon the suspended Member to pay the liabilities stated in the NCCPL notice within the time allowed in said notice.</p>		<p>(i) The CNVM will appoint the trustee in bankruptcy, the trustee in a winding up and approve the trustee for a bankruptcy/legal reorganisation.</p> <p>(ii) Depending on the result of the trustee in bankruptcy's report, the CNVM determines whether winding up / legal reorganization and bankruptcy proceedings should commence.</p> <p>(iii) If necessary, CNVM may assist the tribunal, the bailiff and the trustee with the proceedings.</p>	<p>The regulator continues to supervise the Investment Firm as long as it is licensed, and will coordinate with relevant parties as necessary.</p>

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<b>What are the requirements, if any, governing the segregation and treatment of Client Assets during the insolvency of an Investment Firm?</b>	<p>The investment firm is prohibited from using the services of CDS, which means that the investment firm has no access to any accounts including house account and/or any of its clients' sub-accounts.</p> <p>The reason for barring the investment firm from any sort of control over its account is to safeguard the sub-account holders/clients.</p>	<p>(i) Generally with regard to the post insolvency process there is the provision of the act on trading in financial instruments which states that in case of insolvency of an investment firm the client money deposited at an investment firm in connection with a providing of investment services are not a part of bankrupt estate.</p> <p>(ii) Moreover the client assets including financial instruments are protected by the compensation scheme.</p>	<p>The trustee is fully entrusted with the powers of the Board of the authorised entity under trustee in bankruptcy proceedings.</p> <p>The trustee shall establish measures for the preservation of the assets and the collection of claims to the interest of the investors and of other creditors.</p>	<p>The requirements set out in the SFA and SFR, such as the deposit of customer moneys into a trust account would apply during the insolvency of an Investment Firm as long as the Investment Firm is still licensed under the SFA.</p>
<b>Does the Regime facilitate or encourage the transfer of Client Assets from an insolvent Investment Firm to a solvent Investment Firm?</b>	<p>The CDC offers its sub-account holders the option to transfer their securities from sub-account of a restricted Participant account to a sub-account of any other Participant account or even move it to an investor account.</p> <p>This is subject to conducting verification and authentication of the sub-account.</p> <p>Upon notice from a Sub-Account holder, CDC may, in accordance with the Procedures, upon giving seven (7) Business Days' notice to such Participant of CDC's intention to do so, comply with the notice received from the Sub-Account Holder to transfer the book-entry</p>		No.	<p>(i) When MAS is notified by an Investment Firm who is the holder of a CMS licence or becomes aware that the base capital of the Investment Firm has fallen below the minimum requirement; or the financial resources of the Investment Firm have fallen below 120% of its total risk requirements, MAS may require the Investment Firm to transfer all or part of any client's margins, collateral, assets and accounts to another Investment Firm who is the holder of a CMS licence.</p> <p>(ii) There will be close monitoring to ensure that the transfer is done without undue delay.</p>
<b>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?</b>	None.		No information given.	<p>(i) In relation to a company which is being wound up, there are express provisions provided in the CA against transactions giving an undue preference, transactions at an undervalue, and fraudulent trading.</p> <p>(ii) 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.</p>

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<b>Does the Regime have a scheme to compensate clients for losses suffered due to the insolvency of the Investment Firm?</b>	<p>The Karachi Stock Exchange (KSE) maintains the Investors' Protection Fund (IPF) and allows disbursement of Rs. 75 million per investment firm from IPF for satisfaction of claims of aggrieved clients in case of default/expulsion of such Firm.</p> <p>If the claims against the defaulting Member exceed the amount available (Rs.75 million) settlement of such claims shall be satisfied on a pro-rata basis.</p> <p>The claims still remaining unsatisfied after pro-rata sharing will then be paid from the IPF in accordance with the KSE Investors Protection Fund Regulations. The order of priority is as follows, whereby the per claimant distribution shall, in any case, not exceed the amount of claim:</p> <p>(a) Initial Disbursement of up to a maximum of Rs. 500,000/- equally per claimant among all claimants by utilizing 50% of maximum allowable contribution i.e. Rs. 37.5 million. Such disbursement shall</p>	<p>The client assets including financial instruments are protected by the compensation scheme. Which is regulated under the act on trading in financial instrument and operated by the National Deposit.</p>	<p>The intermediaries authorised to provide investment services and management companies, which manage individual investment portfolios, must be members of the Investment Compensation Fund. The purpose of the Fund is to compensate investors, in compliance with the conditions set out in the Capital Market Law (Law no. 297/2004, with the following amendments) and with C.N.V.M. regulations, if Fund members fail to return the funds and/or the financial instruments owed by or belonging to investors, which have been held on their behalf for providing investment services or managing individual investment portfolios.</p> <p>"Investor" refers to any person which has entrusted a Fund member with funds or financial instruments in order to provide investment services.</p>	<p>(i) 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\$50,000, net of the bank client's liabilities to the bank. (See <a href="http://www.sdic.org.sg">http://www.sdic.org.sg</a>).</p> <p>(ii) 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:-</p> <p>(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;</p> <p>(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</p>
<b>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?</b>	<p>Clients are not treated differently based on permissions they have granted pre-bankruptcy.</p> <p>Securities pledged from sub-accounts of clients are utilized up to their outstanding exposures and losses of clients cannot be allocated to other clients of defaulted investment firm. The clients who have authorized the investment firm in writing may lose right to reclaim such securities.</p> <p>The claims still remaining unsatisfied after pro-rata sharing will then be paid from the Investor Protection Fund by utilizing up to aggregate amount of Rs. 75 million in accordance with methods and procedures prescribed in the Regulations relating to the IPF.</p>		<p>Clients are not treated differently based on permissions that clients granted to the Investment Firm prior to insolvency.</p>	<p>This would depend on the terms and conditions of the Client's agreement with the Investment Firm.</p>
<b>If there is a shortfall (i.e., client claims exceed Client Assets), then how does the Regime allocate such loss?</b>	<p>Where the claims admitted by the Exchange against an investment firm are more than the amount of surplus as mentioned in the Default Management Regulation, all the claims will be satisfied on pro-rata basis.</p> <p>The claims that still remain unsatisfied after pro-rata sharing will then be paid from the IPF in accordance with the KSE Investors Protection Fund Regulations.</p>		<p>No information given.</p>	<p>Client Assets held in trust accounts belong to the customers, and creditors are not entitled to claim from the Client Assets. There is recent case authority which held in the particular winding up that the interim distribution of moneys to Clients be based on an equitable tracing principle. That is, a Client's entitlement to the available Client segregated moneys is determined on the basis of his respective contribution and interest in the available moneys as can be allocated and identified. As such, Clients whose moneys attributable to them but yet to be recovered by a liquidator would not receive any distribution as such unrecovered moneys would not be available in the Client accounts. Please note that decision of the High Court of Singapore which we have cited above would not be binding on subsequent cases of a failed investment firm and each case would be decided on its own facts and merits.</p> <p>In the winding up of a company, the priority for payment of debts for creditors is expressly provided in the CA. Preferential creditors such as employees are paid ahead of other unsecured debts. All creditors of equal rank are paid pari passu in equal proportions.</p>

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	Spain	Turkey	United Kingdom	US-CFTC
<i>Context Questions</i>				
<b>How does your jurisdiction define the term "client assets"?</b>	<p>Client assets is not a defined term in the Spanish Securities Markets Act (Ley 24/1988, del Mercado de Valores).</p> <p>Client assets include both financial instruments and client money.</p> <p>Financial instruments include the products specified under MiFID as well as:</p> <ul style="list-style-type: none"> <li>(i) Shares of companies and transferable securities equivalent to shares, and any other type of transferable security giving entitlement to acquire shares or securities equivalent to shares through conversion or exercise of the rights inherent to them.</li> <li>(ii) Participation shares ("cuotas participativas") of savings banks and "association participation shares" of the Confederación Española de Cajas de Ahorros.</li> <li>(iii) Bonds, debentures and similar securities representing part of a debt claim, including those which are convertible or exchangeable.</li> <li>(iv) Mortgage covered bonds, mortgage bonds and mortgage participations.</li> <li>(v) Asset-backed securities.</li> <li>(vi) Units and shares in UCITS.</li> <li>(vii) Money market instruments, i.e. categories of instruments which are normally traded on the money market, such as treasury bills, certificates of deposit and commercial paper, except those issued on a unique basis and excluding instruments of payment deriving from preceding commercial transactions that do not involve the capture of repayable funds.</li> <li>(viii) Preference shares.</li> <li>(ix) Territorial covered bonds.</li> <li>(x) Warrants and any other derivative transferable security giving the right to acquire or sell any other transferable security or giving the</li> </ul>	<p>Client assets refers to money, securities and positions which are held or controlled by authorized investment firms for investment purposes on behalf of their clients.</p> <p>Client assets include the following:</p> <ul style="list-style-type: none"> <li>(i) cash and convertible foreign exchange in investors accounts and all the returns and rights in respect of these accounts;</li> <li>(ii) securities such as stocks, government bonds and treasury bills;</li> <li>(iii) participation certificates in mutual funds;</li> <li>(iv) positions related to the forex trading and derivative transactions;</li> <li>(v) gold and other valuable items having the standards; and</li> <li>(vi) other assets that may be specified by the Board.</li> </ul>	<p>"Client assets" is not a defined term in the UK regime, however, it is generally used to mean both custody assets (as defined below) and client money (as defined below), unless otherwise specified.</p> <p>Custody assets: (a) a security or contractually based investment (these categories are very wide and include for example, shares, units, options, futures, CFDs and interests in these investments) held for or on behalf of a client; (b) any other asset which is or may be held with one of the investments listed in (a) held for, or on behalf of, a client.</p> <p>Client money: money of any currency that a firm receives or holds for, or on behalf of, a client in the course of, or in connection with, its investment business/agreements; and to which the client money rules apply.</p>	<p>Client Assets refers to customer funds, positions, securities, or other property held on behalf of clients by an FCM. These assets can be used to margin, secure and guarantee commodity futures and swaps transactions. The CFTC's regulatory scheme distinguishes between "account classes" for (a) domestic and (b) foreign exchange-traded futures positions and associated collateral, and (c) cleared swaps customer contracts and related collateral.</p>

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	Spain	Turkey	United Kingdom	US-CFTC
<p><b>What is the nature of a client's ownership rights with respect to its client assets placed with an investment firm?</b></p>	<p>Custody assets held by a firm may be registered in the name of the client, or the name of the firm when the assets are recorded in jurisdictions where "omnibus" accounts are permitted, but clients retain beneficial ownership of the assets at all times.</p>	<p>Capital market instruments such as stocks, bonds, mutual funds and warrants that are dematerialized will be centrally registered in the beneficial owner's name at the "Central Registry Agency" (CRA), the central securities depository.</p> <p>Ownership rights in relation to dematerialized instruments can be used by the participants and owners of capital market instruments through the services supplied by the CRA, such as dividend distributions and redemptions, rights issues, participation to general assembly meetings, pledges.</p> <p>For cash, client assets will be held in a bank account opened in the name of the investment firm, but the cash is recorded to segregated accounts and kept separate from the assets of the investment firm.</p> <p>The proceeds of the client assets in cash deposited in a bank account in the name of the investment firm shall be distributed to the accounts proportionately.</p>	<p>Custody assets: Broadly speaking, custody assets held by a firm may be registered in the name of the client, a nominee company, or even the name of the firm, but clients retain beneficial ownership of the assets at all times. In the event of a firm insolvency, the client has a claim on specific assets; an insolvency practitioner can trace these assets.</p> <p>In the event of a shortfall, clients have a claim as unsecured creditors of the general estate, and, if eligible, would be able to claim against the Financial Services Compensation Scheme (FSCS) if they suffered loss.</p> <p>Client money: client money is received and held by a firm on trust for its clients. In the event of a firm failure, all client money held by a firm on behalf of its clients is pooled. That pool of client money is then shared rateably amongst the clients with a claim on the pool in accordance with their interests in it.</p> <p>Any shortfall in that client money pool is shared rateably amongst the clients. Clients will have claims as unsecured creditors of the firm's general estate in relation to any shortfall and, if eligible, would be able to claim against the Financial Services Compensation Scheme (FSCS) if they suffered loss.</p>	<p>When a client places its assets with an Investment Firm, the client transfers title to those assets to the firm. However, if the Investment Firm becomes insolvent, all clients share pro rata, by account class, in Client Assets, based on the amount of each client's claim.</p>

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	<b>Spain</b>	<b>Turkey</b>	<b>United Kingdom</b>	<b>US-CFTC</b>
<b>How does your jurisdiction define the term "client"?</b>	<p>Client is not a defined term in the Spanish Securities Markets Act per se.</p> <p>Client means a person, individual or legal, to whom a firm (which includes banks and investment firms) provides, intends to provide or has provided a service.</p>	<p>Clients are individuals or legal entities who open accounts with investment firms for investment purposes by way of written contracts.</p> <p>Currently, there is no final legislation or rule that have been adopted on client categorization but the draft is underway. After the new Capital Markets Law enters into force, clients will be separated into two groups: individual clients and professional clients.</p>	<p>Client: a person (including an individual and legal person such as corporate entity) to whom a firm (which includes banks and investment firms) provides, intends to provide or has provided a service in the course of carrying on a regulated activity. The definition of 'Client' will also include other regulated firms, including affiliates or other group entities.</p>	<p>Client refers to a customer (i.e., any natural person, corporation, general partnership, limited partnership, limited liability company, trust or other legal organization whose commodity or swaps account is carried by an FCM).</p> <p>The definition of "client" excludes the types of accounts included under the definition of proprietary account. Proprietary accounts include the firm's own account and so-called "noncustomer" (i.e., affiliated) accounts such as the accounts of an FCM's directors, stockholders, officers, account executives, certain other employees, certain relatives of the preceding persons, and affiliated companies.</p>
<i>Pre-Insolvency Questions</i>				

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	Spain	Turkey	United Kingdom	US-CFTC
<p><b>Does the Regime require the Client Assets of each client to be placed in an individual account?</b></p>	<p>No. Client assets must be maintained separately from the assets of the investment firm.</p> <p>Where client assets are held in omnibus accounts, they must be held in such a way as to be kept separately from the firm's assets and the firm must be able to, at any time and without delay, distinguish client assets held for one client from client assets held for another client or for its own account. Such records must be accurate.</p>	<p>It differs for capital market instruments and for cash. Dematerialized capital market instruments (including stocks, bonds, mutual funds and warrants) which are centrally registered and deposited in accounts opened on a client-by-client basis by the Central Registry Agency (CRA), a central securities depository are required to be placed in individual accounts.</p> <p>Similarly, client cash collateral related to derivatives traded on TURKDEX and forex transactions and collateral related to borrowing and lending of securities for the transactions executed on Securities Lending and Borrowing Market are kept in Custody Bank Takasbank on a client basis.</p> <p>By contrast, cash is deposited in a bank account in the investment firm's own name but kept separately from the investment firm's own assets and recorded to segregated client accounts within the investment firm.</p>	<p>No. An Investment Firm may hold Client Assets in an omnibus account or an individual account.</p>	<p>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.</p>
<p><b>How often does the Regime require the Investment Firm to reconcile its books and records with its segregation requirement?</b></p>	<p>Regular reconciliation must be done of internal accounts with third party accounts where client assets are held.</p> <p>Reconciliation is completed on an aggregate basis and on a client-by-client basis.</p> <p>Reconciliation must be performed as often as necessary.</p>	<p>Investment firms must send monthly reports to their clients in relation to the client accounts.</p> <p>Client account statements must be sent within seven days of the end of the previous month.</p> <p>The monthly reports include all client trades, assets and liabilities.</p> <p>Clients may dispute the information laid in these reports.</p> <p>Investment firms must have a procedure in place to reconcile client assets and internal control procedures for reconciliation.</p>	<p>(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.</p> <p>(ii) For Client Money, internal reconciliations of records and accounts of the entitlement of each client for whom the firm holds client money with the records and accounts of the client money the firm holds. 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.</p> <p>(iii) For Custody Assets the Investment Firm must carry out internal reconciliations of the custody assets held for each client with the custody assets held by the firm and third parties. Reconciliation methods which can be adopted for these purposes include the 'total count method', which requires that all custody assets be counted and reconciled as at the same date.</p>	<p>Daily, by noon of the next business day.</p> <p>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.</p>

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	Spain	Turkey	United Kingdom	US-CFTC
<p><b>Does the Regime permit the Investment Firm to temporarily hold less Client Assets than the amount specified in the segregation requirement?</b></p>	<p>The sum of total client money and financial instruments must be held in separate accounts.</p>	<p>No.</p>	<p>No.</p> <p>(a) If the Investment Firm discovers a deficiency in client money as a result of its internal reconciliation, then the Investment Firm must identify the reason for the deficiency, and ensure that:</p> <p>(i) any shortfall is paid into a client bank account by close of business on the day that the reconciliation is performed; or</p> <p>(ii) any excess is withdrawn in the same period.</p> <p>(b) If the Investment Firm discovers a deficiency in client money while reconciling internal records with external custodial records, then the Investment Firm must identify the reason for the discrepancy and correct it as soon as possible. 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.</p> <p>A firm must inform the FSA in writing if it is not able to comply with the abovementioned rules.</p> <p>With respect to custody assets, a firm must promptly correct any discrepancies which are revealed in the reconciliations envisaged by this section, and make good, or provide the equivalent of, any unreconciled shortfall for which there are reasonable grounds for concluding that the firm is responsible.</p>	<p>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.</p>
<p><b>If a client has a debit balance, does the Regime permit the Investment Firm to deduct such balance in determining its segregation requirement? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?</b></p>	<p>Yes, the debit must be deducted. Client's debit balances does not reduce the Firm obligation to hold total clients credits.</p>	<p>No.</p> <p>A client's debit balance can not reduce the firm's obligations with respect to the total required funds for credit balances of other clients. The netting cannot be made on total basis. For example, according to the provisions of the CMB of Turkey, investment firms shall keep the records of the monetary results of the transactions of the clients to a current account. However this account shall not be netted on total basis, it can only be netted on client basis that, the debit balance of this account reveals the amount clients owe to the investment firm and the credit balance of it reveals the investment firm's obligations to the clients. Investment firms are obliged to keep the amount equal to the credit balance of such account as liquid assets, to be able pay to the clients when demanded. For cash accounts, investment firms can offset credit and debit balances on a client-by-client basis. For margin accounts, this offset is also forbidden.</p>	<p>No. An Investment Firm can offset credit and debit balances for the same client. It cannot offset credit and debit balances across different clients.</p>	<p>No. An Investment Firm can offset credit and debit balances for the same client. It cannot offset credit and debit balances across different clients.</p>

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	Spain	Turkey	United Kingdom	US-CFTC
<p><b>Does the Regime permit the Investment Firm to treat different types of Client Assets (i.e., cash and securities) as fungible?</b></p>	<p>No. Cash is treated as fungible but securities are booked in clients name so is not possible to treat them as fungible assets.</p>	<p>Yes. Client assets are fungible within the same asset classes. Clients' securities which are dematerialized and kept in safe custody are fungible with the securities having the same characteristics. Client money are not fungible with client securities.</p>	<p>No.</p> <p>(i) Client Money is not fungible with client securities.</p> <p>(ii) In general, a specific client security would only be fungible with a security that has the same characteristics. 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. 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).</p>	<p>Yes. In general, Client Assets are fungible.</p>
<p><b>Does the Regime permit the Investment Firm to maintain its own assets in the Client Account as a "buffer" against violating segregation requirements?</b></p>	<p>No, the total amount of client assets must be held in segregated accounts. Firms cash or securities must be held in different accounts of clients cash or securities.</p> <p>No "buffer" against violations must be held.</p> <p>Investment firms must maintain an additional 10 per 100 of all short term credits as liquidity measure.</p>	<p>No. The investment firm's assets must be separated from the client assets. Investment firms are not required nor encouraged to maintain any of their own assets in a client asset account.</p>	<p>Yes, if it is prudent to do so to ensure that client money is protected.</p>	<p>Yes. The Regime strongly encourages the Investment Firm to create a "buffer."</p>

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	Spain	Turkey	United Kingdom	US-CFTC
<p><b>Does the Regime permit the Investment Firm to encumber, re-hypothecate, or otherwise use Client Assets?</b></p>	<p>Investment firms can enter into arrangements for securities financing transactions in respect of client financial instruments or use such financial instruments for their own account or the account of another client of the firm, where the following conditions are met:</p> <p>(a) the client must have given his prior express consent to the use of the instruments on specified terms, as evidenced, in the case of a retail client, by his signature or equivalent alternative mechanism;</p> <p>(b) the use of that client's financial instruments must be restricted to the specified terms to which the client consents.</p> <p>Additionally, investment firms cannot enter into arrangements for securities financing transactions in respect of financial instruments which are held 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, in addition to the conditions set out in the above paragraph, the following conditions are met:</p> <p>(a) each client whose financial instruments are held together in an omnibus account must have given prior express consent in accordance with point (a) of the above paragraph;</p> <p>(b) the investment firm must have in place systems and controls which ensure that only financial instruments belonging to clients who have given prior express consent in accordance with point (a) of</p>	<p>Yes, investment firms can use the client assets with the consent of the clients. This consent may be for the utilization of client money in line with the preferences of the clients, or borrowing and lending of the securities or for the use of the client assets by the investment firm for its own purposes, such as encumbrance or rehypothecation. However the latter one takes place very rarely.</p>	<p>Yes.</p> <p>(i) The Regime permits clients to grant the Investment Firm the right to use Custody Assets.</p> <p>(ii) The Regime permits certain sophisticated clients to convey to the Investment Firm full title to Custody Assets for the purpose of securing or otherwise covering present or future, actual, contingent or prospective obligations. Once the conveyance is made, such assets cease to be Custody Assets and are no longer subject to protection.</p>	<p>Yes.</p> <p>(i) An Investment Firm is permitted to invest Client Money, subject to certain restrictions with respect to Client Money supporting commodity futures.</p> <p>(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.</p>
<p><b>How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?</b></p>	<p>Except for the abovementioned case. The use or re-hypothecate clients assets is forbidden. Clients ownership rights are not affected by these violations, except that the Firm became insolvent or commit fraud. In this case client would be a creditor</p>	<p>Where a client consents to the investment firm's re-hypothecating his/her assets, general provisions of property law related to encumbrances will apply.</p> <p>As an example, where an investment firm hypothecates a client's stock as collateral for repayment of the investment firm's loan (and subsequently fails to repay the loan), the creditor may exercise rights arising from the property law on hypothecated assets.</p> <p>Where the client's consent is in relation to borrowing and lending operations of the capital market instruments, special provisions apply:</p> <p>(i) investment firms may, pursuant to a client contract, undertake borrowing and lending of capital market instruments.</p> <p>(ii) during the borrowing and lending period, dividend or interest payments in respect of the capital market instrument prior to their delivery and any related payments will be made to the lender by the borrower pursuant to the contract.</p> <p>Prior to delivery of shares sold short to the lender, if rights issues and bonus issues of shares due to capital increase by the issuing</p>	<p><u>Full Title Transfer</u></p> <p>If a client agrees to full title transfer of its assets to the firm and the firm exercises its rights to take full ownership of assets in accordance with the client agreement, the assets will be moved out of the client assets regime for the period during which the firm exercises full ownership rights. If a firm fails during that period, the client will rank as a general creditor of the firm in relation to those assets.</p> <p><u>Security Financial Collateral Arrangements</u></p> <p>With a security financial collateral arrangement, the client retains beneficial interest in the assets until such time as the condition in the agreement allowing the firm to exercise its security right is met.</p>	<p>An Investment Firm is permitted to rehypothecate or invest Client Assets in a limited set of instruments so long as the Firm maintains in segregation the value necessary to repay all clients with positive (i.e., credit) balances in full. However, this does not result in any change to the client's ownership rights: In the event of insolvency, the client remains entitled to a pro rata share of the Client Assets, based on the client's allowed claim.</p>

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How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?	Prior express consent.	A client's consent to permit an investment firm to use assets must be stated in a written form.  In borrowing and lending of capital market instruments a contract of engagement shall be signed between the parties.	Through contract - investment firms must agree terms with clients in relation to use of client assets or conditions in relation to full title transfer. Generally, the agreement can form part of the terms of business or agreements clients sign-up to.  New rules that came into force 2011, require prime brokers to set out clearly in a separate annex in the client agreements a summary of the agreed right to use of custody assets (CASS 9.3 prime brokerage agreement disclosure annex).	Not Applicable.
How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (i.e., established by statute or regulation, established by prior judicial decision)	Client retains beneficial ownership of the assets at all times.	Pre-insolvency or bankruptcy, where a client consents to the investment firm's re-hypothecating his/her assets, general provisions of property law related to encumbrances will apply.  Generally, where an investment firm hypothecates a client's stock as collateral for repayment of the investment firm's loan (and subsequently fails to repay the loan), the creditor may exercise rights arising from the property law on hypothecated assets.  However, upon the complaint of the client or recognition of the state by the CMB, the investment firm would be inspected in the frame of the Article 47-A-5 of the Capital Market Law, on capital market institutions' using client assets for own benefit. According to the Article 47-A-5 of the Capital Market Law, authorized persons of investment firms who sell or create a pledge or use in whatever manner for the benefit of themselves or someone else, client assets shall be punished with a prison sentence and a heavy pecuniary fine.  A client, whose assets are used or re-hypothecated without his/her consent, may file a debt case against the investment firm and his/her loss would be remedied with the decision of the court.	If a firm takes full ownership over custody assets and uses them without the client's agreement, in our view, the client asset regime should continue to apply to those assets, that is, they should still be held on trust by the firm for the client. If the firm has used the assets as its own the client/insolvency practitioner may attempt a tracing exercise.  Similarly, if a firm uses client money without the consent of the client to whom the money belongs, this money would still be subject trust and in the event of a firm's insolvency the client would be entitled to claim on the client money pool.  In the event of the firm's insolvency, the client would usually be reliant on the insolvency practitioner to represent its interests in resolving issues relating to misuse of its assets and money. However, on a business as usual basis, in the event that the firm misused a client's assets and the client had suffered loss, the client could potentially sue the firm for breach of contract or negligence.	Pursuant to Section 766(h) of the Bankruptcy Code, a client remains entitled to a pro rata share of the value of its Client Assets (i.e., the client's allowed claim) in an Investment Firm insolvency.
Does the Regime permit the Investment Firm to hold Client Assets with a third-party affiliate?	Investment firms must ensure that client funds or securities deposited in a third country are held in an account such that the client funds or securities are separately identifiable from any accounts belonging to the investment firm.  If the safekeeping of financial instruments is subject to specific regulation and supervision in the jurisdiction where the investment	Yes. But only if this affiliate is a credit institution.	Yes.  In the context of client money, a firm must limit the funds that it deposits or holds with another group entity or combination of such entities so that those funds do not at any point in time exceed 20 per cent of (broadly) the aggregate client money balance that it holds.	Yes.

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	Spain	Turkey	United Kingdom	US-CFTC
<p><b>Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)? If so, what protections are applicable to the Foreign Investment Firm’s Client Assets? What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets? What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?</b></p>	<p>Investment firms may hold client assets from investment firms in other jurisdictions in the client omnibus account.</p> <p>Prior to transfer clients assets to a foreing Firm, client must be assessed about legal regime abroad, risks and investors righths, such as:</p> <p>a) summary description to ensure client protection, including investors compensation scheme.</p> <p>b) Inform client where financial instruments or cash wuold be held by a third party and responsibility of the Firm and the consequences of foreing Firm insolvency.</p> <p>c) Where financial instruments are held in an omnibus account by a third party, Firm shall inform clients of this fact and shall provide a prominent warning of risks.</p> <p>d) Firm shall inform client where accounts that contain financial instruments or cash belonging to client are or will be subject to the law of a jurisdiction other than that of a EU Member State and shall indicate that the rights relating to those financial instruments or cash may differ accordingly.</p> <p>e) Firm shall inform the client about the existence and the terms of any security interest or lien which the firm has or may have over the client’s financial instruments or cash</p> <p>Firms can not deposit financial instruments held on behalf of clients with a third party in a foreing country that does not regulate the holding and safekeeping of financial instruments on behalf of investors.</p>	<p>Yes. Investment firms are allowed to hold omnibus accounts in foreign jurisdictions only in activities as white labels of foreign investment firms authorized by the competitive authority of the involved jurisdiction.</p> <p>Investment firms are obliged to keep records of the client assets which are held in foreign jurisdictions in segrageted accounts. Currently, these accounts are not subject to investors’protection schemes."</p>	<p>The UK client assets rules do not differentiate between client assets held for UK or overseas clients.</p>	<p>Yes. Such Client Assets are entitled to the same protections as those Client Assets of U.S. customers held by Investment Firms in the United States. Such protections cannot be reduced.</p>
<p><b>Does the Regime permit clients to waive or otherwise reduce or vary any of the Client Asset protection requirements?</b></p>	<p>Yes.</p> <p>(i) A retail client, who meets certain requirements of experience and knoweldge can waive specific protections. Such a client would be unable to claim against the compensation scheme.</p> <p>(ii) A professional client can request to be treated as a retail client.</p> <p>(iii) The above requests must be made in writing.</p>	<p>No.</p>	<p>A client may only choose to disapply client asset protections through entering into a a full title trasnfer collateral agreement with a firm where the client has a contingent or actual liability to the firm. However, in certain situations this option is not available to retail clients.</p>	<p>No.</p>

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	Spain	Turkey	United Kingdom	US-CFTC
<p><b>Under the Regime, what actions may the Regulator take to protect the Clients Assets of an Investment Firm in distress?</b></p>	<p>(i) If a firm's financial situation is deteriorating or the firm drops below minimum capital thresholds, the Securities Market Commission will consider an appropriate course of action.</p> <p>(ii) The most usual orders require the firm to raise new capital, remove the firm's licenses, require the firm to transfer business, return client assets or enter insolvency proceedings.</p>	<p>The Capital Market Board has broad authority where it has determined that a financial institution's financial position is weakened. It may:</p> <p>(i) request that a capital market institution strengthen its financial position within a prescribed timeframe where the Capital Market Board has determined that the financial structure of a capital market institution has become weakened significantly;</p> <p>(ii) restrict or remove the signature authorities of the employees of such institution;</p> <p>(iii) take the necessary measures where the institution has not acted within the timeframe or where their financial situations have become weakened to the extent that they shall not be able to meet their commitments, stop temporarily the operations of these institutions without giving any period of time or to stop them permanently and remove their authorities;</p> <p>(iv) make a decision for gradual liquidations in case these measures do not produce results and to request direct bankruptcy without gradual liquidation or when needed following the conclusion of liquidation.</p>	<p>The regulator may remove a firm's permissions or require the Investment Firm to, among other things, raise capital, transfer business, return Client Assets, or enter insolvency proceedings.</p>	<p>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.</p>

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	Spain	Turkey	United Kingdom	US-CFTC
<p><b>Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically, does the Investment Firm report where client assets are held? Does the Investment Firm or depository report the protections applicable to such client assets? Does the Investment Firm or depository report the amount of assets that are held? In each case, are such reports provided on request or periodically? If periodically, with what frequency?</b></p>	<p>(i) On a monthly basis, Sociedades de valores (Broker-dealers) and Agencias de valores (Brokers) report information to the securities regulator about clients financial instruments.</p> <p>(ii) The report does not specify in which intermediaries the clients securities or cash is deposited, apart from the intermediary itself. The total amount of clients financial instruments and money are reported.</p>	<p>As a general requirement, there is no provision that requires investment firms to report client assets to SROs or regulators. Nevertheless, investment firms are obliged to send their capital adequacy reports to the CMB in the periods determined by the Board.</p> <p>Currently, investment firms electronically send their general ledger and reports related to the capital adequacy requirements on a weekly basis.</p> <p>In these reports, the amount of the client assets and where they are held is shown on a balance sheet basis.</p>	<p>Firms holding client money and/or custody assets in connection with investment business are categorised as:</p> <ul style="list-style-type: none"> <li>• CASS Large firm, where client money held exceeds £1 billion and/or custody assets exceeds £100 billion;</li> <li>• CASS Medium firm, where it is not a CASS Large firm, but client money held exceeds £1 million and/or custody assets exceeds £10 million; and</li> <li>• CASS Small firm, where it is not a CASS Large or CASS Medium firm, but holds client money and/or custody assets.</li> </ul> <p>Annual reporting is applicable to all of these firms and requires them at the start of each year to report their highest client money and assets holding for the previous year, or the highest projected client money and assets holdings if they have not previously held.</p> <p>All CASS Large and Medium firms are required to provide a monthly Client Money and Assets Return - "CMAR" - that contains information on the following:</p> <ul style="list-style-type: none"> <li>• Highest/lowest balances of client money and assets held</li> <li>• Auditor arrangements</li> <li>• CFTC Part 30 Exemption arrangements</li> <li>• Reconciliations – timings, methods used and discrepancies</li> <li>• Client money calculations – allocated/unallocated balances and discrepancies.</li> <li>• Segregation of client money and assets – segregation methods used/details of third parties</li> <li>• Record keeping &amp; breaches – trust/acknowledgement letters, client money accounts and notifiable CASS breaches.</li> <li>• Outsourcing/offshoring arrangements – nature of arrangements, details of service providers</li> </ul>	<p>FCMs are required to maintain evidence of the existence and amount of Client Assets held, including the Client Assets at each depository. They are also required to maintain in their records "confirmation" letters from each depository acknowledging that the assets (i) belong to clients of the FCM, (ii) are being held to support Futures, Foreign Futures or Cleared Swaps, and (iii) are being held in accordance with Section 4d of the Act or in the case of Foreign Futures, Rule 30.7. Such records are reviewed during (approximate) annual examinations conducted by the DSRO.</p> <p>Moreover, an FCM must prepare a segregation statement daily showing Client Assets and obligations. The statement must be completed by noon for balances at the close of the previous business day. Such statements are included in a report that is filed monthly with the CFTC which provides an FCM's net capital position, statement of segregated assets, and other financial information, as well as in an FCM's annual audited financial statements. An FCM must immediately report, pursuant to Regulation 1.12(h), the existence of a deficiency in any omnibus account to the CFTC. Currently, the CFTC is considering additional and more real-time reporting regarding the holding of Client Assets.</p>

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	Spain	Turkey	United Kingdom	US-CFTC
<p><b>What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify where Client Assets are held, the amount of Client Assets held at a depository, and the safeguards applicable to Client Assets held at a depository?</b></p>	<p>No Self-Regulatory Organizations have powers to conduct inspections, examinations or audits.</p>	<p>Investment firm accounts are subject to independent auditing on a 6-month basis.</p> <p>These audits include the verification of availability of the client assets.</p> <p>On the occasions of the audits of the accounts of the investment firms in detail every 6 months and on-site inspections, the CMB check client assets and for the consistency between investment firm and custodian records.</p> <p>Additionally, Takasbank as custodian for collateral for forex trading sends periodic reports on collateral for forex accounts to the CMB.</p>	<p>Firms are required to send out notification and receive acknowledgement letters from third parties where client money is placed (CASS 7.8.1 R and CASS 7.8.2 R). They are required to undertake regular external reconciliations (CASS 6.5.6 R and CASS 7.6.9R), and promptly rectify any discrepancy. If a firm is unable to rectify or make good a discrepancy, they are required to notify the FSA without delay (CASS 6.15.13 R and CASS 7.6.16 R).</p> <p>In mid 2010, the FSA launched the Client Assets Unit (around 40 individuals today and growing). The Unit is a multi-disciplinary specialist unit with risk, policy and supervision specialists focused on the client assets regime. The unit utilises a combination of firm self-reporting (including CMAR), external auditor reporting and whistle blowing to assess risks in firms and industry trends. It utilises a supervision inspection program, sector thematic reviews and independent specialist reviewers ('section 166 reviews') to examine firms.</p> <p>Furthermore, external independent auditors are required to provide to the FSA an annual reasonable assurance report on the adequacy of the client assets systems and compliance as at the period end.</p> <p>Rules introduced in 2011 require investment firms to appoint an individual within their firm the responsibility for oversight of the firm's operational compliance with the client assets rules, and reporting to the firm's governing body and the FSA.</p>	<p>DSROs conduct annual compliance examinations of FCMs, which include the verification of Client Assets. Such verification includes a review of the "confirmation" letters maintained by the FCM.</p> <p>Recently, NFA approved new rules, which would require futures brokerages to provide regulators with view-only Internet access to the segregated account information of customers. The newly approved requirements have been sent to the CFTC for approval.</p>

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	Spain	Turkey	United Kingdom	US-CFTC
<p><b>Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (i.e., of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify the amount and/or value of such Client Assets, and the protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?</b></p>	<p>Deposit of clients assets in Spain must be recorded on behalf of the client or clients, no “omnibus” accounts are permitted.</p>	<p>In Turkey, foreign investment firms open omnibus accounts with the domestic investment firms and the Central Registry Agency to trade on the Istanbul Stock Exchange (ISE) and TURKDEX.</p> <p>Foreign investment firms are required to provide written confirmation that they will provide information on the identities of the customers on behalf of whom the transactions are to be made.</p> <p>However, foreign investment firms avoid giving information on details of the identity of their clients.</p> <p>Omnibus accounts are subject to protection on a total basis.</p> <p>A foreign regulator with jurisdiction over foreign investment firms holding client assets in Turkey may request information on such client assets from investment firms in Turkey or the CMB within the frame of Memorandum of Understanding signed between the authorities if it exists, or on the grounds of reciprocity.</p>	<p>Where there is an applicable memorandum of understanding between the relevant regulators, the foreign regulator could request information from the domestic regulator through that memorandum of understanding.</p>	<p>A foreign regulator could obtain confirmation directly from the Investment Firm in the U.S. Moreover, where there is an applicable Memorandum of Understanding (“MOU”), the foreign regulator could obtain information through that MOU.</p> <p>These Client Assets are entitled to the same protections as the Client Assets of U.S. customers as set forth in Section 766(h) of the Bankruptcy Code.</p>
<i>Post-Insolvency Questions</i>				

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	Spain	Turkey	United Kingdom	US-CFTC
<b>Under the Regime, how does an Investment Firm enter the status of "insolvent," "bankrupt," or the equivalent?</b>	Any of the following persons (investment firm, Securities Market Commission or creditors) can apply to a judge for insolvency procedures.	<p>The Capital Market Board has broad authority where it has determined that a financial institution's financial position is weakened. It may, inter alia make a decision for gradual liquidations and request direct bankruptcy without gradual liquidation or when needed following the conclusion of liquidation.</p> <p>A decision may also be made by the Board for gradual liquidation of an investment firm, the authorities of which have been removed in accordance with subparagraph (h) of the first paragraph of Article 46 of the Capital Market Law.</p> <p>In a gradual liquidation, the provisions related to liquidation in the Turkish Commercial Code, the Execution and Bankruptcy Law and the other legislation shall not be applied.</p> <p>The principles and method for gradual liquidation of intermediary institutions shall be set forth in a regulation promulgated by The Capital Market Board.</p>	<p>(i) Usually, directors of a firm would apply to court to make an administration order. Where the firm is being liquidated, the firm's creditors apply to court for a winding-up order.</p> <p>(ii) Administrators can be appointed by the court, by the company, the directors or the holding of a qualifying floating charge.</p> <p>(iii) In general, Investment Firms enter administration rather than liquidation.</p> <p>In February 2011, the Investment Banking Special Administration Regulations (SAR) came into force. The SAR can be applied to UK incorporated firms that undertake investment business activity. A court can appoint an administrator over such entity on the application of various parties including the FSA or the investment bank's directors if such entity becomes insolvent.</p>	<p>(i) In general, an Investment Firm enters into bankruptcy in the same manner as any other company -- <i>i.e.</i>, either the Investment Firm itself files a voluntary bankruptcy petition or the creditors of an Investment Firm file an involuntary bankruptcy petition.</p> <p>(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.</p>
<b>Under the Regime, what is the process of appointing an Administrative Officer?</b>	<p>The administrator is appointed by the Court based on a proposal by the Securities Market Commission.</p> <p>The administrator must have proper qualifications and experience in insolvency procedures.</p>	<p>After a decision has been taken for gradual liquidation, the Investors' Protection Fund has responsibility for the duties and authorities of the legal entities of the investment firm until the liquidation is concluded.</p> <p>The Investors' Protection Fund shall be managed and represented by CRA (who is responsible for keeping records of capital market instruments, in accordance with the provisions of the Capital Market Law).</p> <p>The decision making body of the Investors' Protection Fund is the decision making body of CRA. The Investors' Protection Fund activities and transactions are managed and executed by a separate unit to be organized in CRA.</p>	The court, the Investment Firm or the FSA (in accordance with SAR) selects the Administrative Officer. The Administrative Officer is then appointed by court process. 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.

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	<b>Spain</b>	<b>Turkey</b>	<b>United Kingdom</b>	<b>US-CFTC</b>
<b>What guidance is available to such Administrative Officer?</b>	Insolvency Practitioners have to transfer clients assets, if not already done so by the Regulator, and have to make a proposal to the court for distribution of the remaining assets (to creditors).	The related provisions of the Capital Markets Law and the regulation on principles and procedures of progressive liquidation of intermediary institutions.	Statute. IPA Statements of Insolvency Practice and Guidance. There is no guidance specific to Investment Firms.	Statute ( <i>i.e.</i> , Subchapter IV of Chapter 7 of the Bankruptcy Code) and regulations provide specific guidance for an Administrative Officer liquidating an Investment Firm.
<b>What is the standard of liability for such Administrative Officer?</b>	Insolvency Practitioners who are appointed as administrators or liquidators have total personal liability.	There is not a specific provision for the liability of the Investors' Protection Fund. However in general, all practices and accounts of the Investors' Protection Fund are subject to the supervision of the Capital Markets Board.	Full personal liability.	Liability for gross negligence or willful disregard of fiduciary duties.

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	<b>Spain</b>	<b>Turkey</b>	<b>United Kingdom</b>	<b>US-CFTC</b>
<b>How is the regulator involved in the insolvency of an Investment Firm, including in the return of Client Assets?</b>	<p>The Securities Market Commission is not directly involved in the process of returning Client Assets, that is the role for the administrator or liquidator.</p> <p>The Court may ask the Securities Market Commission's advice on matters related to the securities market.</p>	<p>The initiation and the closing of the gradual liquidation process are decided by the Board. But the process of returning of the client assets is executed by the Investors Protection Scheme.</p>	<p>The regulator continues to supervise the Investment Firm, but does not play a direct role in the return of Client Assets. Where the firm is subject to SAR, the FSA monitors the work of the administrator and can direct the insolvency practitioner to prioritise one SAR objective (e.g. the return of client assets as soon as reasonably practicable) over other SAR objectives.</p>	<p>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.</p>

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	Spain	Turkey	United Kingdom	US-CFTC
<b>What are the requirements, if any, governing the segregation and treatment of Client Assets during the insolvency of an Investment Firm?</b>	<p>(i) A new article 12 bis has been introduced into the Securities Markets Act regarding the right of withdrawal in the event of insolvency of the entities responsible for book-keeping or participants in the record-keeping system, and the pro rata rule.</p> <p>(ii) In the event of insolvency of an entity responsible for the accounting of securities represented by book entries or of an entity participating in the record-keeping system, the holders of securities recorded in those registers will have the right to withdraw the securities registered in their name and to request their transfer to another entity.</p> <p>(iii) The insolvency judge and the insolvency administrators will safeguard the rights from the settlement operations under way at the time that the entity responsible for the accounting of securities by book entries or the member entity of the record-keeping system declares insolvency, according to the rules on clearing, settlement and record-keeping.</p> <p>(iv) When securities with the same International Securities Identification Number (ISIN) separated from the estate of the insolvent party are insufficient to fulfill the rights of the registered holders of the securities with the same ISIN, the shortfall will be distributed pro rata among all holders without prejudice to their right to claim for indemnity from the entity for the value of the part not paid in securities, which must be paid in money.</p> <p>(v) Where there are limited rights or liens of any other kind on the securities, and without prejudice to agreements between the guarantor and the beneficiary of the guarantee, once the pro rata rule has been applied, such liens shall be understood to be apply to the</p>	<p>There are no requirement for the investment firm governing the segregation of client assets since the management of the investment firm during the insolvency period is executed by the Investors Protection Scheme.</p>	<p>The client assets regime continues to apply to the Investment Firm during the insolvency - until it ceases to conduct regulated activities and its permissions are canceled. In the event of a firm failure, all client money held by a firm on behalf of its clients is pooled. That pool of client money is then shared rateably amongst the clients with a claim on the pool in accordance with their interests in it (in accordance with the client money distribution rules). Client securities are not pooled.</p>	<p>During the insolvency of an Investment Firm, a Trustee segregates Client Assets as part of the process of returning assets on a pro rata basis, proportional to allowed claims, to clients of the Investment Firm through transfer or distribution.</p>
<b>Does the Regime facilitate or encourage the transfer of Client Assets from an insolvent Investment Firm to a solvent Investment Firm?</b>	<p>The Securities Market Commission can order the transfer of Client Assets.</p> <p>(i) A new article 12 bis has been introduced into the Securities Markets Act regarding the right of withdrawal in the event of insolvency of the entities responsible for book-keeping or participants in the record-keeping system, and the pro rata rule.</p> <p>(ii) In the event of insolvency of an entity responsible for the accounting of securities represented by book entries or of an entity participating in the record-keeping system, the holders of securities recorded in those registers will have the right to withdraw the</p>	<p>A decision may be made by The Capital Market Board to transfer portfolio management functions from an intermediary institution which has become bankrupt or insolvent to another institution. This includes mutual funds and investment company portfolios.</p>	<p>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."</p>	<p>Yes. Both the applicable statute (<i>i.e.</i>, 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.</p>
<b>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?</b>	<p>The Court is able to determine the date that looks back to the insolvency procedure.</p>	<p>No. There is a not requirement for the clients to return assets (or the values thereof) that were distributed to them prior to the insolvency proceeding, unless there is an unlawful action.</p>	<p>No, because the Investment Firm holds Client Assets in trust.</p>	<p>No.</p>

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	Spain	Turkey	United Kingdom	US-CFTC
<b>Does the Regime have a scheme to compensate clients for losses suffered due to the insolvency of the Investment Firm?</b>	<p>(i) In case of insolvency, as a general rule, securities and financial instruments of any type of clients are segregated from financial intermediaries positions.</p> <p>(ii) Even though there are individual accounts, money may not be not segregated from the rest of creditors and it may depend on the judge's consideration of the issue.</p> <p>(iii) Money accounts are covered by the Investors Compensation Scheme (ICS) up to the limit of 100.000 euros.</p> <p>(iv) These rules apply to every type of securities or financial instruments, no matter if it is traded on a regulated market or not (OTC).</p>	<p>(i) The Investors' Protection Fund has been created to cover liquidation expenses from any insolvency or gradual liquidation and to carry out the gradual liquidation or insolvency process.</p> <p>(ii) All intermediary institutions are required to participate in the Investors' Protection Fund.</p> <p>(iii) In a gradual liquidation, the first step is distribution of the capital market instruments to the customer settlement accounts.</p> <p>(iv) The capital market instruments that are settled in the customer account are compared the separate accounts and shall be used only for meeting the obligations to these account holders.</p> <p>(v) For the holders of settlement accounts who have enough to meet what is owed in the account or who do not have any shares, a total of 63,700,00 Turkish Lira of their cash and share receivables (for the year 2012) shall be paid by the Fund without waiting for the</p>	<p>Yes, for (broadly) retail investors only. Limited to £50,000 (approximately US\$79,000).</p>	<p>No.</p>
<b>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?</b>	<p>In general terms there are no differences in treatment of clients under insolvency procedures, except for the application of investors compensation schemes to retail customers. Professional and eligible counterparties are not covered by the investors compensation schemes.</p> <p>There are other situations, such as bilateral or multilateral compensation agreements, or other types of positions like mortgages, liens, pledges that implies differences among the same type of clients due to these particular situations.</p>	<p>All client assets are subject to the same regime whether or not the client granted permissions to the investment firm.</p>	<p>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.</p>	<p>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.</p>
<b>If there is a shortfall (i.e., client claims exceed Client Assets), then how does the Regime allocate such loss?</b>	<p>Pro rata distribution criteria is applied.</p>	<p>(i) Where the assets of the Investors Protection Fund are not sufficient, then intermediary institutions will pay further dues for subsequent years shall be paid up to one per thousand of the monetary amount of the share transaction volumes for the previous year for a temporary period.</p> <p>(ii) If the dues received from intermediary institutions are not sufficient to meet the needs, then an advance shall be given to the Investors Protection Fund by the Istanbul Stock Exchange for the remaining portion.</p> <p>(iii) The Investors Protection Fund, after making the advance payments, shall continue the gradual liquidation of the intermediary institution.</p> <p>(iv) The liquidation balance of the receivables from the holders of the rights subject to the scope of the liquidation shall be used for the payment of the receivables which are not completely met.</p>	<p>(i) <i>Client Money</i>. Pro rata distribution, with shortfalls claimed against the FSCS.</p> <p>(ii) <i>Custody Assets</i>. If assets are held in a pooled omnibus account, they would be distributed pro rata to the extent that an individual's assets cannot be traced. If 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.</p>	<p>Pro rata .</p>

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	US-SEC
<i>Context Questions</i>	
<b>How does your jurisdiction define the term "client assets"?</b>	"Client Assets" is not a defined term but would generally refer to customer funds or securities (as defined under Exchange Act section 3(a)(10)) held on behalf of customers by a broker-dealer.

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	US-SEC
<p><b>What is the nature of a client's ownership rights with respect to its client assets placed with an investment firm?</b></p>	<p>Exchange Act Rule 15c3-3 ("customer protection rule") generally governs the nature of a client's ownership rights and provides as follows:</p> <ul style="list-style-type: none"> <li>• A broker-dealer must obtain and maintain possession and control of customer fully paid and excess margin securities. This generally includes holding customer securities free of lien in a good control location;</li> <li>• Free credit balances cannot be used to finance a broker-dealer's inventories or expenses;</li> <li>• Customer net credits must be "locked away" in a Reserve Account so that if a broker-dealer is liquidated, the customer securities and funds would be available to be returned to customers.</li> </ul> <p>"Free credit balance" means liabilities of a broker-dealer to customers that are subject to immediate cash payment to customers on demand, whether resulting from sales of securities, dividends, interest, deposits or otherwise, excluding funds in commodity accounts which are segregated in accordance with the Commodity Exchange Act or in a similar manner. (paragraph (a)(8) of Rule 15c3-3)</p> <p>Paragraph (l) of Rule 15c3-3 states, with regard to the delivery of securities, that nothing stated in Rule 15c3-3 shall be construed as affecting the absolute right of a customer of a broker-dealer to receive in the course of normal business operations following demand made on the broker-dealer, the physical delivery of certificates for:</p> <ol style="list-style-type: none"> <li>(1) Fully-paid securities to which he is entitled, and</li> <li>(2) Margin securities upon full payment by such customer to the</li> </ol>

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<p><b>How does your jurisdiction define the term "client"?</b></p>	<p><b>US-SEC</b></p> <p>The term "client" refers to a "customer," which is generally any person from whom or on whose behalf a broker-dealer has received or acquired or holds funds or securities for the account of that person.</p> <p>The "customer" also includes any other person to the extent that person has a claim for property or funds, which by contract agreement or understanding, or by operation of law, is part of the capital of the broker-dealer or is subordinated to the claims of creditors of the broker-dealer.</p> <p>The term "customer" generally does not include a broker-dealer, a municipal securities dealer, or a government securities broker or government securities dealer. (Exchange Act Rule 15c3-3(a)(1))</p>
<p><i>Pre-Insolvency Questions</i></p>	

**Appendix A - 2013 Client Asset Protection Questionnaire Summary**

	<b>US-SEC</b>
<b>Does the Regime require the Client Assets of each client to be placed in an individual account?</b>	No. An Investment Firm may hold client Securities on a customer omnibus basis at a "good control location" (e.g., a custodial bank) where the assets must be kept free of lien.
<b>How often does the Regime require the Investment Firm to reconcile its books and records with its segregation requirement?</b>	<p>(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.</p> <p>(ii) Generally, 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 on an aggregate basis. 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 on the second following business day after the Reserve Computation is made (e.g., usually on a Tuesday, for a Friday Reserve Computation).</p>

**Appendix A - 2013 Client Asset Protection Questionnaire Summary**

	<b>US-SEC</b>
<b>Does the Regime permit the Investment Firm to temporarily hold less Client Assets than the amount specified in the segregation requirement?</b>	No. Exchange Act Rule 15c3-3(e)(1) requires an Investment Firm to at all times maintain in its reserve bank account, cash and/or qualified securities in an amount not less than the amount calculated in the Reserve Computation. If an Investment Firm fails to make its required deposit, it must immediately notify its regulator. The Investment Firm generally performs its Reserve Computation on a Friday (as of the close of the last business day of the week), and makes any required deposit the next Tuesday.
<b>If a client has a debit balance, does the Regime permit the Investment Firm to deduct such balance in determining its segregation requirement? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?</b>	Yes. An Investment Firm's obligation with respect to protecting customer assets may be reduced, within limits, to reflect debit balances. The Investment Firm includes customer debit balances in its Reserve Computation.

**Appendix A - 2013 Client Asset Protection Questionnaire Summary**

	<b>US-SEC</b>
<b>Does the Regime permit the Investment Firm to treat different types of Client Assets (i.e., cash and securities) as fungible?</b>	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.
<b>Does the Regime permit the Investment Firm to maintain its own assets in the Client Account as a "buffer" against violating segregation requirements?</b>	Yes. The Regime encourages the Investment Firm to create a "buffer" and most do so.

**Appendix A - 2013 Client Asset Protection Questionnaire Summary**

	<b>US-SEC</b>
<p><b>Does the Regime permit the Investment Firm to encumber, re-hypothecate, or otherwise use Client Assets?</b></p>	<p>Yes, within limits and with client consent:</p> <ul style="list-style-type: none"> <li>• Margin securities (securities carried for a customer in a margin account, with market value equal to (or less than) 140% of the account's debit balance) are left available to the broker-dealer to finance the debit balance and may be used as collateral for bank loans or stock loans or repurchase agreements;</li> <li>• broker-deals may use customer free credit balances only to finance customer-related debits (e.g. customers' margin loans);</li> <li>• broker-dealers must obtain a customer's written consent to hypothecate securities where permitted to commingle customer securities and must give written notice to a pledgee that, among other things, a security pledged is carried for the account of a customer.</li> </ul>
<p><b>How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?</b></p>	

**Appendix A - 2013 Client Asset Protection Questionnaire Summary**

	<b>US-SEC</b>
<b>How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?</b>	Written consent, for the purposes of Rules Rules 8c-1 and 15c2-1 and 17a-3 of the Exchange Act, is generally obtained through a margin agreement.
<b>How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (i.e., established by statute or regulation, established by <del>or</del> judicial decision?</b>	A Client remains entitled to the return of its cash and securities from the broker-dealer (See Exchange Act Rule 15c3-3(a)(8)) defining "free credit balances"; and 15c3-3(l) relating to delivery of securities).
<b>Does the Regime permit the Investment Firm to hold Client Assets with a third-party affiliate?</b>	Yes. 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:  <ul style="list-style-type: none"> <li>• Securities under the custody and control of a clearing corporation or other subsidiary of either a national securities exchange or a</li> </ul>

**Appendix A - 2013 Client Asset Protection Questionnaire Summary**

	US-SEC
<p><b>Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)? If so, what protections are applicable to the Foreign Investment Firm’s Client Assets? What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets? What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?</b></p>	<p>Yes. The customer protection rules generally do not differentiate between U.S. and foreign clients.</p>
<p><b>Does the Regime permit clients to waive or otherwise reduce or vary any of the Client Asset protection requirements?</b></p>	<p>No. However, a customer may enter into a transaction that is not protected under SIPA if given appropriate notice.</p>

**Appendix A - 2013 Client Asset Protection Questionnaire Summary**

	<b>US-SEC</b>
<b>Under the Regime, what actions may the Regulator take to protect the Clients Assets of an Investment Firm in distress?</b>	<p>(i) An Investment Firm that does not have sufficient net capital must cease conducting business.</p> <p>(ii) An Investment Firm that is otherwise in financial difficulty may be required by its self-regulatory organization to take specific corrective or prophylactic actions, such as reducing their business.</p> <p>(iii) The SEC may petition the court for a freeze on the assets of the Investment Firm.</p> <p>(iv) If it appears that the Investment Firm may not survive its financial difficulty, the SEC 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).</p>

**Appendix A - 2013 Client Asset Protection Questionnaire Summary**

	<b>US-SEC</b>
<p><b>Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically, does the Investment Firm report where client assets are held? Does the Investment Firm or depository report the protections applicable to such client assets? Does the Investment Firm or depository report the amount of assets that are held? In each case, are such reports provided on request or periodically? If periodically, with what frequency?</b></p>	<p>•The SEC requires broker-dealers to file monthly, quarterly, and annual financial reports (commonly referred to as “FOCUS reports”). The FOCUS report includes:</p> <ul style="list-style-type: none"> <li>• a statement of financial condition;</li> <li>• a statement of income;</li> <li>• a statement of changes in ownership equity;</li> <li>• a net capital computation; and</li> <li>• a reserve computation under Exchange act Rule 15c3-3.</li> </ul> <p>Broker-dealers that carry customer accounts generally file FOCUS reports monthly.</p> <ul style="list-style-type: none"> <li>• A broker-dealer also must file an annual audit with the SEC and its designated examining authority under Exchange Act Rule 17a-5(d).</li> </ul> <p>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.</p> <ul style="list-style-type: none"> <li>• Pursuant to Exchange Act Rule 15c3-3, a broker-dealer must immediately notify the SEC and its designated examining authority if the broker-dealer fails to make a required deposit in its reserve bank account. The broker-dealer must promptly thereafter confirm such</li> </ul>

**Appendix A - 2013 Client Asset Protection Questionnaire Summary**

	<b>US-SEC</b>
<p><b>What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify where Client Assets are held, the amount of Client Assets held at a depository, and the safeguards applicable to Client Assets held at a depository?</b></p>	<p>Exchange Act Section 17(b) currently subjects broker-dealers to routine inspections and examinations by staff of the SEC and the relevant SRO.</p> <p>Section 17 of the Exchange Act, together with Exchange Act Rule 17a-5, require a broker-dealer to, among other things, file an annual report with the SEC and the broker-dealer's designated examining authority. The report must contain audited financial statements and certain supporting schedules and supplemental reports, as applicable. An independent public accountant registered with the Public Company Accounting Oversight Board (PCAOB) must conduct the audit.</p> <p>FINRA rules are also relevant.</p> <ul style="list-style-type: none"> <li>• Under FINRA Rule 4110, FINRA may impose greater capital requirements on clearing or carrying broker-dealers for the protection of investors or when in the public interest.</li> <li>• FINRA Rule 4160 (verification of assets) states that a FINRA member firm, when notified by FINRA, may not continue to custody or retain record ownership of assets, whether such assets are proprietary or customer assets, at a financial institution that is not a member of FINRA, which, upon FINRA staff's request, fails promptly to provide FINRA with written verification of assets maintained by the member at such financial institution.</li> <li>• FINRA has made arrangements with the DTCC that provides FINRA with routine and direct access to position reports and similar information that DTCC (and its subsidiaries and affiliates) provides to its participants.</li> </ul>

**Appendix A - 2013 Client Asset Protection Questionnaire Summary**

	<b>US-SEC</b>
<p><b>Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (i.e., of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify the amount and/or value of such Client Assets, and the protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?</b></p>	<p>A foreign regulator could obtain confirmation directly from the U.S. investment firm. Moreover, where there is an applicable MOU, the foreign regulator could obtain information through the MOU.</p> <p>Such client assets are generally entitled to the same protections as the client assets of U.S. customers as set forth under SIPA.</p>
<i>Post-Insolvency Questions</i>	

**Appendix A - 2013 Client Asset Protection Questionnaire Summary**

	<b>US-SEC</b>
<p><b>Under the Regime, how does an Investment Firm enter the status of "insolvent," "bankrupt," or the equivalent?</b></p>	<p>Generally, Investment Firms self-liquidate by transferring customer accounts to a new firm. When self-liquidation is not possible, a court supervised proceeding is conducted under SIPA. The Securities Investor Protection Corporation may file an application for a protective decree with any court of competent jurisdiction. Liquidation proceedings are different for Investment Firms than for other companies.</p>
<p><b>Under the Regime, what is the process of appointing an Administrative Officer?</b></p>	<p>The court appoints (i) the Administrative Officer and (ii) counsel to the Administrative Officer, such persons as the Securities Investor Protection Corporation, in its sole discretion, specifies.</p>

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	<b>US-SEC</b>
<b>What guidance is available to such Administrative Officer?</b>	The Securities Investor Protection Act provides specific procedures for the liquidation of an Investment Firm.
<b>What is the standard of liability for such Administrative Officer?</b>	Liability for gross negligence or willful disregard of fiduciary duties.

**Appendix A - 2013 Client Asset Protection Questionnaire Summary**

	<b>US-SEC</b>
<b>How is the regulator involved in the insolvency of an Investment Firm, including in the return of Client Assets?</b>	The SEC oversees the Securities Investor Protection Corporation, which, in turn, oversees the Administrative Officer. The SEC 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.

**Appendix A - 2013 Client Asset Protection Questionnaire Summary**

	<b>US-SEC</b>
<b>What are the requirements, if any, governing the segregation and treatment of Client Assets during the insolvency of an Investment Firm?</b>	<p>The Trustee is required to treat all Client Assets in accordance with the provisions as set forth under SIPA. SIPA defines the terms "customer," "customer property," "net equity" and other terms. These definitions provide important guidance for implementation of the requirements of SIPA and, in particular, how client assets are to be treated during the liquidation process.</p>
<b>Does the Regime facilitate or encourage the transfer of Client Assets from an insolvent Investment Firm to a solvent Investment Firm?</b>	<p>The Regime aims to effect transfer of Client Assets. 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.</p> <p>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.</p> <p>If a bulk transfer is not possible, the trustee returns customer securities and cash directly to customers through a claims process.</p>
<b>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?</b>	<p>Generally no, but in very limited circumstances the Administrative Officer would have authority to sue for the return of such assets.</p>

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	<b>US-SEC</b>
<b>Does the Regime have a scheme to compensate clients for losses suffered due to the insolvency of the Investment Firm?</b>	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.
<b>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?</b>	No, but customers may enter into a transaction that is not protected under SIPA if given appropriate notice.
<b>If there is a shortfall (i.e., client claims exceed Client Assets), then how does the Regime allocate such loss?</b>	There would be a pro rata distribution that would be supplemented up to \$500,000 per account including a maximum of \$250,000 for cash claims.

**Appendix B – Collated Responses to the Client Asset Protection Survey**

## Australia

### 2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

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(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.*

### Relevant statutes, regulations and other references

- Corporations Act 2001
- Corporations Regulations 2001
- ASIC Market Integrity Rules (ASX Market) 2010
- ASIC Market Integrity Rules (ASX 24 Market) 2010
- ASIC Market Integrity Rules (Chi-X Australia Market) 2011
- ASIC Regulatory Guide 212 *Client money relating to dealing in OTC derivatives*
- ASIC Report 316 *Report on client money handling practices in the retail derivatives sector*

### List of Relevant Acronyms (not exhaustive)

<b>ADI</b>	Authorised Deposit-taking Institution
<b>AFSL</b>	Australian Financial Services Licence
<b>AML</b>	Australian Market Licence
<b>APRA</b>	Australian Prudential Regulation Authority

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<b>ASIC</b>	Australian Securities and Investments Commission
<b>ASX</b>	Australian Securities Exchange
<b>ASX Clear</b>	ASX Clear P/L, a subsidiary of ASX Ltd that provides all clearing services for transactions entered into on ASX's financial products markets
<b>Chi-X</b>	Chi-X Australia is an alternate trading venue for products listed on the ASX.
<b>ASX Settlement</b>	ASX Settlement Pty Limited, a subsidiary of ASX that provides all settlement services for transactions entered into on ASX's financial products markets
<b>ASX 24</b>	The market and trading platform operated by the Australian Securities Exchange
<b>ASX Clear (Futures)</b>	ASX Clear (Futures) Pty Limited, the clearing house for the ASX 24 market.
<b>LEPO</b>	Low Exercise Price Option
<b>NGF</b>	National Guarantee Fund
<b>PDS</b>	Product Disclosure Statement
<b>SEGC</b>	Securities Exchange Guarantee Corporation
<b>SFE</b>	Sydney Futures Exchange
<b>SLF</b>	Surplus Liquid Funds

### **Context**

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

The Corporations Act 2001 (the **Act**) is the primary legislation for the protection of Client Assets in Australia. The Act is supplemented by the Corporations Regulations 2001 (the **Regulations**). In this paper, a reference to a section, subsection, paragraph and subparagraph is a reference to a section, subsection, paragraph or subparagraph of the Act and a reference to a regulation is a reference to a regulation of the Regulations, unless otherwise indicated.

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

- (a) Part 7.8 of the Act contains the provisions for the protection of both Client Money and Client Property (Client Asset Protection Provisions). This paper will deal with the Client Asset Protection Provisions as they relate to both Client Money and Client Property, which together form Client Assets.

The Client Asset Protection Provisions are largely principles-based, aiming to protect Client Assets by:

- (i) separating Client Money from those of the Investment Firm;
- (ii) generally requiring that Client Assets are held on trust for the benefit of the client;
- (iii) requiring that Client Assets are only used, or in the case of Client Money, withdrawn and invested as permitted under Part 7.8;
- (iv) prohibiting or restricting the basis on which, Client Assets may be attached or used as security;
- (v) requiring auditors to verify an Investment Firm's compliance with the Client Asset Protection Provisions in Part 7.8 in the Firm's financial records;
- (vi) specifying how Client Money may be dealt with if the Investment Firm ceases to be licensed or becomes insolvent; and
- (vii) imposing sanctions on an Investment Firm that fails to comply with the Client Asset Protection Provisions in Part 7.8.

Specific provisions apply to Client Money and to Client Property respectively. The Client Asset Protection Provisions do not distinguish between retail and wholesale clients.

- (b) The Act does not address the treatment of Positions. This is left to contractual terms between the Investment Firm and the client.
- (c) Investment Firms must comply with the Client Asset Protection Provisions. A breach constitutes an offence under the Act. As part of our supervisory functions, ASIC can seek information from Investment Firms on compliance with these provisions. Further, pursuant to section 983A, on application by ASIC, a court may order Client Money accounts be frozen if it is satisfied:
  - (i) there are reasonable grounds for believing there is a deficiency in the client money account (whether the account is maintained in Australia or elsewhere);
  - (ii) there has been undue delay, or unreasonable refusal, on the person's part in paying, applying or accounting for Client Money; or
  - (iii) there has been a breach of section 981B.
- (d) Client Money issues do not typically 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

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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.

- (e) In addition, ASIC imposes further obligations on Investment Firms who are also market participants on the ASX, ASX 24 and Chi-X market. These obligations are contained within the:
- (i) ASIC Market Integrity Rules (ASX Market) 2010 Part 3.5 Client Money and Property;
  - (ii) ASIC Market Integrity Rules (ASX 24 Market) 2010 Rule 2.2.6 Clients' Segregated Account obligations and Part 2.3 Account Reconciliation Obligations; and
  - (iii) ASIC Market Integrity Rules (Chi-X Market) Part 3.5 Client Money and Property.

These rules detail how market participants are required to deal with margining obligations, holding client money and holding client property.

For example, on the ASX 24 Market, a market participant is required to deposit Client Money for trading on the ASX 24 market into a clients' segregated account on the day it is received, or by the next business day. It also specifies what Client Money can be deposited, permissible investments, permitted withdrawals from the account and the requirement to maintain accounting records.

- (f) In addition to complying with the statutory requirements of Part 7.8 and exchange and clearing house requirements, a person carrying on a financial services business of a type described in the definition of 'Investment Firm' must hold an appropriate Australian Financial Services Licence (AFSL). A condition of the AFSL is that the Licensee must comply with Australia's financial services laws. An AFSL 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 an Investment Firm is a reference to a person who is an AFSL holder.
- (g) An Investment Firm is permitted to use Client Money that is related to derivatives as margin in accordance with section 981D.
- (h) An Investment Firm is permitted to use Client Property that is related to derivatives as margin in accordance with subsection 984B(2).
- a. How does your jurisdiction define the term “client assets?” If the jurisdiction uses an analogous term, please provide that term and its definition.

The Act does not define the term 'Client Assets' as such. However Subdivision A of Division 2 of Part 7.8 describes the money and property to which the Client Asset Protection Provisions will apply.

### Client Money

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Section 981A in Division 2 describes money to which the protective provisions of Division 2, Subdivision A will apply.

Under this section, Client Money is money paid to an Investment Firm in the following circumstances:

- (a) the money is paid in connection with:
  - (i) a financial service that has been provided, or that will or may be provided, to a person (the *client*); or
  - (ii) a financial product held by a person (the *client*); and
- (b) the money is paid:
  - (i) by the client; or
  - (ii) by a person acting on behalf of the client; or
  - (iii) to the Investment Firm in the Firm's capacity as a person acting on behalf of the client.

The Client Money Protection Provisions in Subdivision A of Division 2 do not apply to money paid to the extent that:

- (a) the money is paid by way of remuneration payable to the Investment Firm, or the Investment Firm is entitled to deduct such remuneration from the money; or
- (b) the money is paid:
  - (i) to reimburse the Investment Firm for payments made to acquire, or acquire an increased interest in, a financial product; or
  - (ii) to discharge a liability incurred by the Investment Firm in respect of the acquisition of a financial product or an increased interest in a financial product, or to indemnify the Investment Firm in respect of such a liability; or
- (c) the money is paid to acquire, or acquire an increased interest in, a financial product from the Investment Firm, whether by way of issue or sale by the Firm; or
- (d) the Investment Firm is a licensed trustee company, and the money is paid to the Firm in connection with traditional trustee company services provided by the Firm; or
- (e) Subdivision B applies to the money. (Loan money is dealt separately in Subdivision B of Division 2. Section 982A describes money to which that subdivision applies).

Further, the Client Money Protection Provisions do not apply:

- (f) to a payment if a person pays money to an Investment Firm in order for it to be deposited to the credit of a deposit product held by the person or another person with the Firm; or
- (g) property other than money (e.g. share certificates). This property is dealt with as Client Property under Division 3 of Part 7.8. See further below.

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### Client Property

Section 984A of Division 3 of the Act describes property to which the protection provisions of Part 7.8 will apply.

Client Property is property other than money (for example, share certificates) that is given to an Investment Firm in the following circumstances:

- (a) the property is given in connection with:
  - (i) a financial service that has been provided, or that will or may be provided, to a person (the *client*); or
  - (ii) a financial product held by a person (the *client*); and
- (b) the property is given:
  - (i) by the client; or
  - (ii) by a person acting on behalf of the client or for the client; or
  - (iii) for the benefit of the client; or
  - (iv) the Investment Firm is accountable for the property.

Property that is given as security for a standard margin lending facility is exempt from the client asset protection obligations of Division 3.

- b. What is the nature of a client's ownership rights with respect to its client assets placed with the investment firm?

### Client Money

The Act does not refer to or specifically address 'ownership rights'. However, it does impose fiduciary obligations on an Investment Firm in favor of the client with respect to Client Money to the extent that:

- (a) the Investment Firm must operate the client money account into which all Client Money must be paid as a trust account (regulation 7.8.01(5)(a)); and
- (b) hold all moneys paid into the client money account (with limited exceptions – see below) on trust for the benefit of the person who is entitled to the moneys (regulation 7.8.01(5)(c)).

This is reinforced by subsection 981H(1) which provides that money is taken to be held in trust by the Investment Firm for the benefit of the client.

These obligations may be displaced by and/or are subject to (as applicable):

- (a) the Regulations (for example, regulation 7.8.01(5)(c) provides for an exception to the obligation to hold all monies paid into the account on trust for the benefit of the person entitled to the moneys if the moneys are paid to an Investment Firm under the Firm's obligation to call margins from clients under the market integrity rules, the operating rules of a licensed market or the operating rules of a licensed clearing settlement facility (**Rules**). In

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this case, the Investment Firm may operate the account as either a segregated account or a trust account); and

(b) relief granted by ASIC.

### Client Property

The Act does not refer to or specifically address 'ownership rights' with respect to Client Property. However, it does impose a fiduciary obligation on an Investment Firm to hold the Client Property in trust for the benefit of the person who is entitled to it (regulation 7.8.07(2)).

As with Client Money, these obligations may be displaced by and/or are subject to (as applicable):

(a) the Regulations (for example, under regulation 7.8.06A property given as security for a standard margin lending facility is exempt from Division 3 of Part 7.8); and

(b) relief granted by ASIC.

c. How does your jurisdiction define the term “client”? If the jurisdiction uses an analogous term, please provide that term and its definition.

For the purposes of Divisions 2 and 3 of Part 7.8, a 'client' is a person who has been, may be or will be provided with, a financial service or who holds the financial product, in relation to:

(a) Client Money (subsection 981A(1)): money paid to the Investment Firm in connection with such financial service or financial product (but not necessarily paid by the client);

(b) Client Property (section 984A): property is given to the Investment Firm in connection with such financial service or financial product (but not necessarily by the client).

These Divisions in Part 7.8 do not distinguish between a 'retail client' and a 'wholesale client' (in effect, a sophisticated investor). This means that the obligations of the Investment Firm apply regardless of the client categorisation. Rather, it is the categorisation of money as Client Money and property as Client Property which attracts the Client Asset Protection Provisions.

For the purposes of ASX 24 market participants, a 'Client' is defined to mean any person, partnership or Corporation on behalf of whom the market participant enters, acquires or disposes of a futures contract or option contract; or on whose behalf the market participant proposes to enter, acquire or dispose of a futures contract or options contract; or from whom the market participants accepts instructions to do so (ASIC Market Integrity Rules (ASX 24 Market) Rule 1.4.3).

For the purposes of futures contracts traded on the ASX, 'Client' is defined to mean a person on behalf of whom the market participant deals, or from whom the market participant accepts instructions to deal, in futures contracts (ASIC Market Integrity Rules (ASX Market) Rule 3.5.8).

d. Please describe any notable exclusions from the terms “client” or “client assets.”

### Client

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There are no statutory exclusions to the term 'client'. However, ASIC may grant relief from the Client Asset Protection Provisions in certain circumstances. For example ASIC may modify section 981B to enable money of clients that are resident in specified jurisdictions to be held in accounts of specified overseas financial institutions.

For the purposes of the ASX 24 clients' segregated account obligations 'Client' is defined to exclude a related body corporate as defined in the Act or a division of the market participant.

### Client Money

Please refer to response for question 1 (a).

### Client Property

Please refer to response for question 1(a).

*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? **No.**
  - 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?

There are no special authorisation requirements for Investment Firms to hold Client Assets. However, as discussed above, Investment Firms must hold an AFSL to carry on a financial services business in Australia.

Prior to being issued an AFSL, 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

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(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 AFSL 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 Asset Protection Provisions and further to that, a requirement to report significant breaches to ASIC, which may include breaches of these Provisions.

Section 912A of the Act requires AFSL holders to:

- do all things necessary to ensure that the financial services covered by the Investment Firm's AFSL are provided efficiently, honestly and fairly;
- have in place adequate arrangements for the management of conflicts of interest in relation to activities undertaken by the licensee or its representative in the provision of financial services;
- comply with conditions on the AFSL;
- comply with the financial services law (as defined under the Act);
- take reasonable steps to ensure that the Investment Firm's representatives comply with the financial services law;
- have available adequate resources including financial, technological and human resources to provide the financial service to provide the (licensed) financial services and to carry out supervisory arrangements (this does not apply to an Investment Firm that is also supervised by the Australian Prudential Regulation Authority (APRA));
- maintain the competence to provide the financial services;
- ensure that the Investment Firm's representatives are adequately trained and competent to provide the financial service;
- provide a dispute resolution system for retail clients (see section 761G for definition of retail client);
- have adequate risk management procedures in place (does not apply to an Investment Firm that is also supervised by APRA); and
- have compensation arrangements if financial services are provided to retail clients (specified under section 912B).

In addition to the requirements above, Investment Firms (excluding licensees prudentially regulated by APRA and market and clearing participants registered with the ASX, Chi-X, ASX 24 or ASX Clear) that hold Client Money or Client Property must comply with additional financial requirements.

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Specifically, if at any time an Investment Firm:

- (a) is required to hold money in a separate account under Division 2 of Part 7.8;
- (b) holds money or other property on trust for a client or is required to do so under regulation 7.8.07(2) or otherwise; or
- (c) has the power to dispose of a client's property under power of attorney or otherwise,

the Investment Firm must hold at least \$50,000 in surplus liquid funds (SLF) unless the value of the money and property for all clients in total is less than \$100,000. This does not apply to an Investment Firm who is registered as a market and clearing participant with the ASX, Chi-X, ASX Clear, or who is otherwise regulated by APRA (essentially ADIs, insurance companies and superannuation entities). The SLF requirement also does not apply to an ASX 24 and/or ASX Clear (Futures) participant who restricts their financial services business to participating in the ASX 24 market or ASX Clear (Futures) market respectively and incidental business. Investment Firms within these categories will have to comply with ASX, Chi-X, ASX 24, ASX Clear, ASX Clear (Futures) or APRA requirements, as the case may be.

Under section 989B, an Investment Firm 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. Pursuant to regulation 7.8.13 the auditor's report must contain a statement of the auditor's opinion of:

- (a) the effectiveness of internal controls used by the Investment Firm to comply with the Client Money and Client Property provisions;
- (b) whether each Client Money account required to be maintained by the Investment Firm has been operated and controlled in accordance with the Client Money protection provisions of Division 2; and
- (c) whether all necessary records, information and explanations were received from the Investment Firm.

In addition to reviewing an auditor's report, ASIC also undertakes a risk-based approach to the review and testing of an Investment Firm's compliance the Client Asset Protection Provisions.

### *Additional requirements for market participants*

In addition to the requirements under the Act, Investment Firms who directly execute, clear or settle securities/derivatives in relation to products traded on the market will also need to be admitted as a participant of the relevant market. As a participant of the ASX, ASX Clear, Chi-X, ASX 24 and/or ASX Clear (Futures), the Investment Firm is required to comply with the relevant ASIC Market Integrity Rules, ASX or Chi-X Operating and/ or Clearing Rules (as applicable) on an ongoing basis.

ASX 24 market participants that hold client monies are required to submit an independent audit report confirming they have suitably designed and effective internal controls to comply with the obligations in relation to clients' segregated accounts: ASIC Market Integrity Rules (ASX 24) 2.3.5.

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For ASX market participants that are not recognised as principal traders, 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 the capital requirement.

Similarly, for ASX 24 market participants that are not recognised as principal traders, there is a requirement to submit an independent auditor's report confirming compliance with their capital 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.

### Client Money

Paragraph 981B(1)(a) requires Client Money to be paid into an account that is:

- (i) an account with an Australian ADI; or
- (ii) of a kind prescribed by regulation 7.8.01(2), namely an account with an approved foreign bank or a cash management trust.

The requirement for Client Money to be kept separate from the Investment Firm's own assets is achieved through paragraph 981B(1)(b). Under this paragraph, the only money that can be paid into the client money account is (in summary):

- (i) Client Money;
- (ii) interest standing to the credit of the client money account;
- (iii) interest on permitted investments using Client Money or the proceeds of the realisation of permitted investments;
- (iv) money paid by an Investment Firm into a client money account due to the requirements of the Rules;
- (v) other money permitted to be (initially) paid into the account by the Regulations, e.g. mixed money and unidentified money.

Under section 981B, an Investment Firm must pay Client Money into a client money account on the day the Firm receives it or on the next business day.

The requirement for separation of Client Money is reinforced through regulations 7.8.01(5) and 7.8.01 (11) – (14) (inclusive).

Under regulation 7.8.01(5), a client money account must be designated and operated as a trust account and, unless money has been paid to the Investment Firm pursuant to the Firm's obligations under the Rules, the Firm must hold all money paid into the account on trust for the benefit of the person who is entitled to the money. If the exception applies, the Investment Firm must still segregate Client Money from their own funds but may operate the account as a

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segregated account or a trust account and may pay all Client Money into that account (i.e. even if some of the Client Money is not for the purposes of margins collected under the relevant rules). In this case, pursuant to section 981H, Client Money is taken to be held on trust for the benefit of the client except for that portion of money paid to the Investment Firm for margins required under the relevant rules.

Regulation 7.8.01(11) allows mixed money and unidentified money to be paid into a client money account. However in the case of:

- (i) mixed money (i.e. money that is received by the Investment Firm as a single payment and is not wholly Client Money but includes Client Money): the Investment Firm must remove the part of the mixed money that is not Client Money as soon as practicable but within one month after the mixed money is paid into the client money account;
- (ii) unidentified money (i.e. money that the Investment Firm receives as a single payment where, at the time of receipt, the Investment Firm is unable to identify whether the money is Client Money or mixed money that might include client money): the Investment Firm must identify any part of the money that is not Client Money and remove it from the client money account as soon as practicable.

ASIC has stated in 'Regulatory Guide 212 Client money relating to dealing in OTC derivatives' (**RG212**) that the Client Money provisions of the Act do not permit an Investment Firm to deposit its own funds into a client money account by way of 'buffer' or otherwise. It is ASIC's position that buffers cannot be used by an Investment Firm as a way of ensuring that there are adequate funds in the client money account to ensure that the Investment Firm does not face a shortfall in the account when payments are made from the client money account, e.g. as a result of incorrect bank fees or other unintended or uncontrollable errors that may reduce the balance of the account.

### Client Property

Under subsection 984B(1), an Investment Firm must ensure that Client Property is only dealt with in accordance with the Regulations, the terms and conditions on which the Client Property was given to the Investment Firm and any subsequent instructions given by the client. There is provision for Client Property to be used for the purpose of meeting margin requirements for hedging (even where the relevant dealings do not pertain specifically to the client) under subsection 984B(2).

The Regulations essentially require that 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 the client. There is no absolute requirement for the property to be held with a third party custodian or with an Australian ADI.

Under regulation 7.8.07(8) an Investment Firm must not deposit Client Property as security for a loan or advance to the Investment Firm unless:

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- (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).

### *Additional requirements for market participants*

In addition, ASX market participants must establish one or more clients' trust accounts or clients' segregated accounts if they receive money from clients for:

- futures market transactions; and
- options market transactions over an underlying financial product which is a futures market contract: ASIC Market Integrity Rules (ASX) 3.5.2.

Chi-X market participants that receive money in connection with dealings in equity market transactions must establish one or more clients' trust accounts: ASIC Market Integrity Rules (Chi-X) 3.5.1

ASX 24 market participants must:

- deposit monies received from clients or persons acting on behalf of clients into an account maintained by the ASX 24 market participant and designated as a clients' segregated account;
- comply with rules regulating permitted deposits into and permitted withdrawals from a clients' segregated account, rules dealing with permissible investments, payments to another AFSL holder, segregation of property, and maintaining accounting records for withdrawals;
- refrain from making an agreement with a client that the client's money is not to be held or does not need to be held in a segregated account for the benefit of the client;
- not use a clients' segregated account to meet any initial or variation liabilities which relate to trading by the ASX 24 market participant on its own behalf or a related corporation;
- keep Client Property segregated from the ASX 24 market participant's own property and ASX 24 market participants must be able to liquidate Client Property as soon as practicable when required; and

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- not use property held in safe custody to satisfy an ASX 24 Market Participant's debt: (ASIC Market Integrity Rules (ASX 24) 2.2.6).
- a. Must the Client Assets of one client be maintained separately from those of other clients?

No.

### Client Money

An Investment Firm is not required to maintain separate accounts for each client. Further, subsection 981B(2) allows an Investment Firm to maintain one or more client money accounts in which Client Money may be commingled. If an 'Omnibus Account' is used, regulation 7.8.05 requires that it must still be operated as a client money trust account and, subject to the exception under the Rules, hold all monies paid into the account on trust for the persons entitled to the monies.

If 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 (section 981D).

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.

#### *Additional requirements for market participants*

For ASX and Chi-X market participants, ASIC Market Integrity Rules provide that a trust account may include the property of multiple clients (ASIC Market Integrity Rules (ASX Market), Rule 3.5.1 and ASIC Market Integrity Rules (Chi-X Market), Rule 3.5.1). 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 clients' segregated account.

With respect to ASX 24 futures transactions, Client Money must be paid into a clients' segregated account on the day it is received by the Market Participant, or the next business day (ASIC Market Integrity Rule (ASX 24 Market), 2.2.6 (c)).

### Client Property

There is no statutory requirement for Client Property of one client to be kept separate from the Client Property of other clients. The primary obligation is for an Investment Firm to only deal with Client Property in accordance with the Regulations, the terms and conditions on which the Client Property was given to the Firm and any subsequent instructions given by the client.

Notably, subsection 984B(2) allows Client Property to be used for the purpose of the Investment Firm meeting obligations incurred by it in connection with margining, guaranteeing, securing,

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transferring or settling dealings in derivatives by the Firm (including dealings on behalf of people other than the client) if the financial service is or relates to a dealing in a derivative or the financial product is a derivative.

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

See response to question 3(a) above.

Where omnibus accounts are operated by an ASX 24 market participant (e.g. on behalf of another broker), a House account and Client account are to be maintained separately at all levels (including at the Clearing and Settlement Facility level) (ASIC Market Integrity Rules (ASX 24 Market), 2.2.6(a)(iii)).

ASX and Chi-X market participants may use omnibus accounts but there are no specific rules in place about the use of Omnibus accounts, except for futures market transactions which are dealt with in a similar way to the ASX 24 requirements.

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

### **Client Money**

Protection is afforded under the provisions which govern:

- (a) Permitted withdrawals from the client money account;
- (b) Permitted investments; and
- (c) Protection from attachment.

#### *Permitted Withdrawals*

Under regulation 7.8.02, payments which may be made out of a client money account are:

- (1) making a payment to, or in accordance with the written direction of, a person entitled to the money;
- (2) defraying brokerage and other proper charges;
- (3) paying to the Investment Firm money to which the Investment Firm is entitled;
- (4) making a payment of monies due to an insurer in connection with a contract of insurance;
- (5) making a payment that is otherwise authorised by law; and
- (6) paying to the Investment Firm money to which the Investment Firm is entitled pursuant to the market integrity rules or the operating rules of a financial market.

There is also provision under regulation 7.8.02(1A) for making a payment to another Investment Firm provided the receiving Investment Firm is notified that the money has been withdrawn from Client Money and pays it into its client money account.

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An Investment Firm may include broad authorisations, written directions and consent of the client which enable it to comply with its obligations under Division 2 of the Act while withdrawing Client Money from the client money account and using it for the purposes set out in the client agreement.

In addition, pursuant to section 981D, if a financial service is or relates to a dealing in a derivative or the financial product is a derivative, the Investment Firm may use the money 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.

This means 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.

In ASIC Regulatory Guides 212, ASIC states that:

- (a) any permitted use of Client Money for the purposes of meeting margin payments to the Investment Firm requires that the Firm has incurred an obligation in connection with margining, guaranteeing, securing, transferring, adjusting or settling dealings in derivatives (as permitted by section 981D) and does not permit the Firm to use Client Money or withdraw it from the client money account in anticipation of an obligation arising; and
- (b) the amount of Client Money that is used in exercise of this right should be limited to the amount necessary to meet the Investment Firm's obligations so incurred in connection with margining, guaranteeing, securing, transferring, adjusting or settling dealings in derivatives.

### *Permitted Investments*

Subject to certain exceptions to the application of the investment permissions (see below), regulation 7.8.02(2) permits the following kinds of investment in relation to a client money account:

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

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Pursuant to regulation 7.8.02(3) an Investment Firm must not invest Client Money in a way permitted by regulation 7.8.02(2) 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:

- (a) the making of the investment;
- (b) 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 client money account);
- (c) 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 client money account);
- (d) 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
- (e) the fee (if any) that the Investment Firm proposes to charge for the investment.

The restrictions on investment do not apply to those made in accordance with the written direction of the client (regulation 7.8.02(5)).

Market practice is that the Investment Firm typically obtains the client's written agreement to the investment by including an appropriate term in the client agreement. Investment of Client Money is disclosed to clients in the Investment Firm's PDS for the relevant financial service and financial product, e.g. contracts for difference as a derivative.

### *Protection from Attachment*

#### **Client Money**

Section 981E prohibits Client Money (both in a client money account and before or after it is paid into a client money account), other money which is in the account or investments made with Client Money from being attached or otherwise taken in execution or being made subject to set-off 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. However this does not apply to Client Money or Client Property used by the Investment Firm for margining which is typically posted to a counterparty without a lien or other security interest in favour of the client.

#### **Client Property**

The protection provisions of the Act which apply to Client Property are less extensive than those for Client Money.

Essentially the Client Property protection provisions require that, subject to an exception in subsection 984B(2), Client Property be only dealt with in accordance with the Regulations (which in turn govern the safe custody, registration and security arrangements for Client Property), the terms and conditions on which Client Property was given to the Investment Firm and any subsequent instructions given by the client. The exception contained in subsection 984B(2) is that if the financial service provided by the Investment Firm is or relates to a dealing

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in a derivative or the financial product is a derivative, the Client Property may be used for the purpose of meeting obligations incurred by the Investment Firm in connection with margining, guarantee, securing, transferring, adjusting or settling dealings in derivatives by the Firm (including dealings on behalf of people other than the client). This means that the Client Property of 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 Client Property held by the Investment Firm on their behalf if there is a deficit of Client Property and Client Money available to the Firm and the Investment Firm becomes insolvent or is otherwise unable to pay the deficiency.

In summary, under the regulations an Investment Firm must:

- (1) deposit Client Property in safe custody at the written request of the client or notify the client of their failure to do so;
- (2) if requested by the client, arrange for the body corporate that issued or made available the securities or managed investment products underlying the property, to register the Client Property in the name of a nominee controlled by the Firm;
- (3) not deposit the Client Property by way of security for a loan or advance to the Investment Firm unless certain conditions are met including that the client owes the Firm an amount in connection with a transaction entered into by the firm on the client's behalf. Within one business day of repayment, the Firm must withdraw the Client Property from the deposit facility.

### *Additional requirements for market participants*

If a ASX or ASX 24 market participant invests money from a clients' segregated account pursuant to paragraph 981C(a), the investment must be readily realisable and at least 50 per cent of the money invested under that section must be invested on 24 hour call terms (ASIC Market Integrity Rules (ASX Market), Rule 3.5.6 and ASIC Market Integrity Rules (ASX 24 Market), Rule 2.2.6).).

If a client does not satisfy its margin or settlement obligations the Investment Firm must pay into the clients' 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 (ASIC Market Integrity Rules (ASX Market), Rule 3.5.7 and ASIC Market Integrity Rules (ASX 24 Market), Rule 2.2.6).

ASX 24 market participants are specifically prohibited from using client money to satisfy 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 (ASIC Market Integrity Rule (ASX 24) 2.2.6(j))

Client Money belonging to one client may, however, be used by Investment Firms to meet margin obligations of other clients. This exposes the client to the risk that they may not receive back all the money held by the Investment Firm, on their behalf, in the client money account, if:

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- there is a deficiency in the client money account; and
- the Investment Firm becomes insolvent or is otherwise unable to pay the deficiency.

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 Act does not expressly require an Investment Firm to reconcile the Client Asset Account.

However, in its 'Report 316 Review of Client money handling practices in the retail OTC derivatives sector', ASIC expresses the view that effective Client Money accounting and reconciliation processes are fundamental to risk management for Investment Firms because they serve as key controls that prevent deficiencies arising in Client Money accounts. This is in the context of the requirement for AFSL holders, such as Investment Firms, to have adequate risk management systems under paragraph 912A(1)(b). ASIC also expresses the view that daily reconciliations may identify and resolve Client Money account deficiencies in a timely manner.

See also the response to question 3(b)(ii) below with regard to reconciliation requirements for market participants.

In addition, an Investment Firm must keep financial records that correctly record and explain all money received or paid by the Investment Firm in relation to a client money account and explain all money received or paid by the Investment Firm in relation to a client money account (sections 988A and 988E and regulation 7.7.11).

Further, pursuant to section 989B and regulation 7.8.13, an auditor's report lodged with an Investment Firm's financial statements must contain a statement of the auditor's opinion of:

- (a) The effectiveness of internal controls used by the Investment Firm to comply with the Client Money and Client Property provisions in Divisions 2 and 3 of Part 7.8;
- (b) Whether each client money account required to be maintained by the Investment Firm has been operated and controlled in accordance with the Client Money provisions; and
- (c) Whether all necessary records, information and explanations were received from 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?

The Act does not deal with this issue specifically. However, in practice Client Assets are fungible within Client Money and Client Property classes respectively.

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

Please see response to question 3(b)(ii)(C) below.

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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? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

The Act regulates payments in and payments out of the client money statutory trust account. The Act does not specify how to determine what balance should be held.

For the purposes of performing daily reconciliations of Client Money, participants of the ASX, Chi-X and ASX 24 market deduct a client's debit balance 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?

See generally the response to question 2(b)( i) above.

Although the Act does not specify when the reconciliation is required (see however, *Additional requirements for ASX, Chi-X and ASX 24 market participants* below) generally Investment Firms conduct reconciliations daily on an aggregate basis. An Investment Firm will use their own funds to account for the deficiency however the Act does not contain any deeming provisions in this situation. See response to question 2 on authorization and financial requirements for more information.

In RG 212, ASIC states that this record keeping would include prudent reconciliation processes to ensure the accuracy of the financial records.

### *Additional requirements for ASX and Chi-X market participants*

ASX and Chi-X market participants must perform a reconciliation of clients' trust accounts and segregated accounts.

In relation to clients' trust accounts this must reconcile:

- the aggregate balance held by it at the close of business on each business day in clients' trust accounts and the corresponding balance as recorded in the ASX or Chi-X market participant's accounting records; and
- the balance held by it at the close of business on the last business day of each week on trust for each person on whose behalf money is held in a trust account and the corresponding balance as recorded in the ASX or Chi-X Market Participant's accounting

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records (Market Integrity Rules (ASX Market) Rule 3.5.9 or ASIC Market Integrity Rules (Chi-X Market) Rule 3.5.9).

ASX and Chi-X market participants must prepare a schedule of trust account amounts by no later than 5 business days after 31 March, 30 June, 30 September and 31 December in each year 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 (ASIC Market Integrity Rules (ASX Market) Rule 3.5.11 and ASIC Market Integrity Rules (Chi-X Market) Rule 3.5.11).

In relation to clients' segregated accounts, an ASX market participant must reconcile the aggregate balance held by it at the close of business on each business day in clients' segregated accounts and the corresponding balance as recorded in the ASX market participant's accounting records (ASIC Market Integrity Rules (ASX Market) Rule 3.5.8). This requirement does not apply to Chi-X market participants

Responsible executives of ASX and Chi-X market participants (or persons authorised in writing by a responsible executive) must also sign a statement stating that the signatory believes, and has no reason not to believe, that the reconciliation is accurate in all respects (ASIC Market Integrity Rules (ASX Market) Rule 3.5.9(1)(d) and ASIC Market Integrity Rules (Chi-X Market) Rule 3.5.9(1)(d)).

ASX and Chi-X Market Participant must notify ASIC in writing within two business days if they:

- do not perform such a reconciliation in accordance with the relevant rule; or
- perform such a reconciliation which then reveals a deficiency of funds in the trust accounts. (See Rule 3.5.10 of both the ASIC Market Integrity Rules (ASX Market) and ASIC Market Integrity Rules (Chi-X Market))

An ASX market participant must also notify ASIC within two business days if reconciliation under Rule 3.5.8 of the ASX Market Integrity Rules reveals that total deposits are less than total third party client money (ASIC Market Integrity Rules (ASX Market), Rule 3.5.10(c)).

### *Additional requirements for ASX 24 market participants*

ASX 24 market participants must perform a daily reconciliation of client funds by 7pm on the business day after the business day to which the reconciliation relates. The reconciliation must be of the aggregate balance held by the ASX 24 market participant in the clients' segregated account at the close of each business day and the corresponding balance in the market participant's accounting record (ASIC Market Integrity Rules (ASX 24 Market), Rule 2.3.2).

An ASX 24 market participant must notify ASIC, in writing, within 2 business days, if:

- the reconciliation has not been performed;
- the total deposits is less than total third party client money; or
- if it is unable to reconcile its clients' segregated account. (ASIC Market Integrity Rules (ASX 24 Market), Rule 2.3.4)

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ASX 24 market participants also have an obligation to perform a monthly reconciliation of clients' segregated accounts and provide this to ASIC (ASIC Market Integrity Rules (ASX 24 Market), Rule 2.3.3).

ASX 24 market participants must reconcile the aggregate balance held by it in the clients' segregated account at the close of each business day and the corresponding balance in the market participant's accounting record.

The monthly reconciliation of client funds must be given to ASIC by the last business day of the calendar month following the calendar month to which the reconciliation relates. It must contain a statement signed by a Director or a person authorised in writing by a Director, stating that the signatory believes, and has no reason not to believe, that the reconciliation is accurate in all respects.

ASX 24 Market Participant are required to give to ASIC within three months of the end of the financial year, an independent audit report on compliance with client money rules (ASIC Market Integrity Rules (ASX 24 Market), Rule 2.3.5).

### Preparing Client Funds Reconciliations

With respect to preparing the client funds reconciliation, a client that has a debit balance (i.e., the client owes the Investment Firm monies), such balances are deducted in determining the amount the Investment Firm is required to hold.

### Top Up Requirements

Where there is insufficient client money to meet margin liabilities in the clients' segregated account, a market participant must 'top up' the clients' segregated account by the extent of any shortfall with money from the house account within five clear business days (e.g. ASIC Market Integrity Rules (ASX 24) 2.2.6(f)). Such "top up" monies may only be withdrawn in accordance with permitted withdrawal requirement and only after such monies have been received from the client by the market participant.

- 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 protection provisions do not permit Investment Firms to maintain their own funds in a client money account. The requirement for Client Money to be kept separate from the Investment Firm's own assets (in relation to the client money account) is achieved through paragraph 981B(1)(b). See response to question 3 for more information.

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

See the response to questions 3(a)(ii) regarding Client Assets being maintained separately from the Investment Firm's own assets. In particular, the permissions afforded by section 981D (for Client Money) and subsection 984B(2) (for Client Property).

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- 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 use, the Client Assets? If so, please describe.

Yes. See the response to question 3(c)(i) below on re-hypothecation and ownership rights.

See further the response to permitted investments in the response to question 3(a)(ii) regarding what measures are used to protect the Client Assets of each client from losses due to the activities of other clients.

- i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?

On 'ownership rights' generally, see the response to question 1(b), which describes the nature of these rights with respect to Client Assets.

### Client Money

While the Act sets out the circumstances in which Client Money can be withdrawn from the client money account and what constitutes permitted use and investments, it does not address 'ownership rights'.

If an Investment Firm has the right to withdraw Client Money and use it or invest it under the client agreement, and the exercise of those rights is not prohibited under the Act, whilst the Investment Firm remains solvent and holds the AFSL, a client's rights would be limited to those arising out of the client agreement with the Investment Firm.

In the case of the Investment Firm's insolvency, Regulation 7.8.03 provides for priority of payments including to those persons who are entitled to be paid money from the account. If the money in the account is insufficient then it must be paid in proportion to the amount of each person's entitlement. See the response to question 18 below.

### Client Property

The Act does not contain a prohibition against an Investment Firm using Client Property as security for a loan or advance for its use and benefit.

Under the Regulations an Investment Firm must:

- (1) deposit Client Property in safe custody at the written request of the client or notify the client of their failure to do so;
- (2) if requested by the client, arrange for the body corporate that issued or made available the securities or managed investment products underlying the property, to register the Client Property in the name of a nominee controlled by the Firm;
- (3) not deposit the Client Property by way of security for a loan or advance to the Investment Firm unless certain conditions are met including that the client owes the Firm an amount in connection with a transaction entered into by the firm on the client's behalf. Within

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one business day of repayment, the Firm must withdraw the Client Property from the deposit facility.

- ii. How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?

Adopting the interpretation of this term as described in question 3(d)(i) above, for:

- (i) Client Money - the consent must be in writing e.g. by inclusion of appropriate terms in the client agreement. Refer to regulation 7.8.02(1) (a) and regulation 7.8.02(3(a));
- (ii) Client Property – the only requirement for an item to be in writing arises under regulation 7.8.07(8) which requires a written notice to be given to the client by the Investment Bank which identifies the property and states that the Firm proposes to deposit the Client Property as security for a loan or advance to the Firm. Section 984B requires that Client Property be dealt with subject to the terms and conditions on which the Client Property was given to the Investment Firm and to any subsequent instructions given by the client.

### *Additional requirements for ASX 24 market participants*

On the ASX 24 Market, prior to the commencement of trading for a Client, an Investment Firm must have in force, a duly signed agreement with that client containing the minimum terms.

An Investment Firm must obtain the client's prior written agreement on specified matters before investing money from a clients' segregated account: ASIC Market Integrity Rules (ASX24) 2.2.6(i) (applies to all Client Assets). This includes the following:

- (a) the marking of any investment of client money;
- (b) how earnings on the investment are to be dealt with;
- (c) how the realisation of the investment is to be dealt with;
- (d) how any losses made on the investment are to be dealt with;
- (e) the fee (if any) that the market participant proposes to charge for the investment; and
- (f) such investment must be readily available and at least 50 per cent on 24 hour call.

- iii. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (*i.e.*, established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator)?

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On the nature of a client's 'ownership rights' see the response to question 1(b).

Rehypothecation of Client Assets is not regulated by the Act.

### Client Money

As Client Money is a fungible Asset, the concept of 'ownership rights' is not easily reconciled.

It is possible a client would pursue an action against the Investment Firm for recovery of the amount due to it under, or in conjunction with, the terms of the client agreement and related transactions and services. The Act provides for priority of payments in those cases where the balance of the client money statutory trust account is insufficient to meet investor claims and the Investment Firm has become insolvent or has ceased to trade. See the response to question 22. Client Money is subject to the terms of the statutory trust established by Part 7.8 of the Act. See also the response to question 3(a)(ii) on the prohibition against Client Money being attached, set-off or used as security.

### Client Property

Any hypothecation of the Client Property to the Investment Firm would be addressed under the terms of the client agreement or related document. Depending on the facts of the case, if the Investment Firm had re-hypothecated Client Property without the consent and default by the client, it is possible the client would pursue a claim against the Investment Firm for recovery of the Client Property in specie, seek compensation for the loss of the Client Asset or seek to recover the Client Asset from third parties holding the Client Asset under the re-hypothecation.

- 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?

ASX Clear and ASX Clear Futures both require collateral provided by the Investment Firm to be held in separate accounts depending on whether it is the Investment Firm's assets or the client's assets.

4. Are Investment Firms in your jurisdiction permitted to transfer to, or hold Client Assets belonging to clients in your jurisdiction in, another jurisdiction?

### **Client Money**

As explained in the response to question 3 regarding what money may be deposited into a client money account, an Investment Firm must pay Client Money into a client money statutory trust account that complies with the requirements of the Act. In practice, unless relief is granted by ASIC, this means the account is held with an "Australian ADI". Note that this term may include Australian-owned banks, branches of foreign banks and foreign subsidiary banks provided appropriate authorisation has been granted by APRA.

Subsequent to paying Client Money into the client money account, provided the client has authorized and consented to it, Client Money may be withdrawn and then transferred and held in another jurisdiction.

### **Client Property**

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There is no prohibition against transferring or holding Client Property in another jurisdiction. However, an Investment Firm that wishes to do so must ensure that this dealing with Client Property is in accordance with the terms and conditions on which the Property was given to the Firm, any subsequent instructions of the client and the regulations (which deal with the holding of such Property on trust, depositing the Property in safe custody, registration of the Property and depositing the Property as security for a loan or an advance).

### *Additional requirements for ASX and Chi-X market participants*

As noted above, Client Money must be held in a client trust 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 for a deposit of funds in an approved foreign bank.

(Rule 3.5.3 and Rule 3.5.4 in both ASIC Market Integrity Rules (ASX Market) and ASIC Market Integrity Rules (Chi-X Market)).

### *Additional requirements for ASX 24 market participants*

Client Money must be deposited in a clients' segregated account. If the account is operated outside Australia and the law in force in the jurisdiction requires the account to be designated in a particular way, the Investment Firm must designate the account in that way (ASIC Market Integrity Rule (ASX 24 Market), Rule 2.2.6(a)(ii).)

There is provision for the Investment Firm to invest client money outside Australia if it is with an Approved Foreign Bank or is in accordance with a specific direction of a client (ASIC Market Integrity Rule (ASX 24 Market) Rule 2.2.6(h)).

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?

The Act deals with the handling of Client Money and dealing with Client Property received from clients of the Investment Firm's Australian business, even if those clients reside in a foreign jurisdiction. The Act does not deal with Client Money or Client Property relating to an Investment Firm's foreign businesses, even if foreign laws permit its transfer to Australia.

- 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?

For Client Assets related to the Investment Firm's Australian business, see the response to question 4(a) above. For assets that have been transferred from other jurisdictions and identified as assets in those jurisdictions, this will depend on applicable foreign law.

If so, please provide details of those requirements.

5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by

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Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)? If so,

- a. What protections are applicable to the Foreign Investment Firm’s Client Assets?
- b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?
- c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?

We understand this question to be asking if an Investment Firm in Australia can comingle its Client Money with that of a Foreign Investment Firm in the same Omnibus Account.

As explained in the response to question 3 regarding separation of assets, an Investment Firm must pay Client Money into a client money statutory trust account that complies with the requirements of Division 2 of Part 7.8. The Act places restrictions on what money may be deposited into this account, namely the client money account. Client Money of a Foreign Investment Firm would not be permitted to be paid into and therefore comingled in a client money account.

Subsequent to paying Client Money into the client money account, provided the client has authorized and consented to it, Client Money may be withdrawn and paid into another account. This account may be an Omnibus Account that could also hold money from foreign clients.

- a. No statutory protections apply to Client Assets that have been subsequently deposited into an Omnibus Account with the client's consent and authority.
- b. Not applicable under Australian law however regulation in the foreign jurisdiction may dictate what steps the Foreign Investment Firm must take, if any.
- c. See the response to question 5b.

### *Additional requirements on ASX 24 market participants*

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 (ASIC Market Integrity Rule (ASX 24 Market), Rule 2.2.6(e)).

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 requirements.

Where an Investment Firm chooses to operate an omnibus account (on behalf of another broker), there is a requirement that a House Account and Client Account are to be maintained separately at all levels in the chain, down to the clearing and settlement facility level, notwithstanding the

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fact the investment is in another jurisdiction (ASIC Market Integrity Rule (ASX 24 Market), Rule 2.2.6(a)(iii)).

6. 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?

See the response to question 2.

A custodian would need to hold an AFSL with a specific authorization that permits the custodian to 'provide a custodial or depository service' – unless the service is an incidental part of the custodian's business.

- 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 dictate the terms of the custody agreement however see further the response for question 3(a)(ii) regarding protecting Client Money from attachment. For Client Property, see response for the same question for conditions on an Investment Firm depositing the Property as security for a loan or advance to the Investment Firm (regulation 7.8.08(8)).

7. 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?

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 amongst 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 published 'Regulatory Guide 227 Over-the-counter contracts for difference: Improving disclosure for retail investors' (**RG227**) which sets out guidelines for Investment Firms for improved disclosure to retail investors in relation to contracts for difference, margin forex and similar products. Under Benchmark 5, an Investment Firm should maintain and apply a clear policy on its use of Client Money, including whether it uses money deposited by one client to meet the margin or settlement requirements of another client.

### *Additional requirements on ASX and Chi-X market participants*

ASX market participants must provide clients trading in products for first time in the ASX explanatory booklets on options, LEPOs and warrants.

ASX and Chi-X market participants must also enter into an agreement in relation to the relevant market transaction. This agreement must contain information about the execution and clearing

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arrangements in place and other mandatory items provided for in the rules. The mandatory items do not specifically require information related to the protection of the client's assets but this may be included by the Investment Firm.

### *Additional requirements on ASX 24 market participants*

The SFE Procedures Determinations and Practice Notes (still in force) in relation to ASIC Market Integrity Rule (ASX 24 Market) Rule 2.2.6 strongly recommends that ASX 24 market participants provide Notice 50/06 to clients.

Notice 50/06 contains a warning to clients that all client money are co-mingled in the clients' segregated account held by the ASX 24 market participant. As a result, the Notice highlights that the operation of a clients' segregated account may not protect an individual client's money in the case of a default arising from the trading of other clients. This is because individual client money is co-mingled in one clients' segregated account.

8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? 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 provisions under the Act or ASIC market integrity rules. 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; and
- (b) an Investment Firm can obtain a written direction to make a payment out of a client money account – ASIC has indicated in RG212 that a broad authorisation may conflict with an Investment Firm's general licensee obligations.

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. ASIC is 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.

In relation to the market integrity rules, an ASX 24 market participant is prohibited from making any agreement with a client that the client's money is not to be held or does not need to be held in a segregated account for the benefit of the client (ASIC Market Integrity Rules (ASX 24 Market), Rule 2.2.6(g)).

9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:

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In relation to reporting breaches of the Client Asset Protection Provisions, section 912D of the Act requires the Investment Firm that has breached or is likely to breach its AFSL obligations (including the obligation to ensure the Firm has available adequate resources to provide the financial services covered by the licence) to notify ASIC as soon as practicable and in any event within ten business days after it becomes aware of the breach or likely breach where that breach or likely breach is significant.

The relevant factors when determining whether or not a breach is significant are:

- The number or frequency of similar previous breaches;
- The impact of the breach or likely breach on the AFSL holder's ability to provide the financial services covered by the AFSL;
- The extent to which the breach or likely breach indicates that the AFSL holder's arrangements to ensure compliance with those obligations is inadequate; and
- The actual or potential financial loss to clients of the AFSL holder or the AFSL holder itself, arising from the breach.

(See paragraph 912D(1)(b))

In addition, ASIC imposes conditions on an AFSL holder that require it to be notified in certain circumstances (for example, regulation 7.6.04 of the regulations).

- a. Does the Investment Firm report where client assets are held?

See the reference to the PDS in the response to question 7 regarding an Investment Firm's disclosure obligations.

- b. Does the Investment Firm or depository report the protections applicable to such client assets?

The obligation is incumbent on the Investment Firm.

See the reference to the PDS in the response to question 7 regarding an Investment Firm's disclosure obligations.

- c. Does the Investment Firm or depository report the amount of assets that are held?

The obligation is incumbent on the Investment Firm.

In each case, are such reports provided on request or periodically? If periodically, with what frequency?

See response to question 9 above.

In addition, ASX 24 market participant who holds client money are required to report the nature of Client Assets held on a monthly and annual basis. They report the amount of Client Assets held and the nature of the client's investment. The client funds reconciliation is submitted on a monthly basis, one month after the calendar month to which the reconciliation relates.

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On an annual basis, an ASX 24 market participant is required to obtain an independent audit report on whether it has maintained suitably designed and effective internal controls to comply with the requirements of the clients' segregated account Rules.

10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify
  - a. Where Client Assets are held?
  - b. The amount of Client Assets held at a depository?
  - c. The safeguards applicable to Client Assets held at a depository?

ASIC conducts proactive and reactive surveillance of Investment Firms for their compliance with Australia's financial services laws. This will include a requirement that the Investment Firm provide documentary evidence of its compliance such as bank statements where Client Money is held in a foreign jurisdiction.

See also the response to question 12 below regarding the role of the auditor.

### *Inspections of ASX 24 market participants*

An ASX 24 Market Participant is required to perform a daily reconciliation of client funds by 7pm the next business day. The reconciliation requires the ASX 24 Market Participant reconcile the liability owed to the client against the money held in the clients' segregated account.

An ASX 24 Market Participant is required to notify ASIC, within 2 business days if the reconciliation has not been performed, or if there is a deficit (total deposit is less than third party Client Money) or the Market Participant is unable to reconcile its clients' segregated account.

An ASX 24 Market Participant is required to submit its monthly reconciliation of client funds to ASIC by the last business day of the calendar month following the calendar month to which the reconciliation relates. ASIC reviews the client funds reconciliation to ensure it contains the required disclosure and is completed in a timely manner.

An ASX 24 Market Participant is also required to prepare and give to ASIC, an annual declaration for clients' funds. This requires an independent audit of the client monies procedures and controls.

ASIC performs ad hoc inspection of ASX 24, ASX and Chi-X market participant's Client Funds Reconciliations against supporting records to verify that client money is held in accounts designated as clients' segregated account and to determine the nature of any investment.

11. Where an Investment Firm based in a foreign jurisdiction (a "Foreign Investment Firm") deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify
  - a. The amount and/or value of such Client Assets?

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- b. The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?

This will depend on the basis the foreign regulator claims jurisdiction over the Foreign Investment Firm and the relevance of the Client Assets to that issue. However, it may be possible for the foreign regulator to seek ASIC's assistance under the co-operative arrangements between them to share information. Further, certain information is public pursuant to the disclosure and reporting obligations of public companies in Australia.

12. 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 AFSL 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 20 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.

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 (section 990K).

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".

*Additional requirements for ASX and Chi-X market participants*

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The risk-based capital requirements applicable to securities market participants require participants to prepare and submit the following reports:

- Monthly reports, generally within two weeks of the end of the month;
- An audited annual report, generally within three months after the end of the financial year;
- Weekly (or in some situations daily) reports where the capital has dropped to less than 1.2 times the minimum required level; and
- An ad hoc report where the licence holder or ASIC (as appropriate) requests.

### *Additional requirements for ASX 24 market participants*

The capital requirements applicable to futures market participants provide that they must prepare and submit the following reports:

- Monthly reports, generally within two or four weeks after the end of the month (depending on the type of participant);
- An audited annual report, generally within three months after the end of the financial year;
- A report where the capital drops below 1.5 times the minimum required level;
- A report where the capital level falls by more than 20 per cent since the previous report; and
- An ad hoc report where the licence holder or ASIC (as appropriate) requests.

13. 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?

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 (sections 983A - 983E).

If an Investment Firm has become insolvent or has ceased to carry on its financial services business ASIC has grounds to suspend or cancel the Investment Firm's AFSL (section 915B). This power to cancel or suspend an AFSL can be exercised immediately, without ASIC being required to hold a hearing or consider submissions from the AFSL holder. As soon as practicable, ASIC must publish a notice of the action in the *Gazette* and, if the AFSL holder is a

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participant in a licensed market or a licensed clearing and settlement facility, give written notice of the suspension or cancellation to the operator of the market or facility (subsection 915F(2)).

If an AFSL is suspended or cancelled, ASIC can apply to the court for an order to freeze or restrict the dealings of a person (that is, not just the AFSL holder) with accounts with a financial institution (subsection 983A(3)). It does not matter whether the account is within Australia or not.

Where an order is made under section 983A, ASIC or a person affected by the order can apply to the court for an order directing that specific amounts in the frozen account be paid to ASIC or its nominee (section 983D). This order can also include direction to ASIC or its nominee that the money be paid into a separate account, or that ASIC or its nominee are authorised to prepare a scheme for distributing the money to persons who claim and are entitled to the money, or that ASIC or its nominee prepare a scheme to apportion the money in the event that there is a shortfall relative to third party entitlement (section 983E).

As AFSL holders are generally corporations, it is open for ASIC to apply to the court (with the leave of the court) for an order to wind up the corporation on the grounds that the corporation is insolvent (section 459P). Where a company is in liquidation, it must set out, in every public document and in every negotiable instrument of the company the expression *in liquidation* (section 541).

### **Post-Insolvency**

14. 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 appointed, by a creditor holding security over the Investment Firm's property. This may be different if the Investment Firm is an ADI. If it is, it would be subject to the insolvency provisions set out in the *Banking Act 1959*.

### **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 insolvency 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.

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- (2) Creditors Voluntary Liquidation / Winding Up – A company, by special resolution passed by its members, may appoint a liquidator. The liquidator must then convene a meeting of creditors to consider replacing the liquidator. The liquidator takes control of the company's affairs with a view to winding it up; that is, investigating its affairs, realising company assets and distributing any available proceeds to creditors. Again, in almost all instances, the company is deregistered at the end of the liquidation process.
- (3) Members Voluntary Liquidation / Winding Up – A company, by special resolution passed by its members, may appoint a liquidator. This type of winding up differs from a creditors voluntary winding up in that the company must be solvent. As a first step, a majority of directors must make a declaration of solvency. If during the winding up process it is determined that the company cannot in fact 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. At this meeting, creditors may replace the liquidator.
- (4) Voluntary Administration (VA) – A company may appoint a voluntary administrator pursuant to section 436A of the Act where the board resolves 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 VA is to maximise the chances of a 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 Act imposes a moratorium which stays proceedings, restricts the enforcement of security interests 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 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 DOCA 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's terms can be adapted to the company's circumstances and can provide for:
    - (i) the company continuing to trade so that its business can be sold as a going concern: and/or
    - (ii) a restructure of the company's affairs so that it can be returned to solvency.

If a company fails to meet the terms of its DOCA, the deed administrator would seek to terminate the DOCA and, generally, wind up the company.

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15. 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 14, above the Administrative Officer is selected as follows:

- (1) Court liquidation – An applicant who petitions a court to wind up a company ordinarily will seek the consent of a liquidator in the event that the petition is successful. The Court is petitioned to make a winding up order and if granted, the company is wound up by an official liquidator (that is, a registered liquidator who can take court appointments).
- (2) Members Voluntary Liquidation – An Investment Firm's directors seek the consent of a person which is tabled at the meeting convened to consider the resolution to wind up the company. Members may seek the consent of an alternative person and resolve to appoint that person if they wish. Being a registered liquidator is not a requirement to act as a members voluntary liquidator.
- (3) Creditors Voluntary Liquidation – An 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 – An administrator's consent is sought by the party that proposes to make the appointment; that is, the directors, secured creditor or liquidator (a liquidator can appoint a voluntary administrator). Importantly, at the statutory first meeting of creditors, creditors may resolve to replace the appointed administrator. Additionally, creditors may resolve to appoint a different practitioner to act as administrator of any DOCA accepted by them or, if they resolve to wind up the company, appoint a person other than the administrator to 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 Administrator, the person must be a Registered Liquidator.

The required 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 (subsection 1282(2)).

Or has other qualifications and experience that, in ASIC's opinion, are equivalent.

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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.

### 16. What are the duties of the Administrative Officer?

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

- (1) Realise all company property that is capable and commercial to realise and disclaim property which is onerous. 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.
- (2) Keep books and accounts
- (3) 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.
- (4) Examine the circumstances which precipitated the liquidation and which may reveal improper dispositions of property and offences. Investigations may establish if the company directors and officers discharged their duties under the law and, if not, if it is commercial to pursue damages/compensation against them.
- (5) Report to creditors.
- (6) Distribute funds to creditors as soon as practicable in accordance with the priority provisions set out under the Act.

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- (7) Provide a report to ASIC detailing the results of the liquidator's investigations where the liquidator identified possible offences or the company will pay less than 50 cents in the dollar on creditor claims.
- a. What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?

Additional guidance is provided by the following:

- Insolvency Practitioners Association of Australia Code of Professional Practice.
  - Australian Accounting Standards
  - Individual State-based real property legislation
  - Case law.
- 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 liable under common law liable for negligence. An Administrative Officer who is negligent can also be found to be personally liable in certain circumstances.

17. 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, and does not generally get involved in the winding up of an Investment Firm or the distribution of assets. However, 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.
- (c) ASIC is also able to apply for interim freezing orders. The Court is also empowered to give directions regarding the distribution of client money (sections 983A – 983E).

18. What are the requirements, if any, governing the segregation and treatment of Client Assets during the insolvency of an Investment Firm?

The Act provides for how Client Money is to be dealt with if a licensee:

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

If any of the above events occurs, client money is to be paid as follows:

- (a) the first payment is of money that has been paid into the account in error;
- (b) 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;
- (c) the next payment is payment to each person who is entitled to be paid money from the client money account;
- (d) 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
- (e) 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 licensee.

Note: see regulation 7.8.03(6).

### 19. 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. This may be different if the Investment Firm is an ADI as it would be subject to the *Banking Act 1959*.

The *Financial Sector (Business Transfer and Group Restructure) Act 1999* (Transfer of Business Act) allows for the transfer of part or all of an ADI's business to another ADI either voluntarily or compulsorily. Therefore, it is possible to transfer the assets of an insolvent ADI to a solvent ADI under the Transfer of Business Act.

For market participants, where it appears that the Investment Firm is about to fail, the market operator may also require an Investment Firm to move client positions (Rule 5160 of ASX Operating Rules and ASX 24 Operating Rules, and Rule 9.5 and 5.1 Chi-X Operating Rules).

- 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.

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

Not Applicable.

20. 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.

21. 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 the event of the failure of an Investment Firm, compensation arrangements are available under the Australian Market Licence (AML) regime where the Investment Firm is a market participant on a licensed market and the transaction took place on that licensed market. Specifically, under the AML regime, there is a requirement that an AML holder have compensation arrangements where market participants on that licensed market are effecting transactions on behalf of retail clients and clients may provide money, property, or authority over property to the market participant (section 881A). The market compensation arrangements are required to be approved by the Minister (sections 881A and 882A).

Generally speaking, an AML holder can satisfy this requirement by either having a compensation regime that is approved by the Minister, or by joining the National Guarantee Fund ('NGF') (sections 881A and 882A). If an AML holder seeks to satisfy the compensation regime requirements by having a regime that is approved by the Minister, the Minister must be satisfied that the compensation regime is 'adequate' before approving the regime. Amongst other things, this requires the Minister to form the view that the compensation regime will provide adequate coverage for losses (section 885B).

The losses to be covered include:

- Where a person gave money or other property, or authority over property to a person who was a participant in the market at that time or who the client reasonably believed was a participant;
- The money was given to the participant in connection with effecting a transaction or proposed transaction effected through the market;
- The effecting of the transaction constitutes or would constitute the provision of a financial service to the client as a retail client; and
- The client suffers loss, if the client gave the participant money or authority over the property, because of either:
  - (i) The defalcation or fraudulent misuse of the money or other property by the participant, or

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- (ii) The fraudulent misuse of that authority by the participant (section 885C of the Act).

### The Securities Exchange Guarantee Corporation (SEGC)

The Act provides for the NGF to give compensation for the default of Investment Firms in on-market transactions (section 888A). The NGF is administered by the SEGC, a wholly owned subsidiary of the ASX. The NGF is intended to provide a compensation arrangement for a customer when trading via a broker on a market covered by the NGF. The circumstances in which compensation may be claimed are specified in considerable detail in the Regulations, and include claims against an insolvent dealer where that dealer has not discharged its obligations to hold property for the claimant (regulation 7.5.64). The Regulations also provide that the amount of compensation that a person is entitled to is to be determined by reference to the Regulations.

### AFSL regime

In addition, there is a requirement that where an AFSL holder is providing financial services to a retail client they are to have in place a compensation arrangement that complies with subsection 912B(2) of the Act. The purpose of this compensation arrangement is to compensate clients for breaches by the AFSL holder or their authorised representatives of their AFSL obligations.

Regulation 7.6.02AAA specifies the requirements that must be met for compensation arrangements under section 912B. This essentially states that the AFSL holder (apart from exempt licensees) must have adequate professional indemnity insurance cover and specifies the circumstances that should be taken in account in determining what would be 'adequate'. RG 126 Compensation and insurance arrangements for AFS licensees provides guidance on how ASIC administers section 912B.

ASIC's standard licensing conditions also make provision for an obligation to maintain professional indemnity insurance when individual circumstances warrant such a requirement. In addition, for the responsible entity of a collective investment scheme or the operator of an investor directed portfolio service it is a standard licence condition for the AFSL holder to maintain adequate professional indemnity and officers' fraud insurance to cover the value of property held.

The retail clients of such an AFSL holder might be able to make a claim under the dispute resolution system that the AFSL holder is required to have in place (paragraph 912A(1)(g) of the Act). However, given that the AFSL holder would be insolvent, the investor is unlikely to be able to recoup their loss through this avenue even if the internal or external dispute resolution schemes found in their favour.

- 22. 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

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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: regulation 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 regulation 7.8.03(6).

These rules override anything to the contrary in the *Bankruptcy Act* or in company law: regulation 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.

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23. 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.

24. 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 26.

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

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.

25. 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 22 and 23 above.

26. 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 see our answer to question 22 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 (section 556). 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 (section 559):

- (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 (section 466));
- (c) the debts incurred by a Voluntary Administrator of the company they are indemnified for under paragraph 443D(a), even if the administration ended before the relevant date, except

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expenses covered by (a) above and deferred expenses — these are the debts for which the administrator is personally liable under section 443A of the Act (general debts for services rendered, goods bought, property hired, leased, used and occupied) and section 443B (payments for property used or occupied or in the possession of the company, after seven day breathing space).

(d) Repealed;

- a. if the Court ordered the winding up — costs and expenses that are payable under subsection 475(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 section 475 (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;
- b. costs and expenses payable under subsection 539(6) — being the costs of an audit of liquidators/provisional liquidators accounts, if undertaken, as fixed by ASIC;
- c. any other expenses (excluding those mentioned above), except deferred expenses, (see below), properly incurred by a liquidator or other relevant authority;
- d. deferred expenses as defined below, being primarily remuneration of a liquidator or other relevant authority;
- e. 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 subsection 553(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:

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- (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 paragraph 556(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 section 443A (i.e. for services rendered) pursuant to paragraph 556(1)(c);
- any amounts classifiable as an expense properly incurred by a liquidator or other relevant authority, pursuant to paragraph 556(1)(dd);

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- 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 (subparagraph 556(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 (subsection 556(1B)); or
- retrenchment payments **payable**; but —excluded employees|| are **not allowed to rank for any retrenchment amount** attributable to non-priority days (subparagraph 556(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 treaties that would be useful for obtaining a general understanding of client asset protection in your jurisdiction?

Corporations Act 2001	<a href="http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/">http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/</a>
Corporations Regulations 2001	<a href="http://www.austlii.edu.au/au/legis/cth/consol_reg/cr2001281/">http://www.austlii.edu.au/au/legis/cth/consol_reg/cr2001281/</a>
ASIC Market Integrity Rules (ASX Market) 2010	<a href="http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/asic-market-integrity-rules-asx-market-2010-Feb-2011.pdf/\$file/asic-market-integrity-rules-asx-market-2010-Feb-2011.pdf">http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/asic-market-integrity-rules-asx-market-2010-Feb-2011.pdf/\$file/asic-market-integrity-rules-asx-market-2010-Feb-2011.pdf</a>
ASIC Market Integrity Rules (ASX 24 Market) 2010	<a href="http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC-ASX24-Market-Integrity-Rules-20100708.pdf/\$file/ASIC-ASX24-Market-Integrity-Rules-20100708.pdf">http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC-ASX24-Market-Integrity-Rules-20100708.pdf/\$file/ASIC-ASX24-Market-Integrity-Rules-20100708.pdf</a>
ASIC Market Integrity Rules (Chi-X Australia Market) 2011	<a href="http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC-market-integrity-rules-Chi-X-Australia-market-2011.pdf/\$file/ASIC-market-integrity-rules-Chi-X-Australia-market-2011.pdf">http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC-market-integrity-rules-Chi-X-Australia-market-2011.pdf/\$file/ASIC-market-integrity-rules-Chi-X-Australia-market-2011.pdf</a>

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ASIC Regulatory Guide 78 <i>Breach reporting by AFS licensees</i>	<a href="http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg78.pdf/\$file/rg78.pdf">http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg78.pdf/\$file/rg78.pdf</a>
ASIC Regulatory Guide 212 <i>Client money relating to dealing in OTC derivatives</i>	<a href="http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg212-9July2010.pdf/\$file/rg212-9July2010.pdf">http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg212-9July2010.pdf/\$file/rg212-9July2010.pdf</a>
ASIC Regulatory Guide 227 <i>Over-the-counter contracts for difference: Improving disclosure for retail investors</i>	<a href="http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg227-published-12-August-2011-1.pdf/\$file/rg227-published-12-August-2011-1.pdf">http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg227-published-12-August-2011-1.pdf/\$file/rg227-published-12-August-2011-1.pdf</a>
ASX Operating Rules	<a href="http://www.asxgroup.com.au/asx-operating-rules-guidance-notes-and-waivers.htm">http://www.asxgroup.com.au/asx-operating-rules-guidance-notes-and-waivers.htm</a>
ASX24 Operating Rules	<a href="http://www.asxgroup.com.au/asx-24-operating-rules-and-waivers.htm">http://www.asxgroup.com.au/asx-24-operating-rules-and-waivers.htm</a>
ASX Clear Operating Rules	<a href="http://www.asxgroup.com.au/asx-clear-operating-rules-guidance-notes-and-waivers.htm">http://www.asxgroup.com.au/asx-clear-operating-rules-guidance-notes-and-waivers.htm</a>
Chi-X Operating Rules	<a href="http://www.chi-x.com/resources/au/file/Chi-X%20Australia%20Draft%20Operating%20Rules%20040311.pdf">http://www.chi-x.com/resources/au/file/Chi-X%20Australia%20Draft%20Operating%20Rules%20040311.pdf</a>

**Brazil**  
**2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

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(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.
  - a. How does your jurisdiction define the term “client assets?” If the jurisdiction uses an analogous term, please provide that term and its definition.
  - b. What is the nature of a client’s ownership rights with respect to its client assets placed with the investment firm?
  - c. How does your jurisdiction define the term “client”? If the jurisdiction uses an analogous term, please provide that term and its definition.
  - d. Please describe any notable exclusions from the terms “client” or “client assets.”

Client asset protection is addressed both by federal laws (Law 6,024/74; Law 9,447/97 and Law 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, according to provisions set forth in Law 6,024/74. The scope includes all financial institutions, encompassing a sizeable portion of Brazilian Investment Firms.

“Clients” are natural persons or legal entities that hold accounts at Investment Firms. Brazil follows a Custodial Regime, therefore the relationship between the Investment Firm and its clients with respect to Client Assets is primarily a custody arrangement under civil law. Nevertheless, in case of insolvency “Client Money” is sometimes treated as a general obligation of the Investment Firm, whereas “Securities” and “Positions” are always segregated from the pool of assets of the Investment Firm at the custodian level.

Margins placed by Clients as collateral for derivatives positions are also segregated, and can be transferred to other Investment Firms at will or in case of insolvency. On the other

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hand, margins placed as collateral in loans granted by the Investment Firm to purchase Equities are not segregated from the pool of assets of the Investment Firm.

Client Assets categorized as “Securities” can be divided in two major groups, based on Law 6,385/76, art. 2. The main types of the first group are equities, corporate bonds/commercial papers, shares of mutual funds and all derivatives. On the second group are government bonds, currency spot and time/demand deposits.

*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?

According CVM Instruction 89/88, only authorized financial institutions may act as custodians. Eligible financial institutions are 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 (Comissão de Valores Mobiliários (CVM), Banco Central do Brasil (BCB) or both) (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

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adequacy of implemented internal controls and IT infrastructure in order to perform the custodian services.

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?

Client Assets are always maintained separately at the custodian level, providing a high degree of protection from losses due to the activities of other clients.

Derivatives and equities positions are identified at the final beneficial owner level throughout the holding chain, including the clearing and custodian levels (applicable to all "Securities" listed in Law 6,385/76, art. 2.)

Government bonds and some corporate bonds are held in omnibus accounts, nevertheless are segregated among clients at the custodian level.

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? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

Reconciliation applies exclusively to cash maintained by clients at securities or futures brokers, and it is conducted in a client-by-client basis. Accordingly, debit cash balances in client accounts are deducted in order to determine the amount the Investment Firm is required to hold.

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As for all other cases (securities, derivatives and positions), assets are kept in accounts segregated from the assets of the Investment firm. Except for cash, all client positions match automatically, needless of reconciliation.

Ever since the dematerialization of securities, fungibility is the rule rather than exception. The regime in Brazil permits Investment Firms to deliver assets that are fungible within the same asset class, as is the case for assets that have the same terms and conditions, or the same ISIN code.

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?

Reconciliation must be performed on a daily basis, unless specific situation arises (*e.g.* risk exposure, margin calls, etc.), requiring ongoing follow up. If a deficiency is identified, the Investment Firm should it make good as soon as possible.

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 such rules exist regarding buffer assets.

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

Not possible, since assets are held separately at the custodian level. 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 use, the Client Assets? If so, please describe.

i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client’s consent?

ii. How is a client’s consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client’s consent must an Investment Firm have in order to use or re-hypothecate Client Assets?

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iii. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (*i.e.*, established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator)?

Currently there are no laws or regulations concerning rights of use or re-hypothecation of client assets. In practical terms, rights of use and re-hypothecation are not feasible, since assets posted as collateral by the client are kept in individual accounts, out of reach of the Investment Firm for its own use as collateral on proprietary positions or on positions entered into by other clients.

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?

Margins placed by Clients as collateral for derivatives positions at clearinghouses or other central counterparties must be fully segregated at the final beneficial owner level.

4. Are Investment Firms in your jurisdiction permitted to transfer to, or hold Client Assets belonging to clients in your jurisdiction 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.

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

5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions ("Foreign Investment Firms") in an Omnibus Account (that includes Client Assets from domestic clients)? If so,

- a. What protections are applicable to the Foreign Investment Firm's Client Assets?
- b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?

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- c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?

There are no specific rules regarding this issue; the general rule is that the final beneficial owner must be identifiable at all times.

**(a)(i):** Local omnibus accounts are an exception to the rule, as explained before. Protections applicable to Foreign Investment Firms' Client Assets held at omnibus accounts are the same applicable to Local Investment Firms' Client Assets. There is a high degree of protection since Client Assets are always segregated, at the custodian level, from the Investment Firm's Assets and from assets belonging to other Clients, even in the case of Bonds held in omnibus accounts.

**(a)(ii):** No further steps are required to secure such protections.

**(a)(iii):** Currently there are no laws or CVM instructions concerning reduction in protections (waiver of rights).

6. 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 question (2) for requirements on third party custodians. There are no limitations to the use of a custodian that is affiliated to 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.

Yes, but only if authorized by 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.

7. 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 financial firm or third parties (e.g. custodians) are outlined in the contracts signed by the client. There are no specific provisions concerning assets held in another jurisdiction.

8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

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Currently there are no laws or CVM instructions that allow an Investment Firm to waive, reduce or vary Client Asset protection requirements. Nonetheless, “opting out” of requirements for segregation of client assets is not possible since segregation is mandatory, at least at the custodian level. In-depth details of client asset segregation are outlined in the Internal Rules of the Central Securities Depository (CBLC), namely in items 113, 137.1.1, 138.2 and 138.3.

9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:
- Does the Investment Firm report where client assets are held?
  - Does the Investment Firm or depository report the protections applicable to such client assets?
  - Does the Investment Firm or depository report the amount of assets that are held?

In each case, are such reports provided on request or periodically? If periodically, with what frequency?

Reporting on Client Assets by Investment Firms is required only in cases of administrative investigation (by the Market Authority or by the SROs) or by court order. Nevertheless both the exchange (BM&FBovespa) and trade repositories (OTC organized markets like CETIP or BM&FBovespa) report all derivative open interest positions on a daily basis to the Market Authority (CVM).

10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify
- Where Client Assets are held?
  - The amount of Client Assets held at a depository?
  - The safeguards applicable to Client Assets held at a depository?

In all examinations, inspections and audits performed by either CVM or Self-Regulatory Organizations, Investment Firms are assessed for compliance with asset segregation rules.

11. Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify
- The amount and/or value of such Client Assets?
  - The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?

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In these cases, general rules concerning the exchange of information between jurisdictions for enforcement purposes would apply (e.g. MMoU). For more details on omnibus accounts in Brazil, please refer to item 3.

12. 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 anomalous situation must be timely reported to CVM and BCB. In addition, according to Section 2 of Law 6,024, an Investment Firm must notify BCB of an insolvency situation.

13. 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 6,024, including injunctions, investigatory and sanctioning procedures, and restriction of activities. In 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 an exchange or clearinghouse member, part of this function may be performed by these institutions, acting as assistants to BCB.

### **Post-Insolvency**

14. 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?

Rules applicable to insolvent Financial Firms are set out in Law 6,024/74, and are applicable to all Investment Firms (art. 52).

The process by which an Investment Firm enters the status of "insolvent" or "bankrupt" can be initiated: (i) *ex-officio* by the Central Bank; (ii) by requisition of the managers or (iii) by the Exchange (art. 52, §1).

BCB may initiate 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

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within 90 days of a cancellation of the license of an Investment Firm, its dissolution process has not been initiated.

15. 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?

Administrative Officers is assigned by the Central bank (Law 6,024, art. 5). There are no minimum qualifications an Administrative Officer must have, but usually a BCB employee of a former (retired) BCB employee with experience in financial markets is selected.

16. What are the duties of the Administrative Officer?
- What guidance (whether pursuant to the Regime in your jurisdiction or otherwise), if any, is provided to the Administrative Officer?
  - 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 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 that should be the case.)

He/she 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 from the intervention date, the Administrative Officer must present a report to BCB 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.

The Administrative Officer has broad powers of management and liquidation, particularly those to check and to classify credits, to propose judicial demands and to represent the entity in and out of the Courts.

There is not any special protection from liability for the administrator or liquidator. The Administrative Officer has personal responsibility under negligence standards.

17. What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?
- Does the regulator continue to supervise the Investment Firm?
  - How, if at all, is the regulator involved in the process of returning Client Assets?

Yes. As the Administrative Officer is appointed by the BCB (the relevant authority in this case) and has a duty to report any developments on a periodical

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basis or whenever the situation requires, the regulator is able to supervise the intervention process very closely.

18. What are the requirements, if any, governing the segregation and treatment of Client Assets *during* the insolvency of an Investment Firm?

There are no specific rules on that matter. General segregation rules apply during the insolvency of an Investment Firm.

19. 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?

Asset transfer must be instructed by the client and authorized by the Administrative Officer, but chances are that the transfer process will be carried out with ease.

There are no provisions addressing the minimum or maximum period of time, but it must be done without undue delay. Usually the most relevant factors that affect the time period required to accomplish such a transfer are the quality of internal controls of the Investment Firm, and whether any misuse of client assets has been detected. These aspects would demand further work by the Administrative Officer, in order to assure that the appropriated assets are transferred to clients.

20. 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?

Unless inappropriate distribution is detected by the Administrative Officer, there is no such risk.

21. 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).

Currently there are two compensation schemes 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 checking accounts, (c) savings account deposits, (d) time deposits, with or without the issuance of certificates, (e) deposits in accounts not drawable 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

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coverage is limited to R\$ 70,000 (approximately USD 35,000, at the current exchange rate – Sept 1st, 2012). It applies to all financial institutions that offer these investment alternatives, namely banks, savings and loans and financial institutions in the real estate segment. Furthermore, there is a special protection scheme for one type of time deposit called “Depósitos a Prazo com Garantia Especial do FGC - DPGE”, provided by the FGC, which coverage limit is R\$ 20,000,000 (approximately USD 10,000,000, at the abovementioned exchange rate). The rules concerning the FGC are issued by the National Monetary Council (Resolution n. 4.087/2012), but it is structured as a private non-profit Civil Association.

(ii) “Mecanismo de Ressarcimento de Prejuízos” (MRP): it is another protection scheme, but with a more limited approach. It applies only to Investment Firms with direct access to the Brazilian exchange (BM&FBovespa), with equal coverage limit of R\$ 70,000 (approximately USD 35,000, at the current exchange rate – Sept 1st, 2012) per person, upon filing a formal complaint to the SRO of the Exchange (BSM). The assets classes under protection are those listed in the exchange (securities and derivatives).

22. 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 no such circumstances, please refer to question 3.d.

23. 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. Foreign provisions would be applicable.

24. 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.

25. 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 previously stated, clients retain legal ownership of the assets held by the Investment Firm in individual accounts. This mechanism is applicable to Securities, Positions and Margins placed as collateral for derivatives positions (whether in Cash or Securities.) If there is a shortfall, claims in relation to such assets are preferred,

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whereas claims on Client Money deposited at the Investment Firm rank *pari passu* with other unsecured creditors.

In other words, comprehensive asset recovery in relation to amount claimed is the norm for securities held in a CSD. Cash deposited at the Investment Firm (or placed as collateral in loans granted by the Investment Firm to purchase Equities) are not segregated from the pool of assets of the Investment Firm, and recovery will depend on the recovery ratios applicable to all unsecured creditors.

26. 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 question 25.

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.

### **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?

Law 6,385/76, the “Securities Act” (free translation into English)

<http://www.cvm.gov.br/ingl/indexing.asp>

Law 6,204/76, applicable to insolvent Financial Firms (in Portuguese)

[http://www.planalto.gov.br/ccivil\\_03/leis/L6024.htm](http://www.planalto.gov.br/ccivil_03/leis/L6024.htm)

**Canada**  
**2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

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(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.
  - a. How does your jurisdiction define the term “client assets?” If the jurisdiction uses an analogous term, please provide that term and its definition.

*Assets include cash, securities and certain other property such as segregated insurance funds. As per the Ontario Securities Act, this is the definition of a security:*

*“security” includes,*

*(a) any document, instrument or writing commonly known as a security,*

*(b) any document constituting evidence of title to or interest in the capital, assets, property, profits, earnings or royalties of any person or company,*

*(c) any document constituting evidence of an interest in an association of legatees or heirs,*

*(d) any document constituting evidence of an option, subscription or other interest in or to a security,*

*(e) a bond, debenture, note or other evidence of indebtedness or a share, stock, unit, unit certificate, participation certificate, certificate of share or interest, preorganization certificate or subscription other than,*

*(i) a contract of insurance issued by an insurance company licensed under the Insurance Act, and*

*(ii) evidence of a deposit issued by a bank listed in Schedule I, II or III to the Bank Act (Canada), by a*

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*credit union or league to which the Credit Unions and Caisses Populaires Act, 1994 applies, by a loan corporation or trust corporation registered under the Loan and Trust Corporations Act or by an association to which the Cooperative Credit Associations Act (Canada) applies,*

*(f) any agreement under which the interest of the purchaser is valued for purposes of conversion or surrender by reference to the value of a proportionate interest in a specified portfolio of assets, except a contract issued by an insurance company licensed under the Insurance Act which provides for payment at maturity of an amount not less than three quarters of the premiums paid by the purchaser for a benefit payable at maturity,*

*(g) any agreement providing that money received will be repaid or treated as a subscription to shares, stock, units or interests at the option of the recipient or of any person or company,*

*(h) any certificate of share or interest in a trust, estate or association,*

*(i) any profit-sharing agreement or certificate,*

*(j) any certificate of interest in an oil, natural gas or mining lease, claim or royalty voting trust certificate,*

*(k) any oil or natural gas royalties or leases or fractional or other interest therein,*

*(l) any collateral trust certificate,*

*(m) any income or annuity contract not issued by an insurance company,*

*(n) any investment contract,*

*(o) any document constituting evidence of an interest in a scholarship or educational plan or trust, and*

*(p) any commodity futures contract or any commodity futures option that is not traded on a commodity futures exchange registered with or recognized by the Commission under the Commodity Futures Act or the form of which is not accepted by the Director under that Act,*

*whether any of the foregoing relate to an issuer or proposed issuer; (“valeur mobilière”)*

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*A security also includes a commodity futures contract and commodity futures options as defined under the Ontario Futures Act:*

*“commodity futures contract” means a contract to make or take delivery of a specified quantity and quality, grade or size of a commodity during a designated future month at a price agreed upon when the contract is entered into on a commodity futures exchange pursuant to standardized terms and conditions set forth in such exchange’s by-laws, rules or regulations; (“contrat à terme sur marchandises”)*

*“commodity futures option” means a right, acquired for a consideration, to assume a long or short position in relation to a commodity futures contract at a specified price and within a specified period of time and any other option of which the subject is a commodity futures contract; (“option sur contrat à terme sur marchandises”)*

- b. What is the nature of a client’s ownership rights with respect to its client assets placed with the investment firm?

*The client has full ownership interest for any unencumbered cash maintained in its investment account with the member firm (cash in the account due to short selling is excluded). It also has full ownership interest over the securities which have been fully paid for. These securities will be required to be put in segregation and be shown as such on the client’s statement of account. Provincial Securities Acts require those firms acting as custodians to hold these securities in a separate location without lien or charge. This protects customers by preventing the member firm from using these securities for other purposes.*

*Fully paid for securities can also be held in safekeeping where the member firm acts as the client’s custodian, similar to a bank safety deposit box. A written agreement needs to be in place between the member firm and the client and these securities will be shown as held in safekeeping on the client’s monthly statement of account.*

*If the client has a margin account, a proper margin agreement needs to be signed between the member firm and the client. This margin agreement protects the firm for financing customer purchases. This agreement gives the firm the legal right to place a lien on securities*

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*not fully paid for and to use these unpaid securities as collateral to finance the position. If the client fails to meet a margin call, the member firm may liquidate the security in the account and apply the proceeds to satisfy the client's indebtedness. The client will gain back full ownership over the securities when it is fully paid for.*

- c. How does your jurisdiction define the term "client"? If the jurisdiction uses an analogous term, please provide that term and its definition.

*Any individual or entity that opens an account with the member firm and for which services are rendered is considered a client.*

- d. Please describe any notable exclusions from the terms "client" or "client assets."

*No exclusions*

*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 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.*

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- 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?

*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 and 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*

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*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 Rules 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 Rule 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 is required 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 is required 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 is required 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.*

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

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

- The loan value required to be segregated equals:*

$$\text{Net loan value} - \text{client debit balance} = \$125,000 - \$75,000 = \$50,000$$

- 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:*

<i>Security # 123</i>			
<i>XYZ Corporation</i>			
<i>Customer A/C</i>	<i>Last Transaction</i>	<i>Held in Segregation</i>	<i>Required to Segregate</i>
<i>0123</i>	<i>06/13/96</i>	<i>20,000</i>	<i>20,000</i>
<i>1432</i>	<i>05/01/96</i>	<i>30,000</i>	<i>30,000</i>
<i>0987</i>	<i>07/10/96</i>	<i>50,000</i>	<i>50,000</i>
<i>1639</i>	<i>07/25/96</i>	<i>150,000</i>	<i>200,000</i>
	<i>Total</i>	<u><i>250,000</i></u>	<u><i>300,000</i></u>
	<b><i>Net deficiency:</i></b>	<b><i>50,000</i></b>	

*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.*

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### Detailed Segregation Examples

The following are two additional detailed examples of segregation calculations.

#### EXAMPLE 1 - Customer account statement

<b>Cash Balance Dr &lt;Cr&gt;</b>	<b>Holdings</b>	<b>Quantity</b>	<b>Price (\$)</b>	<b>Loan Rate</b>	<b>Market Value (\$)</b>	<b>Loan Value (\$)</b>
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
<b>Security Loan Value</b>						<b>2520.00</b>
<i>Net Loan Value = Total Loan Value - Debit Balance = 2520 – 762 = 1758</i>						

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

<b>Security</b>	<b>Total Loan Value by security (\$)</b>	<b>Net loan value remaining after deducting security loan amount to segregate (\$)</b>	<b>Loan value to segregate [loan amount divided by loan value of one share]</b>	<b>Quantity Required to Segregate</b>
		<i>NLV = 1758</i>		
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.

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### EXAMPLE 2 - Customer account statement

<i>Cash Balance Dr &lt;Cr&gt;</i>	<i>Holdings</i>	<i>Quantity</i>	<i>Price (\$)</i>	<i>Loan Rate</i>	<i>Market Value (\$)</i>	<i>Loan Value (\$)</i>
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
<b>Security Loan Value</b>						<b>4025.00</b>
<i>Net Loan Value = \$4025.00 - \$2500.00 = \$1525.00</i>						

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

<i>Security</i>	<i>Loan Value by security (\$)</i>	<i>Net loan value remaining after deducting security loan amount to segregate (\$)</i>	<i>Loan value to segregate [loan amount divided by loan value of one share]</i>	<i>Quantity Required to Segregate</i>
		<i>NLV = 1525</i>		
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 IIROC Rule 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*

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*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 IIROC Rule 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.*

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

#### ***Segregation Locations***

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

#### ***Segregation Deficiencies/Excess***

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

#### ***Priority for Segregation and Desegregation***

*IIROC Rule 2000.5 permits a member firm to select among the securities carried for the client account which securities 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.*

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*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 IROC 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 IROC Rule 2600, Policy 3, Statements 4 and 5.*

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*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*

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*(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).*

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### 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 a 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:

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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?

*Securities: 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 Rule 2000.5 permits a dealer member to select among the securities carried for the client account which securities 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 Dealer member 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.*

Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

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*Funds: No. As per Statement D of Form 1, the Dealer member is required to do a calculation to see if there is a required amount of free credits to be segregated. The calculation is:*

*Amount required to segregate:*

*Line 1: Net allowable assets (line B6 of Form 1) multiplied by 8 \_\_\_\_\_*

*Line 2: Early Warning reserve (line C12 of Form 1) multiplied by 4 \_\_\_\_\_*

*Line 3: Free credit limit (line 1 plus line 2) \_\_\_\_\_*

*Less client free credit balances:*

*Line 4: Dealer Member's own \_\_\_\_\_*

*Line 5: Carried for Type 3 introducers \_\_\_\_\_*

*Line 6: Amount to segregate (nil if line 3 exceeds line 4 plus line 5)*

*=====*

*As per Rule 1200.1, free credit balances 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.*

*As per Rule 1200.2, each Dealer member which does not keep its client's 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."*

*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)...*

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*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 represent 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-segregated position.*

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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 use, 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 re-pledge 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 which is part of the account opening package.*

i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?

*If the client securities are not fully paid for, there is no ownership right over these unpaid securities. If the client has a margin account, a proper margin agreement needs to be signed between the member firm and the client. This margin agreement protects the firm for financing customer purchases. This agreement gives the firm the legal right to place a lien on securities not fully paid for and to use these unpaid securities as collateral to finance the position. If the client fails to meet a margin call, the member firm may liquidate the security in the account and apply the proceeds to satisfy the client's indebtedness. The client will gain back full ownership over the securities when it is fully paid for. The client's consent over the use by the Dealer member to do financing transaction with the unpaid securities comes in the form of the client signing the margin account agreement.*

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

- ii. How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?

*The client's consent over the use by the Dealer member to do financing transaction with the unpaid securities comes in the form of the client signing the margin account agreement.*

- iii. How are the ownership rights of a client over its client assets changed or affected when the investment firm uses or re-hypothecates such assets without such client's consent?

*The Dealer member cannot do financing transactions with unpaid securities without having in place a proper margin account agreement signed by the client.*

Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (i.e. established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator)?

*When a security is fully paid for, the Dealer member is required to put it into segregation as per IIROC Rule 2000. If the Dealer member declares bankruptcy, CIPF would cover, within limits, the client's fully paid for securities, whether or not they had been put into segregation by the IIROC Dealer member.*

- 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?

*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 in your jurisdiction permitted to transfer to, or hold Client Assets belonging to clients in your jurisdiction 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?

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*Yes – the same segregation requirements and custody requirements apply.*

- c. 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. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)?  
If so,

- a. What protections are applicable to the Foreign Investment Firm’s Client Assets?

*Foreign Investment Firms are allowed to open an omnibus account with an IIROC Dealer member. However, there is no CIPF protection afforded to investment firms, and its customers, dealing with an IIROC Dealer member on an omnibus basis.*

- b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?

*See response in a. There is no CIPF protection offered for such assets.*

- c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?

*Not applicable. See response in a.*

6. 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*

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

*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 Form 1, 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:*

### *Depositories and Clearing Agencies*

- (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.*

*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.*

*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).*

*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.*

*Regulated entities.*

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

*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;*

*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:*

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

*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*

*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*

- i. No use or disposition of the securities shall be made without the prior written consent of the Dealer Member;*
- ii. 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*
- iii. 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 favor of the depository or institution holding such securities.*

7. 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, whether they are held at a domestic or foreign custodian. Dealer members are required to disclose on customer statements and confirmations that they are members of CIPF.*

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8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

*No opt out possible.*

9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:

- a. Does the Investment Firm report where client assets are held?

*There is no report required to be filed concerning where client assets are held. However, under Rule 200 for minimum books and records, the Dealer member is required to maintain at all times a securities record reflecting for each security all long and short positions carried for the Dealer Member's account or for the account of customers, showing the location of all securities long and the offsetting position to all securities short and in all cases the name or designation of the account in which each position is carried.*

- b. Does the Investment Firm or depository report the protections applicable to such client assets?

*As per Rule 29.1, each Dealer member shall include on the front of each confirmation and account statement sent to a customer the CIPF official symbol, and shall also include in legible print on each confirmation and account statement sent to a customer the CIPF official explanatory statement which reads: "Customers' accounts are protected by the Canadian Investor Protection Fund within specified limits. A brochure describing the nature and limits of coverage is available upon request".*

- c. Does the Investment Firm or depository report the amount of assets that are held?

*Client net equity is reported on Schedule 10 of Form 1 on a monthly basis. Client net equity is defined as the total value of cash, securities and other acceptable property owed to the client by the Dealer member less the value of cash, securities, and other acceptable property owned by the Client to the Dealer member. However, there is no reporting for the amount of securities held at custodians. This information is detailed in the securities record mentioned above in response to a.*

In each case, are such reports provided on request or periodically? If periodically, with what frequency?

*Securities records would be provided on request during regular field examinations. As for the filing of the audited Form 1 in which client net equity is indicated, this is produced annually.*

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10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify

a. Where Client Assets are held?

*During regular field examinations done by the Financial & Operations Compliance personnel, we ensure that custodians meet the definition of acceptable securities locations. The custody agreements in place between the Dealer member and the custodian is also looked at to ensure minimum regulatory provisions are included, as required per Rule 2000.*

*On a test basis, we select a sample to review monthly position reconciliations for evidence of the Dealer member's review and approval. We also ensure adequate capital has been provided for unresolved differences over 20 business days.*

b. The amount of Client Assets held at a depository?

*During regular field examinations, tests are done on the securities record and custodians' reconciliations are looked at, as stated above in answer to a.*

c. The safeguards applicable to Client Assets held at a depository?

*During regular field examinations, new custodial agreement are looked at to ensure the minimum regulatory provisions are included. There are also tests conducted on the segregation of securities.*

11. Where an Investment Firm based in a foreign jurisdiction (a "Foreign Investment Firm") deposits Client Assets (i.e., of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify

a. The amount and/or value of such Client Assets?

*The foreign regulator could request from the Foreign Investment Firm to consult the monthly statement of account received from the Dealer member. This monthly statement will show the detailed securities of all the clients comingled into one account opened under the Foreign Investment Firm's name.*

b. The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?

*There is no CIPF protection afforded to Foreign Investment Firms, and its customers, dealing with an IIROC Dealer member on an omnibus basis.*

12. 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?

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*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.*

13. 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**

14. 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.*

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

*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.*

*IIROC 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 Insolvency 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.*

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15. 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.*

16. 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 to assist prospective trustees.*

*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.*

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

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- 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.*
18. What are the requirements, if any, governing the segregation and treatment of Client Assets during the insolvency of an Investment Firm?  
*None officially but in practice, same as going concern*
19. 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 14 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 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.*

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*CIPF speeds up the transfer process by settling the agreed on losses directly with the trustee rather than 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, permits the trustee to transfer client accounts in full. The customer would not necessarily know that CIPF has provided funding.*

20. 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*

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- *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.*
21. 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.*
22. 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 – i.e. 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;*

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*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*

23. 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.*

24. 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.*

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25. 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.*

26. 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 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)*

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See CIPF web site - [www.cipf.ca](http://www.cipf.ca)

Part XII of the Bankruptcy and Insolvency Act : <http://canlii.org/en/ca/laws/stat/rsc-1985-c-b-3/latest/rsc-1985-c-b-3.html>

For Ontario's *Securities Act* and *Commodity Futures Act*: [http://www.osc.gov.on.ca/en/SecuritiesLaw\\_index.htm](http://www.osc.gov.on.ca/en/SecuritiesLaw_index.htm)

**France**  
**2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

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(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.
  - a. How does your jurisdiction define the term “client assets?” If the jurisdiction uses an analogous term, please provide that term and its definition.

In the present answer, “client assets” refers to “financial instruments” and “client money”. “Financial instruments” include both “financial securities” (hereafter “securities”) and “financial contracts”, as defined as follows in the French Monetary and Financial Code:

*“Article L. 211-1. - I. - Financial instruments include both financial securities and financial contracts.*

*II. - Financial securities include:*

- 1. Equity securities issued by joint-stock companies*
- 2. Debt securities, with the exception of bills of exchange and interest-bearing notes*
- 3. Units or shares in undertakings for collective investment*

*III. - Financial contracts, also referred to as “term contracts”, are financial term contracts that appear on a list established by decree.”*

In the present answer, “client money” includes “funds received from the public”, defined by Article L. 312-2 of the French Monetary and Financial Code (see below) as well as funds received by investment firms for the purpose of financial transactions:

*Article L. 312-2. Funds which an entity accepts from a third party, in particular in the form of deposits, with the right to use them for its own account subject to its returning them shall be deemed to be funds received from the public. (...).”*

- b. What is the nature of a client’s ownership rights with respect to its client assets placed with the investment firm?

The client has the ownership rights over his financial instruments held by a custody account-keeper in a securities account. Such financial instruments must be strictly identified on an individual account and the custody account-keeper is not allowed to use those securities without the client’s express consent.

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Financial instruments are materialized by an entry on the account of the client and are presumed to be owned by the client under whose name the account is maintained (Article R. 211-1 of the Monetary and Financial Code and Articles 322-1 et s. of the AMF General Regulation).

c. How does your jurisdiction define the term “client”? If the jurisdiction uses an analogous term, please provide that term and its definition.

The term ‘Client’ is not defined in French legislation. It is in practice understood in line with the MIFID definition: “Client means any natural or legal person to whom an investment firm provides investment and/or ancillary services”, custody being an ancillary service under MiFID. It is understood similarly for banking services including the holding of cash deposits.

The different types of client (professional vs non professional) should be understood in the light of this definition.

*Cf. the 2011 IOSCO Survey (p.4 of Appendix B on France):*

“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 General Regulation (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 towards professional clients.

Moreover, the French legal framework also refers to the concept of “qualified investor”.

“Qualified investors” are defined in Article L. 411-2 II of the Monetary and Financial Code, as “*an individual or an entity possessing the expertise and resources required to apprehend the risks inherent in transactions in financial instruments. The list of investor categories recognized as qualified is determined by decree.*” This list is detailed in Articles D. 411-1 and D. 411-2 of the same code. According to Article D. 411-3, the status of qualified investor is optional for certain categories (which include individuals).

For FMIs, the following terms are used rather than “client”:

For payment systems, securities settlement systems and their operators (the CSDs):

- “participants”: defined in Article 2 of Directive 98/26/EC on Finality: “shall mean an institution, a central counterparty, a settlement agent, a clearing house or a system operator” (transposed in Article L. 330-1 Monetary and Financial Code)
- “indirect participants”: shall mean an institution, a central counterparty, a settlement agent, a clearing house or a system operator with a contractual relationship with a participant in a

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system executing transfer orders which enables the indirect participant to pass transfer orders through the system, provided that the indirect participant is known to the system operator”

For CCPs:

EMIR (cf. infra) refers to:

- “clearing members: “means an undertaking which participates in a CCP and which is responsible for discharging the financial obligations arising from that participation”
- “client”: “means an undertaking with a contractual relationship with a clearing member of a CCP which enables that undertaking to clear its transactions with that CCP”

d. Please describe any notable exclusions from the terms “client” or “client assets.”

They are no such exclusion in French law.

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?

There is no special blanket “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 securities 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;

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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 French Treasury, 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.

In practice, French custodians are either the issuers of the relevant (registered) securities, or are regulated and supervised as investment service providers. Only banks (not investment firms) are, strictly speaking, allowed to hold client money (investment firms must either deposit client money in a bank or use such money to purchase qualifying money market funds).

In order to provide investment services, including custody services, investment service providers must obtain authorisation by the ACP. Prior to granting approval to an investment firm, the ACP 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 ACP 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.

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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 ACP) and the ACP 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 customer 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?

The ACP 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 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 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 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.

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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. However, they must be either deposited in an account maintained by a bank, or used to purchase qualifying money market funds (see below).

As regards financial instruments: Yes. See above Articles 322-17 and 322-4 of the AMF GR. In addition, as per Article 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 client money. Please note however 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.

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With regard to the investment service provider's accounting procedures which ensure the safe accounting and safeguarding of the clients assets in financial instruments: See the developments below on Articles 322-1 and following of the AMF GR.

The following material is taken from the French answers to Question 14(ii) of the FSB survey on client asset protection:

- Client money held by credit institutions (deposits)

Credit institutions are not subject to the principle of segregation due to the nature of their activities which is receiving [money from] clients, recorded as liabilities.

The absence of segregation of client money has no impact on the identification of client assets since the amounts due to each client are recorded as liabilities. It has no direct impact on the transfer to a third party. It does not slow down the speed of money recovery nor its amount thanks to the deposit guarantee scheme, up to 100 000 euros (above, recovery may be delayed or may fail, since depositors rank *pari passu* with the claims of other unsecured creditors).

- Client money held by investment firms

There are specific rules in relation relating to client money held by investment firms. They are contained in an order of 2 July 2007.

Protection of [client money]:

The [money] of clients that an investment firm holds must be deposited in [a credit] institution [, in a central bank or in a qualified monetary market fund] within a specific account. (...) [Cf. article 3 of the order of 2 July 2007]

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 [entity where the money is deposited]. They are also required to report to the ACP on a quarterly basis and provide clients with all the relevant information. (...).

This segregation of client money eases the identification of client money. It is likely to ease the transfer to a third party and it ensures, as a principle, a quick and total money recovery. Moreover, in case of unavailability of the funds, the securities guarantee scheme guarantees recovery up to 70 000 euros.

- Financial instruments owned by the client

Protection of financial instruments:

Pursuant to MiFID article 13.7 transposed at article L533-10, 6, [investment service providers] 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 service provider] 's insolvency, and to prevent the use of a client's instruments on own account except with the client's express consent.

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This principle is further detailed in the implementing directive of MiFID (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.

Moreover, according to article 322-4 of AMF GR, a custody account-keeper must in all circumstances meet the following obligations:

- 1° The custody account-keeper does its utmost to safeguard the financial instruments in its custody and, to this end, ensures that all financial instruments and movements affecting them are booked in strict accordance with applicable rules and procedures. The custody account-keeper also does its utmost to facilitate the exercise of rights attached to financial instruments in its custody.
- 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 organizes 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.
- 3° The custody account-keeper has an obligation to return any financial instruments held in book entry form on its books.

If such instruments exist only in book-entry form, the custody account-keeper responsible for making those entries transfers the instruments to the custody account-keeper that the account holder designates. Such transfer is carried out as quickly as possible provided the account holder has fulfilled his own obligations.”

Its obligation to segregate securities which belong to collective investment schemes from those which belong to its clients and those which belong to it stems from article 322-17 of the AMF GR.

As regards CSDs:

Currently, as stated in Terms and conditions Book I of Euroclear France, the customer securities are protected from theft, loss or misuse since the records maintained enable the identification of the customer's holding of securities at any time and without delay.

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As regards segregation, the CSD maintains records that identify the assets of each client and enables them to segregate their own assets from those of their own clients.

Article 322-4 3° of the AMF GR foresees that custody account keepers also have the obligation to make sure that their own assets are segregated from those of their clients in the books of the central securities depository.

As regards CCPs:

There is no obstacle to segregation in French law which is provided for contractually in the CCP terms and conditions.

When EMIR comes into force, segregation will be provided for in Article 39 indents 1 to 7. In particular, Article 39-1 of EMIR provides: “A CCP shall keep separate records and accounts that shall enable it, at any time and without delay, to distinguish in accounts with the CCP the assets and positions held for the account of one clearing member from the assets and positions held for the account of any other clearing member and from its own assets”.

The obligation of segregation eases the identification of the assets. It is likely to ease their transfer to a third party and the speed of their recovery. As regards the amount to recover, it is a very favorable factor since it helps ensuring the localization of assets and the identification of the rights on these assets.

- 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 that prohibits 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. It 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, Article 322-4).

It must also ensure 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, Article 322-6).

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There are also the prohibitions and rules to prevent “lending from the box” i.e. unauthorized securities lending whereby one client’s securities would be used to settle another client’s trade (see 2° of Article 322-4 and Articles 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 called “the 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 applies.

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 (Article 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 Article 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. Client assets are fungible, in particular securities (fully dematerialized).

- 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 aggregate basis, in accordance with Article 3 of the Order of 2 July 2007.

Moreover, 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”.

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Beyond the approximation which is made on an aggregate basis, the regulatory framework requires investment firms to have an audit trail up to the individual 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? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

No. The accounts receivable (debit balance) of the customer cannot be deducted from the credits. Sums already reflected in the books of the investment firms and submitted by customers cannot be deducted from the customers' funds to segregate on the grounds that they are owed by customers to the investments firm (e.g. funds used to cover transactions with deferred settlement).

No. One client's net debit balance does not reduce the firm's obligations with respect to the required funds to be held on deposit for net credit balances of other clients.

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 to the ACP in regulatory reporting 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 custodian for instance), the depositor of such securities 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. There is no "buffer".

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**Answer to question b) with regards to financial instruments:** see above, AMF GR Article 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° prevent 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
- 2° unalterable electronic data.

In respect of holders of accounts in administered registered financial instruments, the authorised intermediary serving as custody account-keeper must at all times be 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 (usually 5 years).

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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?

Not as far as funds are concerned.

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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 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 use, the Client Assets? If so, please describe.

As regards the funds held by investment firms for their customers, investment firms, or any other party holding such 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 (Article 313-17 as well as Article 322-4 2°).

Article 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.

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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

Article 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.

- i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?

Under French law, only the terms "right of use" are specified. The term "re-hypothecation" is not used.

The legal concept corresponding to the "right of use" stems from Article L. 211-38 III of the French Monetary and Financial Code implementing the financial collateral directive n° 2002/47/EC of 6 June 2002:

*"Article L. 211-38 III. - The deed providing for the sureties referred to in paragraph I may specify the circumstances in which the beneficiary of those sureties may use or dispose of the relevant property and rights, on condition that he return equivalent property or rights to the grantor. The sureties concerned then relate to the equivalent property or rights thus returned as if they had been established on the same equivalent property or rights from the outset. The said deed may allow the beneficiary to offset his liability to return equivalent property or rights against the financial obligations in respect of which the sureties were established, when they have become due.*

*Equivalent property or rights shall be taken to mean:*

*1° In relation to cash: a sum of the same amount in the same currency.*

*2° In relation to financial instruments: financial instruments from the same issuer or debtor, forming part of the same issue or the same category, having the same denomination, denominated in the same currency and having the same designation, or other assets, when the parties so provide, in the event of a fact occurring which concerns or affects the financial instruments that constitute the guarantee.*

*For property or rights other than those referred to in paragraphs 1 and 2, the same property or rights shall be returned."*

It is thus the right, contractually agreed with the pledgor, for a pledgee to use the pledged assets which belong to the pledgor.

As a consequence, in the present answer, any reference to re-hypothecation is understood as a synonym of reuse.

It should also be noted that strictly speaking, in France, the right of use provided by Article L. 211-38 III only concerns assets which are pledged, to the exclusion of assets ceded temporarily as collateral. Indeed, in case of transfer of ownership, there is no need to benefit from a "right of use", since

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ownership automatically includes a right of use (as ownership is legally composed of rights of “*usus*”, “*abusus*” and “*fructus*”).

For the purpose of the present survey, we generally use the expression “right of use” in its broad sense, i.e. a right stemming either from Article L. 211-38 III or from ownership.

If the client has given a right of reuse to the investment firm and the firm has exercised the rights to reuse, the client has lost his ownership right on the asset. This means that the client has a claim on equivalent securities. In case of failure of the firm, the client is therefore one creditor among others.

- ii. How is a client’s consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client’s consent must an Investment Firm have in order to use or re-hypothecate Client Assets?

This is addressed by Article 322-4 of the AMF GR:

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.”

Therefore, as regards investment service providers, the use of financial instruments is authorized only with the prior express consent of the holder. In case of a retail client, it is specified that this consent must be evidenced by his signature or an equivalent alternative mechanism.

See also the above answer.

- iii. How are the ownership rights of a client over its client assets changed or affected when the investment firm uses or re-hypothecates such assets without such client’s consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client’s right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (i.e. established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator)?

If a client has given a right of reuse to the investment firm, in application of Article 313-17 of the GR of the AMF, in case the firm has not exercised its rights to reuse, the client still has an ownership right on his assets.

When the client has not given a right of reuse to the investment firm, the client keeps its ownership rights on its assets.

Therefore, there is no difference regarding the rights on the securities by the client, which still has a restitution right over them.

If the client has given a right of reuse to the investment firm and the firm has exercised the rights to reuse, the client has lost its ownership right on the asset. It means that the client has a claim on

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equivalent securities. In case of failure of the firm, the client is therefore one creditor among others.

Should the firm use/reuse the client's securities without the client's consent and therefore in breach of the regulations, there are two situations:

- i) if the firm is solvent, the rights of the client are not impacted;
  - ii) if the firm is insolvent, the client loses its ownership rights and becomes an unsecured creditor of the firm (the client may also benefit from the statutory investor compensation scheme).
- 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?

At present, AMF General Regulation (Art. 541-23 4<sup>th</sup> indent) states that "The funds deposited by clearing members with the clearing house to cover their commitments are invested in liquid assets with little risk of principal."

Under Article 47 of EMIR<sup>1</sup> (entering into force in January 2013):

1. Financial instruments posted as margins or as default fund contributions shall, where available, be deposited with operators of securities settlement systems that ensure the full protection of those financial instruments. Alternatively, other highly secure arrangements with authorised financial institutions may be used.

2. Cash deposits of a CCP shall be held through highly secure arrangements with authorised financial institutions or, alternatively, through the use of the standing deposit facilities of central banks or other comparable means provided for by central banks.

3. Where a CCP deposits assets with a third party, it shall ensure that the assets belonging to the clearing members are identifiable separately from the assets belonging to the CCP and from assets belonging to that third party by means of differently titled accounts on the books of the third party or any other equivalent measures that achieve the same level of protection. A CCP shall have prompt access to the financial instruments when required.

In addition, Article 39 of EMIR requires that each CCP offers the choice between omnibus client segregation and individual client segregation:

"1. A CCP shall keep separate records and accounts that shall enable it, at any time and without delay, to distinguish in accounts with the CCP the assets and positions held for the account of one clearing member from the assets and positions held for the account of any other clearing member and from its own assets.

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<sup>1</sup> REGULATION (EU) No 648/2012 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 4 July 2012 on OTC derivatives, central counterparties and trade repositories

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2. A CCP shall offer to keep separate records and accounts enabling each clearing member to distinguish in accounts with the CCP the assets and positions of that clearing member from those held for the accounts of its clients ('omnibus client segregation').
3. A CCP shall offer to keep separate records and accounts enabling each clearing member to distinguish in accounts with the CCP the assets and positions held for the account of a client from those held for the account of other clients ('individual client segregation'). Upon request, the CCP shall offer clearing members the possibility to open more accounts in their own name or for the account of their clients.
4. A clearing member shall keep separate records and accounts that enable it to distinguish both in accounts held with the CCP and in its own accounts its assets and positions from the assets and positions held for the account of its clients at the CCP.
5. A clearing member shall offer its clients, at least, the choice between omnibus client segregation and individual client segregation and inform them of the costs and level of protection referred to in paragraph 7 associated with each option. The client shall confirm its choice in writing.
6. When a client opts for individual client segregation, any margin in excess of the client's requirement shall also be posted to the CCP and distinguished from the margins of other clients or clearing members and shall not be exposed to losses connected to positions recorded in another account.
7. CCPs and clearing members shall publicly disclose the levels of protection and the costs associated with the different levels of segregation that they provide and shall offer those services on reasonable commercial terms. Details of the different levels of segregation shall include a description of the main legal implications of the respective levels of segregation offered including information on the insolvency law applicable in the relevant jurisdictions.
8. A CCP shall have a right of use relating to the margins or default fund contributions collected via a security financial collateral arrangement, within the meaning of Article 2(1)(c) of Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements ( 1 ) provided that the use of such arrangements is provided for in its operating rules. The clearing member shall confirm its acceptance of the operating rules in writing. The CCP shall publicly disclose that right of use, which shall be exercised in accordance with Article 47.
9. The requirement to distinguish assets and positions with the CCP in accounts is satisfied where:
  - (a) the assets and positions are recorded in separate accounts;
  - (b) the netting of positions recorded on different accounts is prevented;
  - (c) the assets covering the positions recorded in an account are not exposed to losses connected to positions recorded in another account.(...)"

Also, the investment firm that is a member of the CCP will be required to open a specific account for the clearing of transactions of the customers. The clearing house will then calculate margin calls separately between the own account and third party account.

4. Are Investment Firms in your jurisdiction permitted to transfer to, or hold Client Assets belonging to clients in your jurisdiction 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?

Yes, for both client money and financial instruments.

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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, the relevant regulations are Articles 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 to 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 account-keeper 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 ACP 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?
- c. 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).

5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by

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Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)?

If so,

a. What protections are applicable to the Foreign Investment Firm’s Client Assets?

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b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?

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c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?

Regarding financial instruments, omnibus accounts are not allowed in France. The principle is that all accounts are individually titled (except at CSD level and at other intermediary levels that do not confer ownership rights). See the answers to Question 3 above.

Regarding client money, see also the answers to Question 3 above.

The following further explanation may be helpful. If a non-French bank/investment firm holding client securities asks a French bank/investment firm to hold them on its behalf, the French entity will open a dedicated account for the securities of the clients of the foreign entity (the account will not contain the securities of anyone else). On request, the French entity will open a dedicated account for each of the clients of the non French entity. This will enhance the level of protection but will be more costly.

6. 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?

See the answers to Question 2 above on the licensing of custodians.

As already mentioned, subject to the accounting provisions set forth in Article 322-17 of the AMF General Regulation, the custody account-keeper must ensure 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 (article 322-4 of the AMF GR).

**Articles 313-14 to 313-16 of the AMF GR relate to sub-depositing** and provide for the following:

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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.

In addition, the AMF GR provides that 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.

A decision issued by the highest French Court in commercial matters (Cour de Cassation, Com., 4 May 2010, n°09-14187) recently confirmed the effectiveness of the requirement that a depositary has to return the client assets even when the depositary had delegated the custody to a third party.

The impossibility (save in very limited circumstances i.e. non-French assets and qualified investors) to escape the strict obligation to return assets is a very strong protection likely to ease the transfer to a third party. It guarantees immediate recovery and improves the chance to maximize the amount to recover.

The property rights recognized at the investor's account level combined with the obligation imposed to the custody account keeper to segregate its financial instruments from those held for the account of its clients guarantees (except in the case of a fraud) the restitution of client assets even in case of

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insolvency. This is strengthened by the maintaining of the obligation to return its clients assets even in the case of sub-custodianship.

The segregation obligation is of the utmost importance since it is a prerequisite to the identification of client assets and therefore their transfer to a third party if needed.

The speed and amount of the client asset recovery would depend on the contractual arrangements made and principally re-use agreements which explain the ring fencing of those agreements in the French Law.

In the case of unavailability of client assets, the French Monetary and Financial code sets up a securities guarantee scheme (Articles L. 322-1 and following) that ensures that client securities will be returned (up to 70 000 euros).

As regards client money, investment firms are required to deposit all of the funds of their clients with one or more of 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 day 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. In addition, clients have the right to oppose their funds being invested in a qualifying money market fund.

For financial instruments, Articles 313-14 to 313-16 of the AMF GR (see above) as well as Articles 322-39 and following relate to sub-depositing and provide for the following:

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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.

7. 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?

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With respect to financial instruments and in accordance to Article 314-39 of AMF GR, investment service providers holding financial instruments shall 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 client money 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 foreign 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 foreign 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 client money 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 client money 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 client money, 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 custodian 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.

The agreement between the custody account-keeper and the account holder specifies the manner in which the account-holder is provided with statements showing the nature and number of financial instruments held in the account.

The AMF GR also states that the custody account-keeper must inform each holder of a financial instrument account as quickly as possible (i) of events affecting the account holder's rights in respect of the financial instruments in custody, whenever the account-keeper has reason to believe the account holder is unaware of them, (ii) of executed trades or other movements in the financial instruments or cash held in the account holder's name.

With respect to client money, investment firms are required to communicate to their “non-professional” clients (see above definition) or potential clients the following information on the maintenance of client money:

a)

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- 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 client money 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 client money of the client, or of any right of set-off it holds in relation to client money. If necessary, the investment firms shall inform the client that a custodian may have a security interest or lien, or a right of set-off in relation to client money.

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 client money with a statement of these client money 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.

8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

The waiver of the segregation requirement is not authorized under French law.

The only form of waiver allowed relates to the restitution requirement. With respect to non French securities held for a qualified investor, the parties may agree to share liability, as mentioned above. It is also possible for certain professional collective investment schemes to share liability for the restitution of assets with the investment service provider that holds them in custody.

9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:

- Client money held by credit institutions

On a permanent basis, credit institutions have to report to the ACP the global amount of client deposits held, and moreover there is a dedicated reporting on deposits eligible to the Deposit Guarantee Scheme. Financial firms must also provide any information to the ACP upon request when circumstances require.

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- Client money held by investment firms

As regards client money held by investment firms, each investment firm must ensure that its statutory auditor makes a report to the ACP at least annually on the adequacy of the measures taken to comply with the provisions on safeguarding of the client money (Article 7 of the Order of 2 July 2007).

Required disclosures are 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 the amounts of client money to be segregated.

- Financial instruments held by custody account-keepers

According to Article 313-17-1 of the AMF GR, each custody account-keeper shall ensure that its statutory auditor makes a report to the AMF at least annually on the adequacy of the measures taken by the firm to comply with the provisions on safeguarding of the client financial instruments.

Required disclosures are 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 client money to be segregated and (ii) the amounts of financial instruments eligible for the Investor Compensation Scheme. In addition, custody account-keepers report annually to the AMF on the scale of their custody activities and whether they have outsourced any of these activities.

- a. Does the Investment Firm report where client assets are held?

No. As far as French securities held in an account maintained in France are concerned, the question regarding the location of client assets is likely to be relevant in France only if fraud is suspected, since the final client's securities account materializes ownership, this activity is highly regulated and most French custody account-keepers will have an account with the French CSD (Euroclear France). Concern about the location of client assets is more likely where non-French securities are involved, especially where they are held in a third country where regulation and supervision may not be adequate.

- b. Does the Investment Firm or depository report the protections applicable to such client assets?

See the information provided above on annual audits of the effectiveness of safeguards regarding Client Assets (distinguishing between client money and financial instruments belonging to clients).

We are not sure what is meant by "depository" (here and elsewhere). If the question refers to depositories of collective investment schemes, custody account-keepers report annually to the AMF on the number of CIS for which they act as depository.

- c. Does the Investment Firm or depository report the amount of assets that are held?

In each case, are such reports provided on request or periodically? If periodically, with what frequency?

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Investment firms/custody account-keepers report quarterly to the ACP. See the answers provided above.

10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify
  - a. Where Client Assets are held?
  - b. The amount of Client Assets held at a depository?
  - c. The safeguards applicable to Client Assets held at a depository?

Both the ACP and the AMF undertake inspections relating to Client Assets. Both custody account-keepers, especially the largest of such institutions, and the French CSD (Euroclear France) are subject to periodic inspections. Such inspections will generally focus on compliance with accounting rules and procedures, as well as segregation requirements.

11. Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify
  - a. The amount and/or value of such Client Assets?
  - b. The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?

Such requests will be handled on the basis of the applicable Memorandum of Understanding between the French and foreign regulators.

12. 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. See above.

13. 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?

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The principle is that the client money held by an investment firm, as well as client financial instruments held either by a bank or an investment firms, are not part of the assets of the entity. 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**

14. 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 “inability 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).

15. 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 14. Note also that the provisional administrators are appointed by taking into account the same considerations as those used by the ACP when assessing the fit and properness of the senior managers appointed by the investment firm.

16. 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.

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The obligation of the provisional administrators is also to provide solicited information to the judge, the ACP and the Prosecutor. They also have 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.

- 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.

17. 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?

Indirectly (see previous answers).

18. What are the requirements, if any, governing the segregation and treatment of Client Assets *during* the insolvency of an Investment Firm?

The Monetary and Financial Code provides that, in case of insolvency of a custody account-keeper, the resolution authority verifies that the securities held by the central depository on the custody account-keeper's account are sufficient to allow compliance with its obligations vis-à-vis its account holders (Article L. 211-10).

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Where the number of securities at the custody account-keeper level is insufficient, the resolution authority may proceed with a proportional repartition of the securities between the concerned account holders. The remaining securities are brought into the resolution proceedings.

The account holders might ask for the transfer of the received securities to an account held by another custody account-keeper.

Concerning the particular case of the central counterparties, the AMF GR provides that the operating rules of central counterparties include rules that, should a clearing member fail to fulfill its obligations with regard to the settlement of market transactions or to the security deposits referred to in Article 541-23, and in particular should it be the subject of any of the proceedings under Title II of Book VI of the Commercial Code (insolvency law), the clearing house can:

1° liquidate some or all of the commitments or positions taken by the defaulting clearing member for its own account, in the market conditions prevailing at the time. Subsequent to such liquidation, the clearing house can, if necessary, settle its remaining claims on the clearing member by means of the margin or other security deposits lodged by that member;

2° transfer the positions of the defaulting clearing member's clients, together with the associated assets or guarantees, to another clearing member.

EMIR (which enters into force in January 2013) provides for portability in Article 39:

10. Assets refer to collateral held to cover positions and include the right to the transfer of assets equivalent to that collateral or the proceeds of the realisation of any collateral, but does not include default fund contributions.”

See also the answers to Question 6 above, especially regarding the client's property rights.

19. 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.

See also the answers provided above on EMIR and its provisions regarding CCPs.

- 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?
20. 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 honoring of any prior claim to clients before the beginning of an insolvency procedure is prohibited. In principle, any such a distribution would be null and void.

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21. 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 (Article 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 instruments 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. This includes cash deposits 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 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).

22. 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.

Under French law, only the terms "right of use" are specified. The term "re-hypothecation" is not used. The legal concept corresponding to the "right of use" stems from article L. 211-38 III of the French Monetary and Financial Code implementing the financial collateral directive n° 2002/47/EC of 6 June 2002: "*Article L. 211-38 III. - The deed providing for the sureties referred to in paragraph I may specify the circumstances in which the beneficiary of those sureties may use or dispose of the relevant property and rights, on condition that he return equivalent property or rights to the grantor. The sureties concerned then relate to the equivalent property or rights thus returned as if they had been established on the same equivalent property or rights from the outset. The said deed may allow the beneficiary to offset his liability to return equivalent property or rights against the financial obligations in respect of which the sureties were established, when they have become due.*

*Equivalent property or rights shall be taken to mean:*

*1° In relation to cash: a sum of the same amount in the same currency.*

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*2° In relation to financial instruments: financial instruments from the same issuer or debtor, forming part of the same issue or the same category, having the same denomination, denominated in the same currency and having the same designation, or other assets, when the parties so provide, in the event of a fact occurring which concerns or affects the financial instruments that constitute the guarantee.*

*For property or rights other than those referred to in paragraphs 1 and 2, the same property or rights shall be returned.”*

It is thus the right, contractually agreed with the pledgor, for a pledgee to use the pledged assets which belong to the pledgor.

As a consequence, in the present answer, any reference to re-hypothecation is understood as a synonym of reuse. It should also be noted that strictly speaking, in France, the right of use provided by article L. 211-38 III only concerns assets which are pledged, to the exclusion of assets ceded temporarily as collateral. Indeed, in case of transfer of ownership, there is no need to benefit from a “right of use”, since ownership automatically includes a right of use (as ownership is legally composed of rights of “*usus*”, “*abusus*” and “*fructus*”). For the purpose of the present survey, we generally use the expression “right of use” in its broad sense, i.e. a right stemming either from article L. 211-38 III or from ownership.

- **Client money**

- Client money held by credit institutions: YES

Article L. 312-2 of the Monetary and Financial Code provides that “*Money which an entity accepts from a third party, in particular in the form of deposits, with the right to use them for its own account subject to its returning them shall be deemed to be money received from the public*<sup>2</sup>.” The receipt of money from the public is a banking transaction (Article L. 311-1 of the Monetary and Financial Code), which requires a banking license.

As a consequence, credit institutions can use deposits, without limit since they become the owner of the client money. The depositor (whether professional or not) has only a claim vis-à-vis the credit institution.

- Client money held by investment firms (principle): NO

As regards the client money 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

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<sup>2</sup> However, the following shall not be deemed to be funds received from the public:

1. Funds received or left in an account by a partnership's named or limited partners, members or shareholders holding at least 5% of the share capital, directors, members of the Executive Board or the Supervisory Board or executives, and likewise funds deriving from equity loans;

2. Funds which a firm receives from its employees, subject to the amount thereof not exceeding 10% of its equity. Funds received from employees by virtue of special laws are not taken into account for the calculation of this threshold

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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 [likely] to distort assessment of the effective capacity to repay [client money].

Thus, except in the case of qualifying money market funds, there is no possibility for investment firms to use client money.

- Client money held by financial firms as collateral (specific case): NO in principle but YES if agreed

Client money granted as collateral may be subject to a right of reuse, for instance in the framework of article L. 211-38 of the Monetary and Financial Code (implementation of the Financial Collateral Directive), which enables the constitution of collateral in cash and authorises a contractual right of reuse. This means that a financial firm holding client money as collateral to its benefit may, depending on contractual arrangements, have a right of use on this client money. If its client does not comply with its financial obligation, the financial firm will be authorized to keep the money. On the contrary, if the client complies with its financial obligation, the financial firm will have to return the same amount in the same currency (art. L. 211-38, III, 3°).

- **Financial instruments: NO in principle but YES if agreed**

- NO, the principle is the prohibition for financial firms to use financial instruments since they are still owned by the client.

- ✓ This is the case for custody account keepers

As regards the regulation of [custody account keepers], the AMF GR's main principles are the following (see Articles 322-4 and following):

- [Custody account keepers] **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 [custody account keeper].

- [Custody account keepers] must ensure that **no use is made of those instruments other [than] what the accountholder instructs**. This ensures among other things that the custody account [keeper] must ensure that the securities of one client are not used to settle the trades of another client, a process known as « lending from the box » or unauthorized securities lending.

*Appendix B on France of the 2011 IOSCO Survey mentions:*

“- the obligation for [custody account keepers] to return any financial instruments held in book-entry form on their books contained in the AMF GR. This is also the case when the [custody account keeper] has recourse to subcustodians. This is an “obligation de résultat” (strict liability).

- the prohibition to make use of instruments other than what the accountholder instructs. This ensures that the custody account [keeper] must ensure that the securities of one client are not used to settle the trades of another client, a process known as “lending from the box” or unauthorized

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securities lending. There are also rules to prevent this. In particular, as per Article 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° 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.”

- ✓ This is the case for investment services providers (cf. below, Article 313-17 of the AMF GR).
- YES IF AGREED. The following exceptions give a right of use under strict conditions:
  - ✓ As regards custody account keepers, the use of financial instruments is authorized only with the express consent of the holder.

Cf. Article 322-4 of the AMF GR:

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.”

- ✓ As regards investment service providers, the use of financial instruments is authorized only with the prior express consent of the holder. In case of a retail client, it is specified that this consent must be evidenced by his signature or an equivalent alternative mechanism.

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 or 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

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each client who has given his consent, so as to enable the allocation of any loss of financial instruments.”

- **Financial instruments: specific case of FMIs**

- ✓ As regards CSDs : No.

CSDs have no right of use (they do not receive collateral as principal).

- ✓ As regards CCPs: Yes.

The right for re-use is provided for CCPs by law (Article L. 440-7 of the Monetary and Financial Code) and in the AMF GR (Article 541-23: “The funds deposited by clearing members with the clearing house to cover their commitments are invested in liquid assets with little risk of principal.”)

In EMIR (which will be applicable as from January 2013), the right of use is defined in article 9: “A CCP shall have a right of use relating to the margins or default fund contributions collected via a security financial collateral arrangement provided that the use of such arrangements is foreseen by its operating rules. The clearing member shall confirm its acceptance of the operating rules in writing. The CCP shall publicly disclose this right of use. This right shall be exercised in accordance with Article 47 (which states: “A CCP shall invest its financial resources only in cash or in highly liquid financial instruments with minimal market and credit risk. A CCP's investments shall be capable of being liquidated rapidly with minimal adverse price effect.” ...and “Financial instruments posted as margins or as default fund contributions shall, where available, be deposited with operators of securities settlement systems that ensure the full protection of those financial instruments. Alternatively, other highly secure arrangements with authorised financial institutions...”).

23. 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 to allow their assets to be held in another jurisdiction. Investment firms are required to exercise the utmost care, diligence and competence when selecting, appointing and conducting a periodical assessment of the institution where these assets are deposited and of the provisions governing the holding of the assets. 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).

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

If an investment firm fails to comply with the requirements, the investors are covered by the Securities Deposit Guarantee Fund.

25. 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

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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.

26. 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 25.

### **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](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](http://inbdf/gb/supervi/telechar/regle_bafi/Regulation_99_14.pdf)

AMF General Regulation, Title III: [http://www.amf-france.org/documents/general/7553\\_1.pdf](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**  
**2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

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(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 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.

The Safe Custody Act (Depotgesetz – DepotG) contains provisions to protect investors (retail and institutional 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 applies to all kinds of credit institutions, but not for other financial intermediaries as these are not permitted to hold assets at present. The German transformation act for the EU-AIFM-Directive will enable financial services institutions to acquire a licence for the custody of assets of OGAW and AIFM funds. This new financial service will be covered by the MiFID regulations. Therefore the following explanations for credit institutions also cover such future licences of financial services institutions.

The Official Requirements regarding Safe Custody Business (hereinafter referred to as the Depot-Bek. - Amtliche Anforderungen an das Depotgeschäft - Bekanntmachung über die Anforderungen an die Ordnungsmäßigkeit des Depotgeschäfts und der Erfüllung von Wertpapierlieferungsverpflichtungen vom 21.12.1998) distinguish between different types of securities safekeeping accounts:

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The Depot A (Eigendepot) (no. 10 (4) a Depot-Bek.) 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) (no. 10 (4) b Depot-Bek.) 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) (no. 10 (4) c Depot-Bek.) 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) (no. 10 (4) d Depot-Bek.) 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 anyhow (e.g., exchange-traded or over-the-counter). Regarding the safekeeping of securities there are no differences between both models of trading.

For investment funds, the German Investment Act (Investmentgesetz - InvG) applies to "clients" (and does not distinguish between "retail clients" or "professional clients") and to all kinds of credit institutions, but not for other financial intermediaries as these are not permitted to hold assets. For further details on the scope of application see response to question 1. a..

Sections 20 et seqq. of the InvG and the official circular letter 6/2010 WA regarding duties and responsibilities of the custodian according to sections 20 et seqq. InvG – Rundschreiben 6/2010 WA zu den Aufgaben und Pflichten der Depotbank nach den §§ 20 ff. InvG (Rundschreiben Depotbank) provide regulations with regard to depositary banks.

With regard to investment funds, according to section 24 para. 1 InvG the depositary bank must place the securities and certificates of deposit belonging to the fund in a blocked securities custody account (a blocked securities custody account is a custody account which is subject to certain restrictions with respect to the right of disposition). It may entrust the securities for safekeeping only to the following institutions:

1. a central securities deposit bank within the meaning of section 1 para. 3 of the German Custody Act (DepotG),
2. another domestic credit institution which has a license to operate custody business pursuant to section 1 para. 1 sentence 2 no. 5 in conjunction with section 32 of the German Banking Act,

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3. a foreign investment firm which is authorized to carry on the business of safekeeping pursuant to Annex I Section B no. 1 of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004, p. 1, L 45, 16.2.2005, p. 18) as amended , or
4. another foreign custodian which fulfills the requirements of section 5 para. 4 sentence 1 of the Custody Act (DepotG) accordingly.

According to section 24 para 2 German Investment Act (InvG) the depositary bank is entitled and obliged to transfer balances held in blocked accounts to blocked accounts with credit institutions having their registered office in a Member State of the European Union or another Contracting State to the Agreement on the European Economic Area if the management company instructs the depositary bank to do so. The balances may also be transferred to blocked accounts with credit institutions with their registered office in non-EEA states whose prudential rules are considered by the Federal Supervisory Authority as equivalent to those laid down in European Community law.

All such transfers of clients' assets to admissible custodians outside the German jurisdiction must be subject to no. 3. (4) Depot-Bek. This means all foreign custodians have to declare, accept and guarantee that they will treat as and deliver the assets on first demand as assets of the client and will not claim any pledges, retainers or similar rights with regard to the client of the first German custodian. These restrictions apply accordingly to all other custody relations outside the InvG.

The legal situation will change when the transformation act of the EU-AIFM-Directive takes effect in 2013, the InvG will completely be replaced by the Kapitalanlagegesetzbuch (KAGB).

- a. How does your jurisdiction define the term "client assets?" If the jurisdiction uses an analogous term, please provide that term and its definition.

In Germany, there is no general legal definition of the term "client assets" or an analogous term thereof. However, there are definitions with regard to the scope of application of different kind of laws which contain regulations for client assets.

For example, the term "deposit" is described in the German Banking Act (KWG) and further clarified in a BaFin circular. "Merkblatt – Hinweise zum Tatbestand des Depotgeschäfts", as of 2012/09/09.

The German Investment Act ( InvG) only applies to client assets in terms of a domestic investment asset pool, insofar as it is formed as a separated asset pursuant to section 2 (2) InvG or an investment stock company pursuant to section 2 (5) InvG, see section 1 InvG. The InvG does not provide special or deviating rules for client assets other than the DepotG.

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The DepotG applies to shares, 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.

- b. What is the nature of a client's ownership rights with respect to its client assets placed with the investment firm?

Clients have full ownership rights on any of their client assets other than client's money, whilst they have a claim on their client money. For further details see response to question 3., below.

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 depository, 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 German Insolvency Code (Insolvenzverordnung - InsO) of the investment firm.

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 depository, the depositor is also entitled to claim segregation.

Investment funds which are managed by a management company are asset pools without legal personality. Pursuant to section 30 para. 1 sentence 1 InvG, the investment fund may be held by the investors in direct co-ownership (co-ownership solution) or through the management company acting as owner (trust solution).

A creation of a sub-custody relation outside the German jurisdiction by the German Custodian is only permissible in case the client gets a legal position vs. each of the foreign custodians which is equivalent the co-ownership or sole ownership according to the DepotG.

- c. How does your jurisdiction define the term "client"? If the jurisdiction uses an analogous term, please provide that term and its definition.

In Germany, there is no general legal definition of the term "client" or an analogous term thereof. However, within the scope of the German Securities Trading Act (Wertpapierhandelsgesetz – WpHG), section 31a WpHG defines "clients" as all natural or legal persons, an investment firm is bringing its investment service to.

The Safe Custody Act (DepotG) applies to retail and institutional investors, both terms are not legally definition.

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Also the German Investment Act (InvG) does not distinguish between retail or professional clients, there are no legal definitions.

d. Please describe any notable exclusions from the terms “client” or “client assets.”

There are no notable exclusions from the terms “client” or “client assets”. For the scope of application of the DepotG and the InvG please see response to questions 1. and 1. a..

*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 DepotG and the MiFID rules apply to all kind of clients assets, there are at present no special rules for custodians acting under the InvG.

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

The DepotG and the MiFID rules apply irrespective of the model of buying or selling an asset to all clients assets held by custodians, except money.

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

The DepotG and the MiFID rules apply to all kind of clients of custodians, there are at present no special rules for custodians acting under the InvG.

(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.*

There are no informal arrangements between governmental entities and / or governmental entities and the relevant supervised enterprises. All relevant restrictions are provided in parliamentary acts, statutory instruments and official circulars of the supervisory authorities.

### **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?

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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. When taking effect the transformation act of the EU-AIFM-Directive will enable financial services institutions to acquire a special custody licence for OGAW and AIFM funds. The safe custody business comprises in any case the safekeeping and / or managing of securities clients assets 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, which also comprise the duty of the German custodian to care for a client's legal position equivalent to the sole or co-ownership provided for in the DepotG and Depot-Bek.

- 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 generally requires that client assets must be maintained separately from the assets of an investment firm. Customers may waive this restriction. Details are given in § 14a Wertpapierdienstleistungs- Verhaltens- und Organisationsverordnung (WpDVerOV). 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.

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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 cannot be affected by activities of other clients. Also see response to question 1. b. above.

- 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?

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?

Generally the depositary is required to hold the specific securities deposited by the clients. However, the following exceptions should be mentioned:

- The safekeeper can be authorized to take possession of securities or assign the property to a third party, section 13 (1) DepotG. Thereupon the safekeeper is only bound to return securities of the same kind. The authorization must be given expressly and in writing for the several depositing transaction. This authorization must not refer to other documents nor must it be connected with other authorizations of the safekeeper, section 13 (1) sentence 3 DepotG. The authorization has to reflect that by the exercise of the authorization the property assigns to the safekeeper or a third party and that the depositor only has an in personam claim of delivery a certain kind and amount of securities, section 13 (1) sentence 2 DepotG.

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From the time the safekeeper exercises his right of taking possession of securities or assigning the property to a third party, the regulations of chapter 1. DepotG do no longer apply, section 13 (2) DepotG.

- Section 15 (1) DepotG allows for a special safekeeping. Depositor and depository may agree that the ownership shall directly pass to the depository or a third party and the depository 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 depository is entitled to return securities of the same type in exchange for the deposited securities.
- As already mentioned above (see response to question 1. c. above), pursuant to the DepotG a client (depositor) is generally the owner (or co-owner with regard to collective securities deposits) of the assets he has placed in safe custody. In case of insolvency of the depository, the depositor is entitled to claim segregation and the return of the securities. The securities are not part of the insolvency assets (Section 47 German Insolvency Code (InsO)). As regards securities in sub-custody with a foreign depository pursuant to no. 3. (4) of the Depot-Bek the German depository has to ensure that the depositor obtains a legal status equivalent to that provided by the DepotG. This will also apply to custodians of OGAW and future AIFM funds.

As regards assets where the depositor has agreed, prior to the insolvency proceedings, either i) to transfer full or partial title of its securities to either the investment firm or the third-party depository or ii) to give the investment firm or the third-party depository other rights in rem, the DepotG provides for the following: If these 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 DepotG ensures the equal distribution of certain separate funds (including securities not (re)hypothecated) pursuant to section 33 (2) DepotG. These are the only cases where the client might receive assets that are different to the assets that were originally placed with the depository.

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

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The depository 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.

The Depot-Bek.<sup>3</sup> 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 of a third party safekeeper also has to include whether the securities are kept in the Depot A (Eigendepot), in the Depot C (Pfanddepot) or in the Depot D (Sonderpfanddepot), the latter identified with the respective customer ID. For definition of these depots see response to question 1. and no. 10 (4) Depot-Bek.

The securities account statement has to be accepted by the depositor. Exceptionally, an acceptance 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? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

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.

One client's net debit balance does not reduce the investment firm's obligations with respect to the total required funds on deposit for net credit balances of other clients.

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<sup>3</sup> Official Requirements regarding Safe Custody Business, hereinafter referred to as the Depot-Bek., (Amtliche Anforderungen an das Depotgeschäft - Bekanntmachung über die Anforderungen an die Ordnungsmäßigkeit des Depotgeschäfts und der Erfüllung von Wertpapierlieferungsverpflichtungen vom 21.12.1998).

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ii Timing issues:

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

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. For further details, see response 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).

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 accounts (*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. Also see response to question 3. a. i. above.

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 cannot use client assets of one client for meeting obligations of other clients.

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 use, the Client Assets? If so, please describe.

On the EU level, MiFID (Directive n. 2004/39/EC) prohibits the use of clients' funds (except for credit institutions), but specifies that when the full ownership of the client's assets is transferred to the prime broker for the purposes of securing

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the client's obligations, such assets are no longer regarded as belonging to the client. For details see §§ 34 a WpHG, 14a WpDverOV.

In Germany 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 and 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 transaction 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.

The safekeeper can be authorized to take possession of securities or assign the property to a third party, section 13 (1) DepotG. Thereupon the safekeeper is only bound to return securities of the same kind. The authorization must be given expressly and in writing for the several depositing transaction. This authorization must not refer to other documents nor must it be connected with other authorizations of the safekeeper, section 13 (1) sentence 3 DepotG. The authorization has to reflect that by the exercise of the authorization the property assigns to the safekeeper or a third party and that the depositor only has an in

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personam claim of delivery a certain kind and amount of securities, section 13 (1) sentence 2 DepotG.

From the time the safekeeper exercises his right of taking possession of securities or assigning the property to a third party, the regulations of chapter 1. DepotG do no longer apply, section 13 (2) DepotG.

With respect to investment funds under the scope of the German Investment Act (Investmentgesetz - InvG) the following should be mentioned:

With respect to national law, the management company is allowed to transfer securities to a third party (securities borrower) for the account of the fund against a customary consideration for a limited or unlimited period of time only subject to the provision that the securities borrower must return to the management company for the account of the fund securities of the same type, quality and amount (securities loan) if this is provided for in the fund rules (section 54 para. 1 InvG). Securities loans may only be granted to a securities borrower to the extent that the quoted price of the securities to be transferred together with the quoted price of the securities which have already been transferred to the securities borrower as a securities loan for the account of the fund does not exceed 10 per cent of the value of the fund; If no particular date is stipulated for the repayment of the securities loan, the management company must be entitled to terminate the loan at any time; the time limit for repayment by the securities borrower must not exceed five exchange days. If a date is stipulated for the repayment of the securities loan, repayment must be due after 30 days at the latest. The quoted price of the securities to be transferred for a specified period of time together with the quoted price of the securities which have already been transferred as a securities loan for the account of the fund for a specified period of time must not exceed 15 per cent of the value of the fund.

The management company may only transfer securities pursuant to section 54 para. 1 InvG if, prior to or in return for the transfer of the securities for the account of the fund, it has ensured that it was granted sufficient collateral by way of money payment or a pledge or assignment of deposits or by way of a pledge or assignment of securities or money market instruments pursuant to section 54 para. 2 sentences 2 to 5 InvG and section 54 para. 3 InvG. The deposits granted by disposition pursuant to sentence 1 must be denominated in Euro or the currency in which the units of the fund were issued and must be maintained with the depositary bank or, with its consent, in blocked accounts with other credit institutions which have their registered office in a Member State of the European Union or another Contracting State to the Agreement on the European Economic Area or with a credit institution with its registered office in a non-EEA state pursuant to section 49 sentence 2 half-sentence 2 InvG, or may be invested in money market instruments within the meaning of section 48 InvG in the currency of the deposits; the investment in money market instruments in the currency of the deposits may also be made by way of a repurchase agreement pursuant to section 57 InvG. With the consent of the depositary bank, the securities assigned as collateral pursuant to section 54 para. 2 sentence 1 InvG may be held in custody

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with a suitable credit institution. The income from the investment of the collateral shall be due to the fund. Securities to be pledged must be held in custody with a suitable credit institution. Debt securities shall be suitable as collateral if they are admitted by the European Central Bank or the German Central Bank as collateral for the credit transactions referred to in Article 18.1 of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank of 7 February 1992 (Federal Law Gazette 1992 II p. 1299); shares shall be suitable if they are admitted to trading on an organised market within the meaning of section 2 para. 5 of the Securities Trading Act. Securities which are issued by the securities borrower or by an enterprise which is part of the same group shall not be suitable as collateral unless they have the form of mortgage bonds or municipal bonds.

The amount of the collateral shall be determined taking particular account of the economic circumstances of the securities borrower. The collateral must not be less than the collateral value plus a customary surcharge. The management company must demand the provision of further collateral without undue delay if, on the basis of the determination on each exchange day of the collateral value and the collateral received or of a change in the economic circumstances of the securities borrower, it shows that the collateral is no longer sufficient.

Furthermore, in Germany, for money market funds (MMFs) and UCITS, deposits may be (re)invested in money market instruments denominated in the respective currency of the deposits; or (re)invested in money market instruments by way of repurchase agreements (section 54 para 2 sentence 2 InvG).

i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?

The affect or the change on the ownership's rights depend on the situation given.

E.g. from the time the safekeeper exercises his right to which the depositor has authorized him (section 13 (1) DepotG, see for details response to question 3. b. i. A) and 3. d) of taking possession of securities or assigning the property to a third party, the regulations of chapter 1. DepotG do no longer apply, section 13 (2) DepotG. By assigning the property to a third party, the client loses his ownership rights over the assigned asset.

As set out in my response to question 3. d., above, securities lending according to section 54 InvG is an example for using assets of a fund. However, the words "lending", "loan" or "borrower" used above, are in some ways misleading as the transaction is in fact an absolute transfer of title against an undertaking to return equivalent securities.

For further details see response to question 3. d..

ii. How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a

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client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?

The investment firm needs an express and written authorization. For details see response to question 3. d..

iii. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (*i.e.*, established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator)?

This question concerns civil law matters and is not within BaFin's remit.

- 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 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 in your jurisdiction permitted to transfer to, or hold Client Assets belonging to clients in your jurisdiction in, another jurisdiction? If so, does the Regime in your jurisdiction require Investment Firms to preserve the separate identification of:
- Client Assets transferred to or located in other jurisdictions?
  - 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 generally permitted to transfer to, or hold Client Assets in, another jurisdiction.

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Collective security-deposit banks may deposit transferable securities for collective deposit with a foreign depository in the course of the mutual keeping of accounts entered into for an establishment of international securities-giro-transactions, according to § 5 Abs. 4 DepotG provided that:

- 1.) the foreign depository 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 depository obtains in relation to the collective deposit by such a depository a legal status equivalent to that provided by Safe Custody Act (DepotG),
- 3.) no prohibition of the state of residence of such depository inhibits the claim by the collective-security deposit bank against the depository 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.

No. 3 (4) Depot-Bek.:

All foreign custodians which are not authorized as national Collective security-deposit bank have to meet the requirements of No. 3 (4) Depot-Bek. in connection with section 5 (4) sentence 1 no. 2 DepotG: the foreign financial firm or the foreign safekeeper has to comment to the German financial firm a so called three-point-statement (“Drei-Punkte-Erklärung”). The same applies to custodians under InvG: see chapter IV. no. 4 Rundschreiben Depotbank (official circular letter 6/2010 WA regarding duties and responsibilities of the custodian according to sections 20 et seqq InvG – Rundschreiben 6/2010 WA zu den Aufgaben und Pflichten der Depotbank nach den §§ 20ff InvG), because DepotG and Depot-Bek apply to this custody business as well.

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, except the above mentioned requirement of the “Drei-Punkte-Erklärung” which shall create a legal status of the client with regard to local law equivalent to sole or co-ownership according to the DepotG..

5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)?  
If so,

Within the scope of the DepotG there is no distinction between client assets from domestic clients and client assets belonging to foreign clients.

- a. What protections are applicable to the Foreign Investment Firm’s Client Assets?

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To the Foreign Investment Firm's Client Assets the same protections are applicable as to domestic Investment Firm's Client Assets.

- b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?

There is no need to take any steps for Foreign Investment Firms to secure such protections for its Clients Assets. If German law, i. e. DepotG and Depot-Bek., applies to the custody agreement, the foreign customers benefit from the same protections as a domestic customer.

- c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?

Neither clients nor Foreign Investment Firms can reduce such protections. For further details please refer to response to question 8.

6. 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 another 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.

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No. 3 (4) Depot-Bek. in connection with section 5 (4) sentence 1 no. 2 DepotG: the foreign financial firm or the foreign safekeeper which act as intermediary and / or sub custodian has to comment to the German financial firm a so called three-point-statement (“Drei-Punkte-Erklärung”). The same applies to custodians under InvG: see chapter IV. no. 4 Rundschreiben Depotbank (official circular letter 6/2010 WA regarding duties and responsibilities of the custodian according to sections 20 et seqq InvG – Rundschreiben 6/2010 WA zu den Aufgaben und Pflichten der Depotbank nach den §§ 20ff InvG), because DepotG and Depot-Bek apply to their custody business as well.

7. 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?

No. 3 (4) Depot-Bek. in connection with section 5 (4) sentence 1 no. 2 DepotG: The German Custodian entrusting a foreign financial firm or the foreign safekeeper has to take care that all such foreign firms accept the so called three-point-statement (“Drei-Punkte-Erklärung”). The same applies to custodians under InvG: see chapter IV. no. 4 Rundschreiben Depotbank (official circular letter 6/2010 WA regarding duties and responsibilities of the custodian according to sections 20 et seqq InvG – Rundschreiben 6/2010 WA zu den Aufgaben und Pflichten der Depotbank nach den §§ 20ff InvG), because DepotG and Depot-Bek apply to their custody business as well. If this requirement is not met it has to inform the client of any such circumstances if it not able to choose another foreign custodian for the assets.

The “Forwarding of information” is laid down in no. 16 of the Special Conditions for Dealings in Securities (Sonderbedingungen für Wertpapiergeschäfte). 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 (Sonderbedingungen für Wertpapiergeschäfte).

The Special Conditions for Dealings in Securities have the character of general terms and conditions. Accordingly, the nature of that information is “contractual”.

According to Section 23 a KWG an institution which conducts banking business or provides financial services shall inform customers who are not institutions in its price list of its membership of a scheme to safeguard the claims of depositors and investors (guarantee scheme). In addition, prior to commencing a business relationship, the institution shall inform customers who are not institutions about the guarantee provisions, including the scope and amount of the guarantee, in writing in an easily comprehensible form. If deposits and other repayable funds are not guaranteed, the institution shall draw attention to this fact in its general terms and conditions, in its price list and in a prominent position in the contract documents prior to commencing

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a business relationship, unless the repayable funds are securitised by Pfandbriefe, municipal bonds or other debt securities which fulfill the conditions of Article 52 (4) sentences 1 and 2 of the UCITS Directive 2009/65/EG. Furthermore, upon request, information must be available on the terms and conditions of the guarantee scheme, including the requisite formalities for asserting compensation claims.

For investment funds, according to section 19b InvG – to the extent that the management company has the license to provide individual asset management within the meaning of section 7 para. 2 no. 1 – it must inform the clients concerned which are not institutions in a suitable manner of its participation in a scheme for the protection of claims of the clients (protection scheme); section 23a para. 1 sentences 2 and 5 and para. 2 of the Banking Act (KWG) shall apply accordingly.

8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

For investment funds, the German Investment Act does neither contain any provision that allows clients to ‘opt out’ of certain protections, e.g., requirements for segregation of client assets, nor provisions according to which the client might make a choice that would change the nature of the protection afforded to those assets in the event of the resolution or insolvency of the management company/investment company/depositary bank. With respect of the right to securities loan, however, please refer to response to question 3. d. above.

The requirements of the DepotG cannot be waived by an agreement, they are not optional. With respect to pledging securities or the authorization of a safekeeper to take possession of securities or assign the property to a third party, please refer to response to question 3. d. above.

According to section 34a (1) of the Securities Trading Act (WpHG), the following waive of rights is possible:

Investment services enterprises which have no authorization to conduct deposit business within the meaning of section 1 (1) sentence 2 no. 1 of the Banking Act (KWG) shall without undue delay segregate client money held in safe custody, which they accept in connection with an investment service or ancillary service, from the money of the enterprise and from other clients' money in a trustee account with credit institutions, enterprises within the meaning of section 53b (1) sentence 1 of the Banking Act or comparable institutions domiciled in a third country and authorized to conduct deposit business, a central bank or a qualifying money market fund until the money is used for its intended purpose. A client may, by way of individual contractual stipulation, give any other instruction in respect of the segregation of client money if he has been informed of the protective purpose of the segregation of client money.

9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:

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For example, according to section 44 InvG the management company must present an annual report for each fund as at the end of each fiscal year. The annual report must contain a report on the activity of the management company during the preceding fiscal year and all material information which allows investors to make a judgment about such activity and the results of the fund. With respect to the required report of information and data on the holding of client assets by the management company the annual report must contain the information set out in section 44 para. 1 nos.1-5 as for example:

A statement of assets regarding the assets belonging to the fund and the liabilities arising from borrowings, repurchase agreements, securities loan transactions and the other liabilities. The assets must be listed according to type, nominal amount or number, price and quoted price. The portfolio of securities must be divided into securities admitted to trading on an exchange, securities admitted to or included in an organised market, recently issued securities which are to be admitted to trading on an exchange or to be admitted to an organised market or included in such market, other securities pursuant to section 52 para. 1 nos. 1 and 3 InvG and certificated money market instruments as well as borrower's note loans, provided that a further division in accordance with appropriate criteria, taking account of the investment policies, according to percentages of the value of the fund must be carried out. For each item in the statement of assets, its percentage of the value of the fund must be stated. For each item of the securities, money market instruments and investment fund units, the purchases and sales effected during the reporting period must also be stated according to nominal amount or number. The value of the fund must be stated. It must be stated to what extent assets belonging to the fund are subject to rights of third parties.

According to section 44 para. 5 InvG the auditor must submit the annual report on the auditing of the fund without undue delay after conclusion of the audit to the Federal Supervisory Authority.

There is no special regulation in the DepotG.

According to section 36 German Securities Trading Act (WpHG) there is a yearly audit of responsibilities with respect to the security deposit business of financial firms. There is no special reporting of information and data on the holding of client assets to the BaFin mentioned in the WpHG.

Moreover, all credit institutions in Germany have to declare on their balance sheet any liabilities with regard to their customers (section 21 para. 2 Kreditinstituts-Rechnungslegungsverordnung –RechKredV).

a. Does the Investment Firm report where client assets are held?

Section 44 InvG does not require to report where client assets are held. In general see above 3. b. i. B).

b. Does the Investment Firm or depository report the protections applicable to such client assets?

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Section 44 InvG does not require reporting the protections applicable to client assets. In general see above 3. b. i. B).

- c. Does the Investment Firm or depository report the amount of assets that are held?

According to section 44 (1) no. 1 InvG the value of the fund must be stated.

In each case, are such reports provided on request or periodically? If periodically, with what frequency?

The reports are provided annually.

10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify

- a. Where Client Assets are held?

Annual audits must be made independent accountants according to §§ 29 KWG, 36 WpHG and §§ 56 – 59 Prüfberichtsverordnung (PrüfBV)

- b. The amount of Client Assets held at a depository?

Annual audits must be made independent accountants according to §§ 29 KWG, 36 WpHG and §§ 56 – 59 PrüfBV.

- c. The safeguards applicable to Client Assets held at a depository?

Annual audits must be made independent accountants according to §§ 29 KWG, 36 WpHG and §§ 56 – 59 PrüfBV.

11. Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify

- a. The amount and/or value of such Client Assets?

The law applicable to custodian agreements is, at present, not harmonized by the EU. The Commission works on a respective Directive, which is expected to be consulted in 2013. Therefore a foreign supervisor may only use MiFID rules, Art. 32 MiFID.

According to MiFID and § 3 Abs. 1 Satz 2 DepotG a branch office of a foreign EU custodian, if it is regarded as investment firm, is supervised by BaFin. The home supervisor of the foreign custodian may cooperate with BaFin according to MiFID rules. In case of a third country custodian and supervisor cooperation is possible on the basis of a bilateral or multilateral administrative cooperation agreement between supervisors.

- b. The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?

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See above.

12. 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 overindebtedness of a firm pursuant to section 46b (1) KWG.

13. 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**

14. 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 institution's assets at the competent district court if it has reason to 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

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- proceedings before the competent court themselves, if they become insolvent or overindebted.
15. 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.
16. 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 (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).
17. What is the regulator's role, if any, in insolvency proceedings in respect of an Investment Firm?
- See answer to question 14.
- 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?
- BaFin is not involved in this process.
18. What are the requirements, if any, governing the segregation and treatment of Client Assets *during* the insolvency of an Investment Firm?
- In the insolvency process of the safekeeper, there will be a clearing method between the depositors that have entrusted securities or parts of a collective deposit to the safekeeper, who has pledged those securities or parts of a collective deposit in accordance with section 12 (2) DepotG to his pledge, section 33 DepotG. Also see response to question 3. b. i. A).

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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 depository, 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 depository, the depositor is also entitled to claim segregation.

For further details see response to question 26 below.

19. 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?

20. 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 depository, 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 depository, the depositor is also entitled to claim segregation.

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21. 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 several protection schemes in Germany which compensate certain clients in case of insolvency of a financial institution:

- 2 Statutory Deposit Guarantee Schemes (DGS)
- 2 Voluntary DGS and
- 1 Statutory Investor Compensation Scheme.

All schemes pay compensation independently from insolvency proceedings and hereby accelerate the transfer of value to clients.

### 1. Statutory DGS:

The statutory protection for deposits with credit institutions is governed by the provisions of the Deposit Guarantee and Investor Compensation Act (Einlagensicherungs- and Anlegerentschädigungsgesetz – EAEG) which expresses the minimum scope of harmonisation according to the EU Directive on Deposit Guarantee Schemes (94/19/EC).

There is one scheme for private banks and one scheme for public banks (Compensation Scheme of German Banks -*Entschädigungseinrichtung deutscher Banken GmbH* – and Compensation Scheme of the Association of German Public Sector Banks - *Entschädigungseinrichtung des Bundesverbandes Öffentlicher Banken Deutschlands GmbH* –). All deposit taking credit institutions with their registered offices in Germany are mandatory members<sup>4</sup>. DGS are subject to supervision by BaFin.

Insured deposits are credit balances which result from funds left in an account or from intermediate positions within the scope of the business operations of an institution and which are repayable by the same under statutory or contractual provisions (e.g. giro, savings balance, call money, time deposits). Deposits also include claims which the institution has securitized by issuing a certificate (e.g. registered bonds), although not bearer or order debt securities and liabilities arising from own bills. That means that conventional bonds and certificates as well as structured products are not protected.

DGS protect basically private depositors (individuals/private persons, partnerships, registered associations, foundations, associations of residential property owners) and small enterprises.

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<sup>4</sup> EU branches are not included in the German DGS because they have equivalent systems according to the EU Directive on Deposit Guarantee Schemes (94/19/EC).

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Compensation is payable if a member institution is no longer able to repay deposits or there has been a so-called moratorium for six weeks (section 46a (1) nos. 1 - 3 KWG). It is limited by law to the equivalent of 100,000 EUR of the deposits per customer and bank. Insofar as the DGS meets a compensatee's claim to compensation, the latter's claims are transferred to the DGS which asserts them in the insolvency proceeding.

### 2. Voluntary DGS:

Most private banks in Germany additionally are members of the Deposit Protection Fund of the Association of German Banks (*Einlagensicherungsfonds des Bundesverbandes deutscher Banken e.V.* - ESF). The statutory compensation regulations for German banks are supplemented by this voluntary private scheme. The ESF guarantees deposits per creditor up to an amount equaling 30% of the liable capital of the institution in question. Since 2010 the guarantee amount for new members is limited to up to 250,000 EUR for a period of three years (after that ESF examines if a higher protection - depending on the risk profile of the bank - is possible).

Public banks also have a voluntary protection scheme, the Voluntary Guarantee Fund of the Association of German Public Sector Banks (*Einlagensicherungsfonds des Bundesverbandes Öffentlicher Banken Deutschlands e.V.*) that provides additional security for deposits. The fund protects non-bank deposits exceeding the amount of 100,000 EUR guaranteed by statutory protection schemes.

Both voluntary schemes are not subject to supervision by BaFin.

### 3. Investor Compensation Scheme

The statutory protection for liabilities to the creditor arising from securities transactions with financial services institutions is also governed by the provisions of the Deposit Guarantee and Investor Compensation Act (EAEG) which expresses the minimum scope of harmonisation according to the EU Directive on Investor Compensation Schemes (97/9/EC). All financial services institutions which have been granted authorisation to provide certain financial services and which are registered in Germany are mandatory members<sup>5</sup>. The Scheme is subject to supervision by BaFin.

The compensation procedure generally equates to the procedure of the statutory DGS. Compensation is payable if a member institution is no longer able to meet liabilities arising from securities transactions. Notwithstanding the amount of the claim to compensation is limited by law to 90 per cent of the liabilities arising from securities transactions and the equivalent of 20,000 EUR.

### 4. Schemes Safeguarding the Viability of their Member Institutions

Besides the compensation schemes there are two schemes safeguarding the viability of their member institutions (Joint Liability Scheme of the German Savings Bank Association and Guarantee Scheme of the Federal Association of German Cooperative

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<sup>5</sup> EU branches are not included in the German DGS because they have equivalent systems according to the EU Directive on Deposit Guarantee Schemes (94/19/EC).

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Banks). They protect their member institutions themselves, in particular safeguard their liquidity and solvency, and have at their disposal the requisite funds. Those schemes were designed to prevent insolvencies of their member institutions. Therefore they do not possess any instruments to compensate clients' assets in resolution scenarios.

22. 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 26 below.

23. 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 (see response to question 21 above) are not applicable if assets are held by firms domiciled outside Germany or the European Union.

24. 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 (see response to question 21 above) when they are licensed to provide banking business or financial services.

25. 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 26 below).

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26. 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 to 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.

In the insolvency process of the safekeeper, there will be a clearing method between the depositors that have entrusted securities or parts of a collective deposit to the safekeeper, who has pledged those securities or parts of a collective deposit in accordance with section 12 (2) DepotG to his pledge, section 33 DepotG. Also see response to question 3. b. i. A).

### **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?

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Translations of the DepotG, WpHG, EAEG and the KWG are attached. I would like to give notice though that these are not translations of the most current versions of these regulations as these are not yet available in English. They should suffice to provide a broad overview over the applicable German regulations.

Regulations mentioned above:

- German Banking Act (Kreditwesengesetz – KWG)
- German Safe Custody Act (Depotgesetz – DepotG)
- Official Requirements regarding Safe Custody Business (Depot-Bek.) - Amtliche Anforderungen an das Depotgeschäft - Bekanntmachung über die Anforderungen an die Ordnungsmäßigkeit des Depotgeschäfts und der Erfüllung von Wertpapierlieferungsverpflichtungen vom 21.12.1998)
- German Investment Act (Investmentgesetz - InvG)
- official circular letter 6/2010 WA regarding duties and responsibilities of the custodian according to sections 20 et seqq. InvG – Rundschreiben 6/2010 WA zu den Aufgaben und Pflichten der Depotbank nach den §§ 20 ff. InvG (Rundschreiben Depotbank)
- German Insolvency Code (Insolvenzverordnung - InsO)
- German Securities Trading Act (Wertpapierhandelsgesetz – WpHG)
- Special Conditions for Dealings in Securities (Sonderbedingungen für Wertpapiergeschäfte)
- Deposit Guarantee and Investor Compensation Act (Einlagensicherungs- und Anlegerentschädigungsgesetz - EAEG)
- Kapitalanlagegesetzbuch (KAGB)
- Merkblatt – Hinweise zum Tatbestand des Depotgeschäfts”, as of 2012/09/09
- Wertpapierdienstleistungs- Verhaltens- und Organisationsverordnung (WpDVerOV)
- Kreditinstituts-Rechnungslegungsverordnung (RechKredV)
- Prüfberichtsverordnung (PrüfBV)

**Hong Kong**  
**2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

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(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 Persons Licensed by or Registered with the Securities and Futures Commission (“the Code of Conduct”) require Investment Firms to ensure client assets are adequately safeguarded and properly accounted for. The Securities and Futures (Client Money) Rules (Chapter 571I of the Laws of Hong Kong) (“Client Money Rules”) and the Securities and Futures (Client Securities) Rules (Chapter 571H of the Laws of Hong Kong) (“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.

- a. How does your jurisdiction define the term “client assets?” If the jurisdiction uses an analogous term, please provide that term and its definition.

The term “client assets” is defined in the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) (“SFO”).

“Client assets” means client securities and collateral and client money.

Client securities

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In relation to a licensed corporation<sup>6</sup> (“LC”), means any securities (other than securities collateral) (i) received or held by or on behalf of the LC; or (ii) received or held by or on behalf of any corporation which is in a controlling entity relationship with the LC, which are so received or held on behalf of a client of the LC or in which a client of the LC has a legal or equitable interest.

In relation to a registered institution<sup>7</sup> (“RI”), means any securities (other than securities collateral) (i) received or held by or on behalf of the RI, in the course of the conduct of any regulated activity for which the RI is registered; or (ii) received or held by or on behalf of any corporation which is in a controlling entity relationship with the RI, in relation to such conduct of the regulated activity, which are so received or held on behalf of a client of the RI or in which a client of the RI has a legal or equitable interest.

Client collateral

It means securities collateral<sup>8</sup> and other collateral<sup>9</sup>.

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<sup>6</sup> “licensed corporation” means a corporation which is granted a licence under section 116 or 117 of the SFO.

<sup>7</sup> “registered institution” means an authorized financial institution which is registered under section 119 of the SFO, e.g. a bank. While the authority over LCs lies with SFC, the oversight of RIs is delegated to the Hong Kong Monetary Authority (“HKMA”) in connection with supervision, complaints handling and carrying out investigations and regulated under the SFO and the Banking Ordinance (Chapter 155 of the Laws of Hong Kong). RIs are subject to the provisions of the SFO (including its subsidiary legislation) in the same way as LCs with respect to the protection of client assets. However, to avoid regulatory overlap, RIs are not subject to the Client Money Rules as it is not appropriate for RIs to segregate client money from the other deposits which they maintain in the course of their banking business.

<sup>8</sup> “securities collateral”,

- (a) in relation to a LC, means any securities deposited with, or otherwise provided by or on behalf of a client of the LC to, the LC; or any other intermediary or person, which are so deposited or provided (i) as security for the provision by the LC of financial accommodation, or (ii) to facilitate the provision by the LC of financial accommodation under an arrangement that confers on the LC a collateral interest in the securities; or
- (b) in relation to a RI, means any securities deposited with, or otherwise provided by or on behalf of a client of the RI to, the RI, in the course of the conduct of any regulated activity for which the RI is registered; or any other intermediary or person, in relation to such conduct of the regulated activity, which are so deposited or provided (i) as security for the provision by the RI of financial accommodation, or (ii) to facilitate the provision by the RI of financial accommodation under an arrangement that confers on the RI a collateral interest in the securities.

<sup>9</sup> “other collateral”,

- (a) in relation to a LC, means any property (other than securities or money) deposited with, or otherwise provided by or on behalf of a client of the LC to, the LC; or any other intermediary or person, which is so deposited or provided (i) as security for the provision by the LC of financial accommodation, or (ii) to facilitate the provision by the LC of financial accommodation under an arrangement that confers on the LC a collateral interest in the property; or
- (b) in relation to a RI, means any property (other than securities or money) deposited with, or otherwise provided by or on behalf of a client of the RI to, the RI, in the course of the conduct of any regulated activity for which

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### Client money

In relation to a LC, means any money (i) received or held by or on behalf of the LC; or (ii) received or held by or on behalf of any corporation which is in a controlling entity relationship with the LC, which is so received or held on behalf of a client of the LC or in which a client of the LC has a legal or equitable interest, and includes any accretions thereto whether as capital or income.

In relation to a RI, means any money (i) received or held by or on behalf of the RI, in the course of the conduct of any regulated activity for which the RI is registered; or (ii) received or held by or on behalf of any corporation which is in a controlling entity relationship with the RI, in relation to such conduct of the regulated activity, which is so received or held on behalf of a client of the RI or in which a client of the RI has a legal or equitable interest, and includes any accretions thereto whether as capital or income.

b. What is the nature of a client's ownership rights with respect to its client assets placed with the investment firm?

Sections 4 and 5 of the Client Money Rules and the Client Securities Rules respectively require the Investment Firm to ensure that client assets which are received or held in Hong Kong 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 remain subject to a trust in favour of the client.

c. How does your jurisdiction define the term "client"? If the jurisdiction uses an analogous term, please provide that term and its definition.

d. Please describe any notable exclusions from the terms "client" or "client assets."

Under the SFO, "client", in relation to an intermediary<sup>10</sup>, means a person for whom the intermediary ("first intermediary") provides a service the provision of which

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the RI is registered; or any other intermediary or person, in relation to such conduct of the regulated activity, which is so deposited or provided (i) as security for the provision by the RI of financial accommodation, or (ii) to facilitate the provision by the RI of financial accommodation under an arrangement that confers on the RI a collateral interest in the property.

<sup>10</sup> "intermediary" means a licensed corporation or a registered institution.

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constitutes a regulated activity<sup>11</sup>. “Client” includes another intermediary that deposits securities, money or any property as collateral with the first intermediary and, in connection with a leveraged foreign exchange contract, does not include a recognized counterparty<sup>12</sup>.

*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 Securities and Futures Commission (“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?

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<sup>11</sup> “regulated activity” under the SFO means any of the regulated activities specified in Part 1 of Schedule 5 to the SFO, which are:

Type 1 : dealing in securities;  
Type 2 : dealing in futures contracts;  
Type 3 : leveraged foreign exchange trading;  
Type 4 : advising on securities;  
Type 5 : advising on futures contracts;  
Type 6 : advising on corporate finance;  
Type 7 : providing automated trading services;  
Type 8 : securities margin financing;  
Type 9 : asset management; and  
Type 10 : providing credit rating services.

<sup>12</sup> “recognized counterparty” means (i) an authorized institution as defined in section 2(1) of the Banking Ordinance (Chapter 155 of the Laws of Hong Kong); (ii) in relation to a particular transaction conducted by a corporation licensed for Type 3 regulated activities, another corporation which is also so licensed; or (iii) an institution prescribed by the Securities and Futures (Recognized Counterparty) Rules (Chapter 571B of the Laws of Hong Kong) made under section 397(1) of the SFO for the purposes of this definition as a recognized counterparty.

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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 Securities and Futures (Keeping of Records) Rules (Chapter 571O of the Laws of Hong Kong) require Investment Firms to keep such accounting and other records as are sufficient to (i) account for all client assets that they receive or hold; (ii) enable all movements of such client assets to be traced through their accounting systems and, where applicable, stock holding systems; (iii) reconcile, on a monthly basis, any differences in their balances or positions with other persons, including their associated entities, clearing houses, custodians and banks, etc. and show how such differences were resolved, and (iv) demonstrate compliance by them with specified sections (including payment of client money and deposit/registration of client securities and securities collateral) of the Client Money Rules and the Client Securities Rules, and that they have systems of control in place to ensure compliance with all such provisions;
- the Code of Conduct and Guidance Notes<sup>13</sup> issued by the SFC supplement the law with practical guidelines for Investment Firms holding / handling client assets;
- the law<sup>14</sup> 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 SFO to examine the books and records of an Investment Firm in certain circumstances, e.g. if the SFC has received an auditor report on a matter that, in the opinion of the auditor, constitutes on the part of the Investment Firm a failure to comply with prescribed requirements under the Client Money Rules or Client Securities Rules;
- 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.

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<sup>13</sup> Namely (i) Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission and (ii) 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

<sup>14</sup> Sections 153 and 156 of the SFO and the Securities and Futures (Accounts and Audit) Rules (Chapter 571P of the Laws of Hong Kong)

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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<sup>15</sup> 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;
- (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

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<sup>15</sup> In all the answers to this survey, the word "bank" refers to an "authorized institution" as defined in section 2 of the Banking Ordinance of Hong Kong.

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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? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

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 in the calculation of the amount of Client Assets that a firm is required to segregate.

ii Timing issues:

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

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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 use, 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

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

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.

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- i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?

If a client has granted the Investment Firm the right to use or re-hypothecate his assets, the ownership rights of the client over its assets would be subject to the terms and conditions of the client's grant. The court may (a) characterise a security interest with a right of re-hypothecation as being a title transfer arrangement; or (b) interpret such a security interest as having an implied right for the Investment Firm to acquire full legal and beneficial interest automatically upon a disposal (and a corresponding obligation on the Investment Firm to return equivalent securities in due course).

If the court characterizes a security interest with a right of re-hypothecation as a title transfer arrangement, the client has no proprietary interest in the collateral, but merely a conditional contractual right against the Investment Firm for re-delivery of assets. If the court interprets such a security interest as having an implied right for the Investment Firm to acquire full interest upon a disposal, the client is the beneficial owner of the assets delivered as collateral.

- ii. How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?

A client's consent should be in writing, in one-off direction or standing authority. A standing authority shall specify a validity period not exceeding 12 months and may be renewed upon expiry.

- iii. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (*i.e.*, established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator)?

If a client does not grant the Investment Firm any right to use or re-hypothecate his assets, according to sections 4 and 5 of the Client Money Rules and the Client Securities Rules respectively, the Investment Firm is required to hold the client assets in a segregated account which is designated as a trust account or client account. These assets so segregated remain subject to a trust in favour of the client. If the Investment Firm uses or re-hypothecates the client assets without the client's consent, the client would, in principle, have the right to trace and recover his assets. This conclusion is based on a line of authorities including *C.A. Pacific Securities Limited* (HCCW 36-37/98) and *Re Diplock* [1948] Ch. 465.

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If the Investment Firm, in breach of the relevant statute, rule or regulation, uses or re-hypothecates its client assets without such client's consent, the Investment Firm would have criminal liability on conviction. But it does not affect the client's right to its assets. The client could commence a civil action to trace and recover his assets which were held by the Investment Firm in trust for him. If there is a shortfall of client assets, the client who does not recover all his assets can apply to the court to wind up the Investment Firm and he will rank as an unsecured creditor in the liquidation in respect of the shortfall.

The SFC has established an Investor Compensation Fund to provide a measure of compensation to clients of an intermediary licensed or registered for Types 1, 2 or 8 Regulated Activity who suffer loss by reason of a default committed by the intermediary in connection with securities or futures contracts listed or traded on the Stock Exchange of Hong Kong and Hong Kong Futures Exchange. The compensation payable is limited to HK\$150,000.

- 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 in your jurisdiction permitted to transfer to, or hold Client Assets belonging to clients in your jurisdiction in, another jurisdiction?

Yes, an Investment Firm is permitted to transfer to, or hold Client Assets belonging to clients in our jurisdiction in, another jurisdiction.

The Client Money Rules and the Client Securities Rules require segregation of client money and client securities which are received or held in Hong Kong in a segregated account maintained in Hong Kong. Client's authorization in the form of a written direction or standing authority must be obtained if the client's money or securities received or held in Hong Kong is to be transferred outside Hong Kong unless the transfers are required for the purposes of meeting settlement or margin requirement on behalf of the client.

In addition, the Investment Firm should, in the handling of client transactions and client assets, act to ensure that client assets are accounted for properly and promptly. Where the Investment Firm or a third party on behalf of the Investment Firm is in possession or control of client assets, the Investment Firm should ensure that client assets are adequately safeguarded. Where a client's assets are received or held overseas, additional risk disclosures should be provided to the client informing the client that such client's assets may not enjoy the same protection as that conferred by

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the Client Money Rules and the Client Securities Rules on client assets held or received in Hong Kong<sup>16</sup>.

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<sup>17</sup>, Investment Firms are required to segregate, as far as practicable, such securities from their own assets.

If so, please provide details of those requirements.

5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)? If so,

Yes, an Investment Firm is permitted to hold Client Assets of Foreign Investment Firm in an Omnibus Account together with other client assets.

- a. What protections are applicable to the Foreign Investment Firm’s Client Assets?

Such Client Assets are entitled to the same protection as that conferred on other client assets received or held by the Investment Firm in Hong Kong.

- b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?

Not applicable (see response to 5(a) above).

- c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?

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<sup>16</sup> General Principle 8 and Paragraph 11.1 of the Code of Conduct.

<sup>17</sup> 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.

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The Foreign Investment Firm is subject to the same Client Asset protection requirements as other clients of the Investment Firm. Clients of an Investment Firm are not permitted to waive any of the Client Asset protection requirements.

6. 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<sup>18</sup> 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.

7. 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 SFO, the Client Money Rules and the Client Securities Rules on client assets held or received in Hong Kong.

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<sup>18</sup> An associated entity, 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.

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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)*

8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? 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.

9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:

- a. Does the Investment Firm report where client assets are held?

Yes. Investment Firms are required to report in the analysis of client assets in the financial returns how much client money and client securities are held by it and the amount of client funds segregated and distribution of the client securities by the locations specified in the financial returns, e.g. banks, clearing house, other investment firms. For client securities held in other locations, Investment Firms are required to specify the locations and purposes of the dispositions.

- b. Does the Investment Firm or depository report the protections applicable to such client assets?

Yes. An Investment Firm is required to notify the SFC in writing upon becoming aware that it does not comply with sections 4(4) (provision for a written confirmation of the renewal of the standing authority to client), 5 (requirement for deposit or registration of client securities and securities collateral) or 10(1) (limitations on the treatment of client securities and securities collateral) of the Client Securities Rules and sections 4(1) or (4) (requirement for designation of segregated account and payment of client money into segregated account) or 5(1) (requirement for payment of client money out of segregated accounts) of the Client Money Rules within one business day thereafter.

Section 56 of the Securities and Futures (Financial Resources) Rules (Chapter 571N of the Laws of Hong Kong) ("FRR") requires an Investment Firm to submit financial returns, which include an analysis of client assets, to the SFC on a monthly basis.

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In addition, under section 156 of the SFO and the Securities and Futures (Accounts and Audit) Rules (Chapter 571P of the Laws of Hong Kong) (“Accounts and Audit Rules”), an Investment Firm is required to submit to the SFC on an annual basis, financial returns, which include an analysis of client assets, made up to the last day of each financial year together with an auditor’s opinion as to, among other things, whether the financial returns so submitted are correctly compiled from the records of the Investment Firm.

An Investment Firm is also required under paragraph 12.5 of the Code of Conduct to notify the SFC immediately upon any material breach, infringement of or non-compliance with any laws, rules, regulations, and codes administered or issued by the SFC, the rules of any exchange or clearing house of which it is a member or participant, and the requirements of any regulatory authority which apply to the Investment Firm, or where it suspects any such breach, infringement or non-compliance whether by itself or persons it employs and appoints to conduct business with clients.

c. Does the Investment Firm or depository report the amount of assets that are held?

Yes. Please refer to Answer 9a above.

In each case, are such reports provided on request or periodically? If periodically, with what frequency?

The analysis of client assets is provided to the SFC in the financial returns submitted by Investment Firms on a monthly basis.

10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify
- a. Where Client Assets are held?
  - b. The amount of Client Assets held at a depository?
  - c. The safeguards applicable to Client Assets held at a depository?

Under sections 153 and 156 of the SFO and the Accounts and Audit Rules, an Investment Firm is required to appoint an auditor to conduct annual audit and review on its controls and compliance with the Client Money Rules and the Client Securities Rules and submit an auditor’s report to the SFC. The auditor’s report shall contain the auditor’s opinion as to, among other things, (a) whether each of the financial returns (including an analysis of client assets) made up to the last day of each financial year is correctly compiled from the records of the Investment Firm; (b) whether the Investment Firm had systems of control in place that were adequate to ensure compliance with the Client Money Rules and the Client Securities Rules during the financial year; and (c) whether the Investment Firm has complied with the Client Money Rules and the Client Securities Rules during the financial year.

Under sections 159 and 160 of the SFO, the SFC may appoint an auditor to examine and audit the accounts and records of an Investment Firm in certain circumstances, e.g. upon receiving an auditor report on a matter that, in the opinion of the auditor,

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constitutes on the part of the Investment Firm a failure to comply with the prescribed requirements under the Client Money Rules and the Client Securities Rules. The SFC has the authority under section 180 of the SFO to conduct onsite inspection on Investment Firms and their associated entities and require the production of records and documents from Investment Firms and their associated entities, and make inquiries concerning such records and documents in order to ascertain whether such firms are or have been complying with specified requirements, including those relating to client assets.

11. Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify
  - a. The amount and/or value of such Client Assets?
  - b. The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?

The SFC is a signatory to the IOSCO MMoU (Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information) which facilitates information exchange and mutual assistance between securities regulators.. Moreover, the SFC has entered into a number of bilateral MoUs and other written cooperative arrangements with securities regulators outside Hong Kong.

12. 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 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

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approval in connection with the firm's business, material failure or defects in the firm's operation or systems etc.

13. 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 14 below), apply to court for appointment of administrator, and issuance of injunction or other orders.

### **Post-Insolvency**

14. 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 (Chapter 32 of the Laws of Hong Kong) ("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

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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.

15. 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

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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 up the company 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 insolvency practitioners 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.

#### 16. 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 (Chapter 32H of the Laws of Hong Kong) 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.

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- 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.

17. 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.

18. What are the requirements, if any, governing the segregation and treatment of Client Assets *during* the insolvency of an Investment Firm?

An Investment Firm must still comply with the segregation and treatment of Client Assets as required under the Client Money Rules and the Client Securities Rules during the insolvency of an Investment Firm.

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19. 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. The time required for securing such consents would depend on the circumstances of individual case.

- 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..

20. 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.

21. 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 (Chapter 571AC of the Laws of Hong Kong) and the Securities and Futures (Investor Compensation – Claims) Rules (Chapter 571T of the Laws of Hong Kong).

22. 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

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(or a 'right-to-use' exercised), please explain the client's position under the Insolvency Regime in such event.

Generally, permissions granted by clients pre-bankruptcy would not have impact on the client's position except that the return of client assets that have been re-hypothecated or lent to a third party by the Investment Firm pre-bankruptcy may be subject to fulfillment by the Investment Firm of its liabilities to the third party.

23. 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.

24. 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.

25. 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 of securities, there is a line of authorities<sup>19</sup> 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

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<sup>19</sup> C.A. Pacific Securities Limited (HCCW 36-37/98); Re Forlux 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)

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cash clients and margin clients, the former having priority but clients in the same class sharing pari passu among themselves.<sup>20</sup> The same method is also used to allocate the available cash. However, in a case of misappropriation of Client Assets<sup>21</sup>, 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.

As regards whether clients take in priority to general unsecured creditors, see Answer 26 below.

26. 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](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](http://www.legislation.gov.hk/blis_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc*496*100*568.9#568.9)

#### **Securities and Futures (Client Money) Rules:**

[http://www.legislation.gov.hk/blis\\_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc\\*496\\*100\\*568.10#568.10](http://www.legislation.gov.hk/blis_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc*496*100*568.10#568.10)

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<sup>20</sup> C.A. Pacific, *ibid.*

<sup>21</sup> Re Great Honest Investment Company Ltd & Others (unreported HCMP 2251/2007 per Barma J)

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### **Securities and Futures (Financial Resources) Rules:**

[http://www.legislation.gov.hk/blis\\_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc\\*496\\*100\\*568.15#568.15](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](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](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](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](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](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](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](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](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://en-rules.sfc.hk/en/display/display.html?rbid=3527&element\\_id=1868](http://en-rules.sfc.hk/en/display/display.html?rbid=3527&element_id=1868)

### **Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission:**

[http://en-rules.sfc.hk/en/display/display.html?rbid=3527&element\\_id=162](http://en-rules.sfc.hk/en/display/display.html?rbid=3527&element_id=162)

## **2013 IOSCO Collated Responses to the Client Asset Protection Survey**

### **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://en-rules.sfc.hk/en/display/display.html?rbid=3527&element\\_id=2446](http://en-rules.sfc.hk/en/display/display.html?rbid=3527&element_id=2446)

### **Insolvency Guidance Notes issued by the Hong Kong Institute of Certified Public Accountants:**

<http://app1.hkicpa.org.hk/ebook/index.php>

**India**  
**2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

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(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.

a. How does your jurisdiction define the term “client assets?” If the jurisdiction uses an analogous term, please provide that term and its definition.

**"client assets" means funds, securities and positions held on behalf of client by a investment firm.**

b. What is the nature of a client’s ownership rights with respect to its client assets placed with the investment firm?

**The investment firms are required to settle the funds and securities of the clients within 24 hours of the pay out received from the stock exchanges. In case the shares/funds of the clients are held in the books of investment firms based on their consent, the same is required to be held in the fiduciary capacity on behalf of the client.**

c. How does your jurisdiction define the term “client”? If the jurisdiction uses an analogous term, please provide that term and its definition.

**A client is one who is registered with the investment firm for the purpose of dealing in the securities.**

d. Please describe any notable exclusions from the terms “client” or “client assets.”

**As mentioned above "client assets" include funds, securities and positions.**

**Further, there are no exclusions as on date in the definition of terms.**

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*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?

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?

**No special authorization viz. a specific form of license or registration is required to hold Client Assets. However, investment firm is required to obtained consent from their clients in case the shares/funds of the clients are held in the books of investment firms. In such case, the assets in the books of investment firm are required to be held in the fiduciary capacity on behalf of the client.**

**The compliance of above requirements is verified by SRO and SEBI during inspections of books of investment firm.**

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.**

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- 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?

**No**

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

**Regulation 17 of SEBI (Stock Broker and Sub-Brokers) Regulations, 1992 and SEBI circular SMD/SED/CIR/93/23321 dated November 18, 1993- 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.

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**

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Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

**No**

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).

**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 month or quarter, as per the choice of the client.**

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.**

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- 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 use, 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.**

- i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?
- ii. How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?

**As regards i and ii above, in India, clients assets cannot be used or re-hypothecated by an investment firm.**

- iii. How are the ownership rights of a client over its client assets changed or affected when the investment firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (i.e. established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator)?

**In India, clients assets cannot be used or re-hypothecated by an investment firm.**

- 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**

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**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 in your jurisdiction permitted to transfer to, or hold Client Assets belonging to clients in your jurisdiction 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?
  - c. If so, please provide details of those requirements.

**No. Investment firms are required to hold the assets of the clients in our jurisdiction**

5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)? If so,
  - a. What protections are applicable to the Foreign Investment Firm’s Client Assets?
  - b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?
  - c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?

**No**

6. 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.**

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- 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.*

7. 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.**

**Further, 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 month or quarter, as per the choice of the client. Investment firm is also required to send a periodical statement of accounts to clients on a prescribed interval of time.**

**Further, investment firm do not hold client assets in another jurisdiction.**

8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

**Investment firm has to comply with the requirements as mentioned in the answer to the query no 5 above.**

9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:

investment firms are required to report to

- a. Does the Investment Firm report where client assets are held?
- b. Does the Investment Firm or depository report the protections applicable to such client assets?
- c. Does the Investment Firm or depository report the amount of assets that are held?

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**YES**

In each case, are such reports provided on request or periodically? If periodically, with what frequency?

**The reports are provided both periodically as well as on request.**

10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify
- Where Client Assets are held?
  - The amount of Client Assets held at a depository?
  - The safeguards applicable to Client Assets held at a depository?

**The audits of regulatory requirements of client's assets are carried out by investment firm through an independent auditor on an half yearly basis. Further, Self-Regulatory Organizations conducts annual inspections to verify the same. Inspections are also conducted by regulator which are risk based.**

11. Where an Investment Firm based in a foreign jurisdiction (a "Foreign Investment Firm") deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify
- The amount and/or value of such Client Assets?
  - The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?

**Omnibus accounts cannot be opened in India.**

**Regulation 17 of SEBI (Stock Broker and Sub-Brokers) Regulations, 1992 and SEBI circular SMD/SED/CIR/93/23321 dated November 18, 1993 states that 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.**

**Foreign regulators can approach Indian regulators for accessing/verifying the details mentioned in (a) and (b) in terms of IOSCO MOU, if any entered between the countries.**

12. 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**

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

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 of investment firm is closely monitored by the stock 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.**

13. 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?

**Regulation 16 of the SEBI (stock Brokers and Sub-brokers) Regulations, 1992 requires that a minimum 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 and financials of investment firm is closely monitored by the stock 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.**

### **Post-Insolvency**

**Answers to all the questions pertaining to 'post-insolvency' are consolidated in a 'note' given below.**

14. 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?
15. 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?
16. 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?

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

- 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?
17. 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?
18. What are the requirements, if any, governing the segregation and treatment of Client Assets *during* the insolvency of an Investment Firm?
19. 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?
20. 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?
21. 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).
22. 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.
23. Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?
24. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?
25. 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?

26. 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 fulfill 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](http://www.nseindia.com), [www.bseindia.com](http://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.

Further, SEBI vide circular dated October 28,2004 has provided for the Investor Protection Fund /Customer Protection Fund at the stock exchanges as a mechanism to compensate the clients in case of default.

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 referred 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?

**[www.sebi.gov.in](http://www.sebi.gov.in)**

**[www.nseindia.com](http://www.nseindia.com)**

**[www.bseindia.com](http://www.bseindia.com)**

**Italy**  
**2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

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(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.

a. How does your jurisdiction define the term “client assets?” If the jurisdiction uses an analogous term, please provide that term and its definition.

The term “Client Assets” includes both financial instruments and funds (i.e.: Client Money) pertaining to clients. See Article 22 of Legislative Decree no. 58/1998 (hereinafter, the **“Consolidated Law on Finance”**) in footnote 3. See also the definition of “client assets” set out in Title V, Section I, para. 3 of the Bank of Italy Regulation of August 4, 2000 (hereinafter, the **“Bank of Italy Regulation on Investment Firms”**), according to which “assets” means “funds and financial instruments”.

Financial instruments are defined in accordance with MiFID under art. 1(2) of the Consolidated Law on Finance as meaning:

a) securities;

b) money market instruments;

c) units in collective investment undertakings;

d) options, futures, swaps, futures contracts on interest rates and other derivative contracts linked to securities, currency, interest rates or returns, or other derivatives, financial indices or measures that may be settled by the physical delivery of the underlying asset or by cash payment of differentials;

e) options, futures, swaps, interest rate swaps, and any other derivative contracts on commodities, settlement of which is by payment of the differentials in cash, or at the discretion of one of the parties, except in cases where such option is the result of default or other event leading to cancellation of the contract;

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f) options, futures, swaps and other derivative contracts on commodities, the settlement of which may be by physical delivery of the underlying asset and which are traded on a regulated market and/or multilateral trading systems;

g) options, futures, swaps, forward contracts and other derivative contracts on commodities, the settlement of which may be by physical delivery of the underlying asset, other than those indicated in paragraph f), that have no commercial purpose, and with the characteristics of other derivatives, taking into consideration, amongst other things, whether they are cleared and executed through recognised clearing houses or whether they are subject to regular margin calls;

h) derivatives for the transfer of credit risk;

i) financial contracts for difference;

j) options, futures, swaps, futures contracts, swaps, futures contracts on interest rates and other derivative contracts related to climatic variables, transport rates, emission levels, inflation rates or other official economic statistics, settled by cash payment of differentials or at the discretion of one of the parties, except in cases where such option is the result of default or other event leading to cancellation of the contract and other derivative contracts on assets, options, bonds, indices and measures other than those indicated in previous paragraphs, with the characteristics of other derivative financial instruments, taking into consideration, amongst other things, whether are traded on a regulated market or multilateral trading systems, whether they are cleared and executed through a recognised clearing house or whether they are subject to regular margin calls

b. What is the nature of a client's ownership rights with respect to its client assets placed with the investment firm?

Technically, clients have full ownership right (and not simply a claim) on their Client Assets (including Client Money) placed with an Investment Firm other than a bank. If the Investment Firm is a bank, clients have full ownership right on any of their Client Assets other than Client Money, whilst they have a claim on their Client Money, since banks acquire the ownership of the Client Money placed with them pursuant to Article 1831 of the Italian Civil Code.

c. How does your jurisdiction define the term "client"? If the jurisdiction uses an analogous term, please provide that term and its definition.

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The definition of the term “*client*” is provided for by Article 26, par. 1, letter c), of Consob Regulation no. 16190 of 29 October 2007 (“**Consob Regulation on intermediaries**”) - implementing the provisions on intermediaries of the Consolidated Law on Finance. In particular, “*client*” means “*any natural or legal person to whom an investment firm provides investment and/or ancillary services*”. The definition of “*client*” reproduces the one given by Directive 2004/39/EC (Markets in Financial Instruments Directive, “**MiFID**”).

Moreover, Article 26, para. 1, letters d) and e) of Consob Regulation on Intermediaries define the terms “*retail client*” and “*professional client*”, implementing the definitions given by MiFID. In particular, “*retail client*” is defined as “*the client who is neither professional nor a qualified counterparty*”<sup>22</sup>, whereas “*professional client*” means a client meeting the requirements of Annex 3 of Consob Regulation on Intermediaries, which provides that the possession of experience, knowledge and expertise to make its own investment decisions and properly assess the risks characterize the category and can be presumed for some entities, expressly indicated, or can be assessed on request<sup>23</sup>.

d. Please describe any notable exclusions from the terms “*client*” or “*client assets*.”

As mentioned below, there are some differences in the rules applying to Investment Firms other than banks and to banks providing investment services in respect of the protection of 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)*

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<sup>22</sup> The definition of “*qualified counterparty*” is provided by Article 58, para. 1 and 2, of Consob Regulation on Intermediaries, which read as follow: “*1. Qualified counterparties shall be those customers to whom order execution and/or own account trading and/or receipt and transmission of orders services are provided, defined as such in Article 6, paragraph 2-quater, letters d1), d2), d3) and d5) of the Consolidated Law on Finance.*

*2. Qualified counterparties shall also be companies meeting the requirements of Annex 3, part I, paragraphs (1) and (2) not already indicated under par. 1, to which the aforementioned services are provided, and companies classified as such pursuant to article 24, paragraph 3 of Directive 2004/39/EC, by the law of the home Member State in which they are registered or are subject to identical terms and conditions in the non-EU home State in which they are registered. From such counterparties the intermediaries shall obtain explicit confirmation, in general terms or in relation to each transaction, of their consent to be treated as qualified counterparties”.*

<sup>23</sup> The definition of “*professional client*” covers also public professional clients meeting the requirements of the regulations issued by the Minister for the Economy and Finance pursuant to Article 6, para. 2-sexies of the Consolidated Law on Finance.

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- (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 in individual accounts separately from their own assets and from the assets of other clients (see also response to question 3 below), pursuant to Article 22 of the Consolidated Law on Finance<sup>24</sup>.

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 and segregated 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 Title V of the Bank of Italy Regulation on Investment Firms, as amended on October 29, 2007, in order to specify the rules applicable to the handling of Client Assets. 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). The regime implements the provisions set forth in MiFID and in the Commission Directive 2006/73/EC (implementing MiFID as regards organizational requirements and operating conditions for investment firms, “**MIFID Implementing Directive**”). 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 which receive Client Money are under a duty to open a “third party” omnibus account with a bank or with the central bank within 1 day of receipt. This third party bank account shall be separated from the accounts where the Investment Firm deposits its 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

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<sup>24</sup> Article 22 of the Consolidated Law on Finance reads as follows (unofficial translation): “1. In providing investment and non-core services, the financial instruments and funds of individual customers held in whatever capacity by an investment firm, asset 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, asset 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 an investment firm, asset management company, harmonized management company or financial intermediary entered in the register provided for in Article 107 of the Consolidated Law on Banking may use, on its own behalf or on behalf of third parties, liquid balances belonging to customers which it holds in any capacity”.

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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 on Intermediaries and Consob and the Bank of Italy Regulation of October 29, 2007 (“**Regulation on Internal Organization**”). These rules implement the provisions set forth in MiFID and in the MiFID Implementing Directive.

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 depository bank shall be approved by the Bank of Italy, which shall verify that independency, experience, capital and organizational requirements provided for under Chapter VIII, Title V of the Bank of Italy Regulation of May 8, 2012 (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<sup>25</sup>.

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 Title IV, Chapter 2 of the Consolidated Law on Finance and applied under the supervision and direction of the Bank of Italy.

Moreover, Client Assets are protected through mandatory investor compensations schemes. According to Article 59 of the Consolidated Law on Finance, in fact, an Investment Firm may be authorized provided that it adheres to a duly recognized investor compensation scheme.

### **Pre-Insolvency**

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<sup>25</sup> Article 168 of the Consolidated Law on Finance reads as follows: “*Unless the act constitutes a more serious offence, any person who, in providing investment services or activities or collective asset management services or custody for the financial instruments or funds of a collective investment undertaking, with a view to obtaining an undue profit for himself or for others, violates the provisions governing the separation of assets and thereby causes injury to clients shall be punished by imprisonment for between six months and three years and by a fine of between 500.165 euro and 103.291 euro*”.

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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. Not all Investment Firms are authorized to hold, even temporarily, Client Assets. Safekeeping and administration of Client Assets is an ancillary service under MiFID. A firm must specify in its application for authorization whether it intends to hold Client Assets. As mentioned below, to be authorised as Investment Firms, firms intending to hold Client Assets are required to comply with special capital requirements according to the Bank of Italy Regulation on Investment Firms.

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

To be authorised as Investment Firms, firms intending to hold Client Assets must satisfy higher initial and on-going capital requirements (minimum 1 million €) than those applicable to Investment Firms which do not hold Client Assets (minimum 385,000 €, pursuant to Chapter 1, Title II of the Bank of Italy Regulation on Investment Firms.

Moreover, to be authorised 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.

- 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?

Yes, pursuant to Article 22 of the Consolidated Law on Finance (see footnote 3) and Title V, Section II, of the Bank of Italy Regulation on Investment Firms, Client Assets held by the Investment Firm for one client must be maintained separately from the Client Assets held for any other client and from the Investment Firm's own assets.

For each Client, the Investment Firm must keep separate evidence of the Client Assets on the basis of the type of service/activity provided and maintain evidence of the relevant (if any) custodians and sub-custodians.

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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. As mentioned below, the Investment Firm must conduct, on a regular basis, reconciliations between its internal accounts and records and those of any custodian and sub-custodian by whom the Client Assets are held (see Title V, Section II, para. 1 of the Bank of Italy Regulation on Investment Firms).

i. Are Investment Firms allowed to hold Omnibus Accounts?

In the relationships between the client and the Investment Firm, the Investment Firm shall maintain separate, individual evidence of the Client Assets for each of its Client. This means that Investment Firms must hold Client Assets in the name of the individual client. Omnibus accounts are only permitted in the relationship between the Investment Firm and a third party custodian/depositary (e.g. where the Securities are sub-deposited, for instance, with a central depository or where the Client Money are held through a bank, see below).

As mentioned in the answer to question 2, 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 its own assets. See Title V, Section I, para. 2 and 5 of the Bank of Italy Regulation on Investment Firms.

Moreover, according to Title V, Section I, para. 1 and 3 of the Bank of Italy Regulation on Investment Firms, Investment Firms may sub-deposit client financial instruments in an omnibus accounts with a third party provided that the client gives its consent. If the client is a professional client, an oral agreement will suffice.

The Investment Firm must exercise 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 financial instruments, in accordance with the provisions of Title V, Section I, para. 4 of the Bank of Italy Regulation on Investment Firms, reproducing the provisions of the MiFID Implementing Directive. See also responses to questions 4, 5 and 6, below.

The use of financial instruments held in an omnibus account by the Investment Firm is subject to specific conditions, as mentioned in response to question 3, d below.

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

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As mentioned, Investment Firms must hold Client Assets in the name of the individual client. Set off between positions (both in money and in financial instruments) of different clients is prohibited under Article 22 of the Consolidated law on Finance and Title V, Section II, para. 1, of the Bank of Italy Regulation on Investment Firms. 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 Money (funds/cash) is a fungible asset. 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 be 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 Title V, Section II, para. 1, of the Bank of Italy Regulation on Investment Firms) and on an aggregate basis for each asset class they hold (see Articles 32 and 36 of the Regulation on Central Depositories). See also response to question 3, b, 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? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

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If a client has a debit balance (i.e., the client owes the Investment Firm), the Investment Firm is required to contribute from its own resources. As mentioned in other answers, given the principle of true asset segregation, the obligations to other clients cannot be affected (i.e.: the offsetting between clients is not permitted in Italy, since Client Assets have to be segregated on a client by client, individual basis).

### 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 Title V, Section II, para. 1, of the Bank of Italy Regulation on Investment Firms). Furthermore, according to Article 36 of the Regulation on Central Depositories, within one day from the date of registration, Investment Firms shall check for each type of financial instrument that the balance of their own account at the central depository, or the sum of the balances of their own accounts at the central depositories, coincides with the balance of their own accounts as kept by themselves 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 business 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, were not properly booked or held. The Investment Firm would be liable towards the client to pay damages.

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Moreover, the commingling of Client Assets is criminally sanctioned pursuant to Article 168 of the Consolidated Law on Finance (see footnote 4).

- 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 nor encouraged to maintain any of its own assets in a Client Asset Account.

If the reconciliation reveals an excess, this would be considered as an irregularity. If client accounts and records are kept properly, there should be no excess.

- 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 Client Assets for meeting the obligations of other clients (see Article 22(3) of the Consolidated Law on Finance).

- 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 use, the Client Assets? If so, please describe.

Yes. Investment Firms are prohibited from making use of client financial instruments on their behalf or on behalf of third parties, unless the client has given his written consent. Moreover, Investment Firms other than banks are prohibited from making use of Client Money on their behalf or on behalf of third parties, unless the client has given specific consent (see Article 22(3) of the Consolidated Law on Finance).

Pursuant to Title V, Section II, para. 1, of the Bank of Italy Regulation on Investment Firms, reproducing the provisions of the MiFID Implementing Directive, 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.

Moreover, the Investment Firm cannot use financial instruments held in an omnibus account unless at least one of the following conditions is met: (i) each client whose financial instruments are held together in an omnibus account has given prior express consent (it is not mandatory to acquire the prior express consent from a professional client); (ii) the Investment Firm must have in place systems and controls which ensure that only financial instruments belonging to clients who have given prior express consent are so used.

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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.

The records of the Investment Firm shall include details of the client on whose instructions the use of the financial instruments has been effected, as well as the number of financial instruments used belonging to each client who has given his consent, so as to enable the correct allocation of any loss.

i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?

All Client Assets belong to respective clients, regardless to whether or not any "right of use" was exercised by the Investment Firm. See also response to question 22.

ii. How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?

As mentioned above, if the client is a retail client, 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 (see Title V, Section II, para. 1, of the Bank of Italy Regulation on Investment Firms).

iii. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (*i.e.*, established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator)?

As stated above, the use (including re-hypothecation) of Clients Assets is subject to the Client's specific consent. All Client Assets belong to respective clients, regardless to whether or not any "right of use" was exercised by the Investment Firm. See also response to question 22.

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

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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 in your jurisdiction permitted to transfer to, or hold Client Assets belonging to clients in your jurisdiction 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?

As mentioned in response to question 1, Clients Money shall be held through a custodian, which shall be a duly authorized bank. The custodian can be located in a foreign jurisdiction. The account with the custodian shall be opened in the name of the Investment Firm, and shall indicate that the Money 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 Title V, Section II, par. 2, of the Bank of Italy Regulation on Investment Firms).

Moreover, as mentioned in response to question 3, a, i), Investment Firms are permitted to sub-deposit client financial instruments with a third party (which can be located in another jurisdiction), provided that the client has given his consent (in written form if the client is retail).

These financial instruments 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.

Investment Firms are required to keep evidence of the name of the sub-custodians where the client financial instruments are held, relevant nationality and whether it belongs to the same group.

See also response to questions 5 and 6 below.

- 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. It applies, *mutatis mutandis*, the same rule as above: the Investment Firm shall register Client Assets in an omnibus account, indicating that the assets belong to third parties.

5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)? If so,

- a. What protections are applicable to the Foreign Investment Firm’s Client Assets?

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- b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?
- c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?

As indicated in response to Question 4, the custodian of the Client Money and the sub-custodian of client financial instruments can be located in another jurisdiction. In any case, Investment Firms are required to preserve the separate identification of the Client Assets held with the custodian or sub-custodian.

Investment Firms must exercise all due skill, care and diligence in the selection, appointment and periodic review of the custodian of Client Money and any sub-custodian of client financial instruments and the arrangements for the holding of the Client Assets. They must take into account the expertise and market reputation of such third parties with a view to ensuring the protection of clients' rights, as well as any legal or regulatory requirements or market practices related to the holding of Client Assets that could adversely affect clients' rights.

Moreover, Investment Firms are responsible to periodically monitor the custodian and any sub-custodian in a view of ensuring that they are effective and reliable in maintaining separate identification of these third party assets. The deposit with a third party is without prejudice to the Investment Firm's liability to return the assets to the client.

See also response to question 6 below.

6. 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?

Title V, Section I, para. 4 of the Bank of Italy Regulation on Investment Firms, reproducing the provisions of the MiFID Implementing Directive, sets forth the following rules apply to the selection of the sub-custodian of client financial instruments:

- if the safekeeping of financial instruments for the account of another person is subject to specific regulation and supervision in a jurisdiction where an Investment Firm proposes to deposit client financial instruments with a third party, the Investment Firm must deposit those financial instruments in that jurisdiction with a third party which is subject to such regulation and supervision;
- when the foreign jurisdiction does not regulate the holding and safekeeping of financial instruments for the account of another person, the sub-deposit is admitted only provided that: (i) the deposit is necessary in view of the

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particular financial instrument or the service provided, or (ii) the client is a professional one and has consented in writing to deposit the financial instruments with a third party in that jurisdiction.

As mentioned in response to questions 1 and 4, Clients Money shall be held through a custodian, which shall be a duly authorized bank.

Moreover, as mentioned in response to question 2, a, not all Investment Firms are authorised 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, para. 5, of the Bank of Italy Regulation on Investment Firms).

The custodian of Client Money and the sub-custodian of client financial instruments may be an affiliate of the Investment Firm, provided that the conditions outlined above are met.

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 (see Article 36, para. 2 and 4, and Article 38 of the Consolidated Law on Finance). The custodian must be an authorized EU bank (so called depository bank) subject to ongoing supervision by the Bank of Italy. The appointment of the depository bank shall be approved by the Bank of Italy, which shall verify that relevant requirements provided for under Title IV, Chapter III, par. 2 of the Regulation on Asset Management are met. In particular, the depository bank must satisfy experience, capital (100 million €), organizational and independency requirements and shall act in the interests of 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. An affiliate of the asset management company may be appointed as depository bank only where the aforesaid independence conditions are met.

- 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, 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 placed on the Client Assets, the relevant counterparty and liabilities of the parties. The Investment Firm shall ensure that the sub-custodian complies with the

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terms and conditions agreed with the client, the sub-custody shall be without prejudice to the Investment Firm's liability towards the client. 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 Title V, Section II, para. 1, of the Bank of Italy Regulation on Investment Firms).

7. 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, 29 and 30 of Consob Regulation on Intermediaries).

In particular, according to Article 29, para. 1, lett. g), of Consob Regulation on Intermediaries, the Investment Firm which holds Client Assets shall provide retail clients with a summary description of the methods implemented to guarantee their protection. Pursuant to the following lett. h), the Investment Firm shall also inform retail clients or potential retail clients of the investor compensation system or relevant deposit guarantees, with a summary description of the cover terms.

Moreover, pursuant to Article 30, para. 2, of Consob Regulation on Intermediaries, the Investment Firm which holds Client Assets shall inform retail clients of any possibility that financial instruments or sums of money pertaining to that clients may be held by a third party on behalf of the intermediary, and the liability assumed, in compliance with applicable national law, with regard to any act or omission by said third party and of the consequences that the insolvency of the latter may bring upon the client.

Where financial instruments of the retail client may be held in an omnibus account by a third party, the Investment Firm shall inform the client of this fact and shall provide clear warning of the risks that may derive therefrom (see Article 30, para. 3, of Consob Regulation on Intermediaries).

Where accounts containing Client Assets may be subject to non-EU legislations, the Investment Firm must provide information of this circumstance and indicate to what extent the rights of the client over such assets may be influenced (see Article 30, para. 4, of Consob Regulation on Intermediaries).

The Investment Firm must also inform the client of the existence and terms of any right of guarantee or privileges that the Investment Firm, or sub-depository, shall claim or may claim with regard to the Client Assets, or any related right to compensation that may exist (see Article 30, para. 5, of Consob Regulation on Intermediaries).

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Prior to using, on its own account or on behalf of another client, financial instruments held on behalf of a retail client, the Investment Firm must, in a timely manner and in hard copy, provide the retail client with a clear, complete and accurate information on the obligations and liabilities of the Investment Firm in relation to the use of such financial instruments, including the terms for restitution of the instruments and related risks.

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 retail client, the consent must be in writing). Moreover, in case the client has given consent to the use of his assets by the Investment Firm or custodians/sub-custodians, the Investment Firm shall inform the client of 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.

8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? 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 true segregation regime 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.

9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:
  - a. Does the Investment Firm report where client assets are held?

Yes. The investment firm must report to the regulator about client financial instruments, by distinguishing whether such financial instruments are held by the Investment Firm itself (if authorised to provide the ancillary service of custody of Client Assets) or deposited or sub-deposited with a third party. The data are divided per investment service. In case of deposit/sub-deposit with a third party, there is also an indication of the type of custodian/sub-custodian and its residence.

Moreover, the Investment Firm must report to the regulator about Client Money, by distinguishing whether Client Money is temporarily held by the Investment Firm (if authorised to provide the ancillary service of custody of Client Assets) or deposited with a custodian. The data are divided per investment service. There is also an indication of whether or not the custodian is a bank or another entity.

An investment firm must also report to the regulator on its exposure toward the third party with whom Client Assets are deposited within the information provided in relation to credit risks.

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- b. Does the Investment Firm or depository report the protections applicable to such client assets?

Yes, see above.

- c. Does the Investment Firm or depository report the amount of assets that are held?

See response to question 9, a.

In each case, are such reports provided on request or periodically? If periodically, with what frequency?

The reports are provided periodically on a quarter basis.

10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify

- a. Where Client Assets are held?  
b. The amount of Client Assets held at a depository?  
c. The safeguards applicable to Client Assets held at a depository?

The Bank of Italy and Consob may require authorised Investment Firms to communicate data and information and to transmit documents and records in the manner and within the time limits they establish (see Article 8 of the Consolidated Law on Finance). They can also carry out inspections and investigations and Consob, within the scope of its competences, can exercise all the powers provided for under Article 187-octies.

11. Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (i.e., of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify

- a. The amount and/or value of such Client Assets?  
b. The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?

12. 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 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

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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.

13. 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**

14. 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?

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The insolvency proceedings applicable to Investment Firms are regulated under Articles 56 (special administration) and 57 (compulsory administrative liquidation) 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 do 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 judicially declared 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, hereinafter the “**Bankruptcy Law**”).

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; or 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.

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15. 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 Consolidated Banking Law (see Article 71(6) of the Consolidated Banking Law).

16. 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 and ff. of the Consolidated Banking Law for the special administration and Article 84 and 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 reconstitute 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).

17. 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?

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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.

18. What are the requirements, if any, governing the segregation and treatment of Client Assets *during* the insolvency of an Investment Firm?

During the insolvency of an Investment Firm segregation shall always be maintained, whatever measure the Administrative Officers may adopt for winding-up purposes (transfer of assets and liabilities or continuation of the exercise of the undertaking).

19. 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. Formalities to make the transfer are simplified compared to ordinary regime. The transfer needs to be authorised by the Bank of Italy. 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 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.

20. 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.

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In particular, the claw-back regime provides that the Administrative Officer can revoke the following transactions, unless the party dealing (the party contracting with the insolvent company in the transactions challenged by the customer) is able to demonstrate 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.

21. 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).

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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 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<sup>26</sup>.

22. 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 23 below).

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<sup>26</sup> 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.*

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23. 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 of 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.

24. 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 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, clients are treated as unsecured creditors for the whole. If the rules on segregation among individual clients are not complied with, clients shall be treated as unsecured creditors for the part of their rights which has not been satisfied on a pro rata basis.

25. 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 22 above).

26. 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 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 previous responses). Technically, 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

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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.

In the end, our 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?

Statutes are attached to the accompanying email.

**Japan**  
**2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

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(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 Japan, the protection of client assets is ensured mainly by four tools under the Financial Instruments and Exchange Act (FIEA). One is segregation requirement for an investment firm under which its client assets should be stored separately from the firm’s own assets. Another tool is Investor Protection Fund which will compensate client assets in case of insolvency of an investment firm. The third one is annual checks of the status of segregation by external auditors. The last one is our continuous supervision of investment firms through which we will check the status of the firm’s management of client assets.

- a. How does your jurisdiction define the term “client assets?” If the jurisdiction uses an analogous term, please provide that term and its definition.

Paragraph 3 of Article 79-20 of the Financial Instruments and Exchange Act (FIEA) defines the assets of “general customers” which are entitled to receive compensation by Investor Protection Fund in case an investment firm becomes insolvency as follows.

- Money or securities which are placed by general customers for transactions of exchange-traded securities derivatives or for margin transactions.
- Money or securities which are placed by general customers for transactions of securities.

- b. What is the nature of a client’s ownership rights with respect to its client assets placed with the investment firm?

Placing client assets with the investment firm itself does not change the nature of client’s ownership, which remains in the client.

- c. How does your jurisdiction define the term “client”? If the jurisdiction uses an analogous term, please provide that term and its definition.

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Paragraph 1 of Article 79-20 of the FIEA defines “general customers” which are entitled to receive compensation by Investor Protection Fund in case of insolvency of an investment firm. This excludes sovereigns, local governments and qualified institutional investors with adequate experience and knowledge of investment.

- d. Please describe any notable exclusions from the terms “client” or “client assets.”

The money or securities which are placed by general customers for OTC derivative transactions are excluded from the definition of “client assets” defined above. As to the exclusions from the definition of clients, please see the answer to question c.

*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?  

Only firms registered with the Prime Minister under the FIEA are allowed to conduct financial instruments business in Japan. Minimum entry requirements including minimum capital/deposits, “fit and proper” rules for officers, adequate internal controls and risk management systems and sufficiency of resources will apply to investment firms. On an ongoing basis, investment firms must maintain those requirements.
  - b. If special authorization is not required, how, if at all, is this activity supervised by a regulator?
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

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of the process by which segregation is accomplished, and of the applicable requirements. Specifically:

Yes. Client assets which are placed to an investment firm when the firm provides its intermediary services of securities transactions and exchange-traded derivatives transactions or margin transactions should be segregated from the firm's own assets pursuant to Articles 43-2 and 43-3 of the FIEA. In addition, under Paragraph 3, Article 43-2 of the FIEA, an investment firm should be subject to an external audit regarding the status of segregation of client's assets.

- 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.

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

An investment firm is required to store its client assets at least in a way which it can identify each client's assets under the FIEA. In this sense, losses due to the activities of other clients will never affect each client.

- 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?

Investment firms are required to hold specific assets deposited by each client and return them as they are under the FIEA.

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

Reconciliation should be conducted on a client-by-client basis under the FIEA.

- 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? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

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Yes, a client's debit balance will reduce the Investment Firm's obligation with the client under the FIEA. However, a client's net debit balances will not reduce the firm's net credit balances of other clients under the FIEA.

ii Timing issues:

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

We do not have any specific requirement stated in the FIEA.

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

NA

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?

No. It is not allowed for investment firms.

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. We do not have such requirements. .

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

Yes, if a client gives consent to the use of his or her assets by a firm.

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 use, the Client Assets? If so, please describe.

Yes. Written consent of a client is required for an investment firm to use securities posted by the client under Article 43-4 of the FIEA.

i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?

The ownership rights will be changed by the use or re-hypothecation of client assets by an investment firm.

ii. How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a

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client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?

Written consent of a client is required for an investment firm exercising such rights on the client's securities under Article 43-4 of the FIEA. The document which proves the client's consent should be stored in records pursuant to Article 46-2 of the FIEA and Article 157 of the Cabinet Office Ordinance on Financial Instruments Business, etc.

iii. How are the ownership rights of a client over its client assets changed or affected when the investment firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (i.e. established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator)?

If the firm goes bankrupt, the right of clients to their assets which the firm uses or re-hypothecate will be categorized into the general claims to the firm under our civil law and thus there is possibility that those assets are not returned to clients even in the case where the clients did not give consent to the re-use or re-hypothecation by the firm.

- 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 Japan, investment firms are required to post margins to clearing houses separately for their own positions and for their clients' positions.

4. Are Investment Firms in your jurisdiction permitted to transfer to, or hold Client Assets belonging to clients in your jurisdiction 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?
- Yes.
- 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.
5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions ("Foreign **Investment Firms**") in an Omnibus Account (that includes Client Assets from domestic clients)?

Yes.

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- If so,
- a. What protections are applicable to the Foreign Investment Firm's Client Assets?  

Clients' assets will be at least stored in a manner where a firm can identify each client's assets.
  - b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?  

NA
  - c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?  

NA
6. 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 for client's cash, the investment firm has to put it into a third party custodian licensed in Japan. As for securities, we do not have any specific requirements on the party who stores them on behalf of investment firms.
  - 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.  

After the Lehman's crisis, JFSA asked all the investment firms in Japan to take appropriate actions such as the deletion of LIEN terms if any through Japan Securities Dealers Association in June, 2011.
7. 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?
- Pursuant to Article 46-4 of the FIEA, investment firms are required to disclose to the public the documents which explain the status of business operation and property of the investment firms every business year. The items which should be stated in the documents are raised in Article 174 of the Cabinet Office Ordinance. Based on item (iv), (b) of the article, the firms are required to disclose the volume or amounts of client assets and how each type of those assets is stored or managed to the public regardless of whether clients assets are stored domestically or in other jurisdictions. Investment firms are required to submit a report written by external auditors on the segregation of assets of clients to the JSDA (Japan Securities Dealers Association).

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8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

If a client gives consent to a firm's reuse or re-hypothecation of his or her assets, segregation requirements will not apply to those assets. Written consent of a client is required for the firm to re-use or re-hypothecate his or her assets.

9. Are Investment Firms your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:
- Does the Investment Firm report where client assets are held?
  - Does the Investment Firm or depository report the protections applicable to such?
  - Does the Investment Firm or depository report the amount of assets that are held?

In each case, are such reports provided on request or periodically? If periodically, with what frequency?

Based on Article 56-2 of the FIEA, investment firms are required to report such data to the Japan FSA on a monthly basis.

10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify
- Where Client Assets are held?
  - The amount of Client Assets held at a depository?
  - The safeguards applicable to Client Assets held at a depository?

The Securities and Exchange Surveillance Commission (SESC), an inspection and investigation arm of the FSA as well as JSDA (Japan Securities Dealers Association) will check the firm's status of management of its client assets in its examination on a regular basis. In addition, also checks the status on a regular basis. In addition, under Paragraph 3, Article 43-2 of the FIEA, an investment firm should be subject to an external audit regarding the segregation of client's assets.

11. Where an Investment Firm based in a foreign jurisdiction (a "Foreign Investment Firm") deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify
- The amount and/or value of such Client Assets?

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- b. The protections actually applicable to such Client Assets, in light of steps taken by the Foreign Investment Firm to secure or to reduce such protections?

Where there is an applicable memorandum of understanding between the relevant regulators, the foreign regulator could request information from the domestic regulator through that memorandum of understanding. By law the FSA can share information with overseas regulators, and it has entered into arrangements of cross-border supervisory cooperation with a number of countries. Additionally, the FSA is a signatory of IOSCO MMOU, which covers enforcement cooperation. Regardless of documentation, as long as equivalence of confidentiality obligation is assured, confidential information can be provided by the FSA.

12. 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 are required to maintain records and calculate their own capital adequacy ratio. They are also required to prepare quarterly financial reports which are provided to the FSA and published. These reports include capital adequacy, total assets, clients' assets outstanding and cash positions. In addition, they must provide a monthly risk management report (containing financial information, balance sheet and capital adequacy calculation) to the FSA or the Local Finance Bureau but they do not make this publicly available. If capital adequacy ratio of an investment firm falls below a ratio of 140%, it is required to prepare and submit daily notifications to the FSA of its financial position. If its capital adequacy ratio falls below 120 percent, the FSA will order a firm to submit the plan for specific measures to maintain or improve the ratio ("corrective action").

13. 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 an investment firm fall to less than 50 million yen, the FSA may rescind the firm'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 an investment firm is less than 100 percent, if the FSA finds it necessary and appropriate for the public interest or protection of investors, it 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 FSA has ordered the suspension of all or part of its business and if it finds that the capital-to-risk ratio of firm 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 the firm is not likely to recover, it may rescind the registration of the firm.

## Post-Insolvency

14. 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?

Currently, we do not have a bankruptcy regime specifically applied to investment firms. Likewise other corporates, Civil Rehabilitation Act, Corporate Reorganization Act or Bankruptcy Act will apply to them. Only in a bankruptcy process of under the Bankruptcy Act, the regulator can file for bankruptcy of a firm. However, responding to the FSB’s Key Attributes for Effective Supervision, the Financial System Council, which is an advisory panel to the Minister of Financial Affairs, has considered the necessity for a new resolution regime for non-bank financial institutions. According to their final report, it has concluded that reflecting the global trends, it is necessary to establish a framework for orderly resolution regime of financial institutions including investment firms, in order to address risks that may spread across financial markets. Based on their conclusions, appropriate establishment of a new framework will be prepared by JFSA.

15. 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 will select the Administrative Officer for bankruptcy proceedings. There is no particular qualification for an Administrative Officer.

16. 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?

Under Paragraph 1, Article 85 of Bankruptcy Act, an administrator should perform his/her duties with due care of a prudent manager. We do not have any further specific guidelines for clarifying these duties.

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?

When an administrator fails to fulfill the duty of diligence, he or she will be liable for compensation of damages under the Paragraph 2 of the act.

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

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- a. Does the regulator continue to supervise the Investment Firm?  
When there are concerns about inability to pay of an investment firm, the FSA will issue a business improvement order together with rescinding a registration of an investment firm or issuing a business suspension order. For example, when Lehman Brothers Holdings Inc., the parent company of Lehman Brothers Japan Inc. went bankrupt, the FSA issued business improvement order of which the details are as follows.
- Get hold of information on its investors and their assets deposited precisely.
  - Preserve assets deposited by investors and not use up its property unreasonably.
  - Take full measures for investor protection with considering fair treatment among investors.
  - Try to keep every investors informed appropriately about the retention of deposited assets, and consider appropriate actions for investors.
- b. How, if at all, is the regulator involved in the process of returning Client Assets?  
The FSA will issue a business improvement order, with which we require the firm for smooth return of its client assets.
18. What are the requirements, if any, governing the segregation and treatment of Client Assets *during* the insolvency of an Investment Firm?  
As explained before, when there are concerns about inability to pay of an investment firm, the FSA will issue a business improvement order for client protection together with rescinding a registration of an investment firm or issuing a business suspension order. The FSA will supervise the firm in order to check whether the firm meets the request stated in the order.
19. 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.
- a. What steps, if any, are prerequisite to accomplishing such a transfer? In general, how long does it take to accomplish those steps?  
Consent of each client will be required for the accomplishment.
- b. What factors, if any, affect the time period required to accomplish such a transfer?  
The same above will be a major factor.
20. 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?

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Under Article 52 of FIEA, when there are concerns about inability to pay of an investment firm, the FSA will issue a business improvement order together with rescinding a registration for the investment firm or issuing a business suspension order. Through such order, the FSA will ask the firm to preserve assets deposited by investors and not use up its property unreasonably.

21. 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.

22. 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.

In our bankruptcy process, a client's assets which are re-hypothecated will be categorized into general claims to an investment firm.

However, the client will be protected to some extent by the following means. When a client gives consent to an investment firm concerning its re-use of his/her securities placed in the firm as collateral, section 3, paragraph 2 of article 43-2 of the FIEA requires the investment firm to put the money equivalent to the current price of the securities used as collateral by the firm into a custodian bank licensed in [Japan](#) for the purpose of returning the client's assets in case of insolvency of the firm. In this sense, the client is protected.

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

When liquidating Japanese subsidiary of Lehman Brothers Securities, it was found out that LIEN was attached to the securities which belong to the clients of the subsidiary. Under the LIEN, other group affiliates could exercise the rights on the securities in case of insolvency of the group. Such transaction was done when the Japanese subsidiary posted its client assets to the London operation. This threatened and delayed the return of client assets.

24. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?  
If segregation requirements are not fulfilled by an insolvent investment firm and if Investor Protection Fund finds it difficult for the firm to smoothly return some of client assets, the Fund will compensate the clients concerned up to 10 million yen and the loss which is not covered by the compensation by the Investor Protection Fund will be shared among those clients proportionally.

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25. 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 such case, there is no priority distribution for clients.

26. 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, each client's assets should be returned promptly to the client if those assets are segregated from a firm's own assets. In our solvency regime, there is no difference in treatment between domestic creditors and 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?

English version of FIEA is uploaded on the following link.

<http://www.fsa.go.jp/en/refer/legislation/index.html>

The link to our inspection manual for investment firms is as follows.

<http://www.fsa.go.jp/sesc/kensa/kensa.htm#02>

**Korea**  
**2013 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 both in advance of and 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"** means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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

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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.
  - a. How does your jurisdiction define the term “client assets?” If the jurisdiction uses an analogous term, please provide that term and its definition.

Any financial investment product or money that has been deposited into the client’s investment account as a result of trading through a financial investment business entity.

- b. What is the nature of a client’s ownership rights with respect to its client assets placed with the investment firm?

Client assets are the sole property of the client. In order to protect client assets from a financial investment business entity’s default, etc., client’s deposits are deposited in a financial securities company while securities belonging to clients must be deposited in Korea Securities Depository.

- c. How does your jurisdiction define the term “client”? If the jurisdiction uses an analogous term, please provide that term and its definition.

Under the Financial Services and Capital Markets Act(FSCMA), client’s are deemed to be the counterparty of a financial investment business entity in a transaction of financial investment product and are categorized into “professional investor” and “ordinary investor.”

“Professional investor” means an investor who has an ability to take risks accompanying the investment in light of the expertise that it possesses in connection with financial investment instruments, the scale of assets owned by it, etc., and who falls under any of the following subparagraphs: Provided, That a financial investment business entity shall give consent to a professional investor prescribed by Presidential Decree when the investor notifies the financial investment business entity in writing of its willingness to be treated as an ordinary investor, unless there is a justifiable ground otherwise, and such investor shall be treated as an ordinary investor when the financial investment business entity gives such consent.

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1. State;
2. The Bank of Korea;
3. Financial institutions specified by Presidential Decree;
4. Stock-listed corporations: Provided, That trading over-the-counter derivatives with a financial investment business entity shall be limited to cases where an investor notifies the financial investment business entity in writing of its willingness to be treated as a professional investor; and
5. Other persons specified by Presidential Decree.

The term “Ordinary investor” means any investor other than professional investors.

- d. Please describe any notable exclusions from the terms “client” or “client assets.”

N/A

*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 our jurisdiction, different laws and regulations are applied according to the categories of Client Assets, Models of trading, and categories of clients.

- (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.*

In general, the differences are:

1. **According to the categories of client assets** : client’s deposits are to be deposited and managed separately from the financial investment business entity’s assets and are to be kept in a financial securities company. Client’s securities which were obtained as a result of the trading of financial investment products and any other transactions are to be kept at the Korea Securities Depository.

2. **According to the models of trading**: for transactions that occur in the exchange, trading is possible with multiple parties whereas for transactions that occur outside the exchange(i.e., over-the-counter) only two parties (i.e., one seller and one purchaser) may enter into contract.

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3. According to the categories of clients : For ordinary investors, a financial investment business entity must obtain information about the investment purpose, status of property, experience in investment, etc. of these investors before recommending an investment. A financial investment business entity must not recommend an ordinary investor to make an investment if the investment is deemed unsuitable for the investor in light of the investment purpose, status of experience in investment, etc. However, this requirement is not applicable when dealing with professional investor.

### **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?

Financial securities company which holds the investment deposits of its clients must receive an authorization from the Financial Services Commission. Meanwhile, the Korea Security Depository which holds the securities of investors is a quasi-government entity established pursuant to the Financial Services and Capital Markets Act Art.294 as the sole entity to operate as a central securities depository under the charge of the Financial Services Commission.

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

Any person who intends to obtain authorization as a financial securities company must meet all the following requirements: (1) the person is required to be a stock company under the Commercial Act; (2) Equity capital is required to be not less than 2 billion won and to exceed a minimum amount of 50 billion won; (3) business plan is required to be proper and sound; (4) the person is required to have human resources, data-processing equipment, and other physical facilities sufficient to protect investors and run businesses; (5) an executive is required not to fall under any of the subparagraphs of Article 24; (6) A major shareholder is required to have sufficient contribution capacity, sound financial status and social standing; and (7) the person is required to establish a system to prevent conflict of interest.

\* Art.24 Qualification of Executives : No person who falls under any of the following subparagraphs shall become an executive of a financial investment business entity (including a person falling under Article 401-2 (1) 3 of the Commercial Act who is prescribed by Presidential Decree; hereafter the same shall apply in this Article), and an executive shall lose his/her office if he/she falls hereunder after taking the office:

1. A minor, an incompetent, or a quasi-incompetent;
2. A person declared bankrupt, not yet reinstated;
3. A person for whom five years have not elapsed since the completion (or deemed completion) of, or exemption from, a sentence of imprisonment without prison labor or heavier punishment, pronounced against him/her, or payment of a fine for negligence or greater, imposed upon him/her pursuant to this Act, other finance-related Acts and subordinate statutes specified by Presidential Decree (hereafter referred to as finance-related Acts and subordinate statutes in this Article) or finance-related Acts and subordinate statutes of a foreign country (referring to Acts and subordinate statutes of a foreign country, similar to this Act or any finance-related Acts and

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subordinate statutes; hereafter the same shall apply in this Article);

4. A person against whom a sentence of suspension of imprisonment without labor, or greater punishment, was pronounced and who is still under a period of suspension;

5. A person who was once an executive or an employee of a corporation or company whose business authorization, authorization or registration was revoked pursuant to this Act, other finance-related Acts and subordinate statutes, or finance-related Acts and subordinate statutes of a foreign country (limited to a person who is directly or substantially liable for the occurrence of the cause or event that gave rise to the revocation as specified by Presidential Decree) and for whom five years have not elapsed since such revocation;

6. A person for whom five years have not elapsed since he/she was removed or dismissed pursuant to this Act, other finance-related Acts and subordinate statutes, or finance-related Acts and subordinate statutes of a foreign country;

7. A person against whom a notice was given that he/she should, as a retired executive or employee, have been subjected to a disposition of demand for removal or dismissal pursuant to this Act or other finance-related Acts and subordinate statutes if he/she was in service or in employment at the time of such notice, and for whom five years have not elapsed since such notice was delivered (or seven years since the date of his/her retirement or resignation, in cases where the period of five years after the date of such notice exceeds the period of seven years after such retirement or resignation);

8. A person prescribed by Presidential Decree as likely to undermine the protection of investors or sound trade practice

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, client assets must be maintained separately from the assets of a financial investment business entity. Client's deposits must be identified and kept as client assets. Client's securities must be kept in the Korea Securities Depository and identified as client's securities.

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

Yes, client assets of one client must be maintained separately from those of other clients. The assets are maintained according to each client's customer accounts.

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

Yes, an account which the asset deposited is of an assessed value of less than 100,000 won and which there have not been any trades and deposit/withdrawal for the last six months may be separately maintained as an omnibus account.

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

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As client's accounts are managed separately according to each client, there is no possibility of loss occurring due to the activities of other clients.

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

Reconciliation of client asset account, as part of internal control, is done on a regular basis.

- 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?

Financial investment business entities are required to maintain separately its proprietary property, trust account, and client accounts. Accounting of these assets is to be done separately as well.

- 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 investment firm must hold 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)?

It depends on the investment firm's internal control standards.

- 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? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

In our previous answer, we noted that client's debit balance is not deducted in determining the amount the investment firm is required to hold. Similarly, the net debit balance is not reduced from the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients.

- ii Timing issues:

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

It depends on the investment firm's internal control standards.

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

It depends on the investment firm's internal control standards.

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- 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?

Financial investment business entities are required to maintain separately its proprietary property, trust account, and clients' accounts. Accounting of these assets is to be maintained separately. Any deficiency from the investment business entity's own funds is to be "made good" using its own asset.

- 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?

Financial investment business entities are required to maintain separately its proprietary property, trust account, and clients' accounts. Accounting of these assets is to be maintained separately. The financial investment business entity's own assets are prohibited from being transferred to a client's account.

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

Financial investment business entity may use client assets of one client if it receives consent from the client.

As noted above, it must receive client's consent.

- 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 use, the Client Assets? If so, please describe.

A financial investment business entity may, with client's consent, have the right to use the entrusted securities of its client or provide it as a third-party collateral.

- i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?

There is no change in the ownership rights of a client.

- ii. How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?

The investment firm must receive prior comprehensive consent from its client.

- iii. How are the ownership rights of a client over its client assets changed or affected when the investment firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its

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client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (i.e. established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator)?

Use or re-hypothecation of client's assets without the client's consent may constitute as embezzlement or misappropriation. The person/firm will be subject to not more than 10 years of imprisonment or a penalty not exceeding KRW 30,000,000 (about USD27,000) . Civil remedy may be also available to the client for the amount of the assets that have been used or re-hypothecated, attorney's fees, 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?

N/A.

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

Holding client's assets in another jurisdiction can be categorized into two instances: (1) client purchases securities listed in a foreign country through a financial investment business entity or (2) client wishes to hold securities purchased in our jurisdiction in another jurisdiction.

In the first case, the securities are held in the foreign jurisdiction's depository. In this case, the securities are held in an account under the Korea Securities Depository (KSD). The KSD maintains and holds accounts separately according to each financial investment business entity and the financial investment business entity holds the account separately according to each of its clients. In the second case, the securities must be held in the KSD unless doing so would otherwise conflict with the laws/regulations of the foreign jurisdiction.

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

Please refer to the answers noted above.

- 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?

Financial investment business entities do not differentiate between domestic/foreign client's assets. All client assets are held and maintained separately according to each client's account.

If so, please provide details of those requirements.

- 5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions ("Foreign Investment Firms") in an Omnibus Account (that includes Client Assets from domestic clients)? If so,

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In general, securities received as a result of trading foreign securities through a financial investment entity must be held in a foreign depository appointed by the Korea Securities Depository among the foreign depositories designated and publicly notified by the Financial Services Commission.

- a. What protections are applicable to the Foreign Investment Firm's Client Assets?

To protect such clients, foreign depositories which can hold these assets are restricted to a depository that is established to perform the similar functions of KSD and which is under the regulatory supervision of the foreign jurisdiction's government or regulatory authority.

- b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?

Please refer to the answers noted above.

- c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?

N/A

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

Client's securities can only be held by the KSD; no third party custodians are allowed to hold such assets. However, client's deposits (referring to money deposited by investors in connection with trading of financial investment instruments and other transactions) must be held in a financial securities company. Also, client's deposits may be held in business entities that run a financial investment business concurrently and is among one of the following entities:

- (1) Banks
- (2) The Korea Development Bank
- (3) The Industrial Bank of Korea
- (4) Insurance companies

- 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 noted above, third party custodians are prohibited from holding clients' assets. Among business entities that run a financial investment business concurrently and is bank, KDB, IBK, or an insurance company may hold clients' deposits.

- 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.

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Except in cases where there has been a merger of the financial entity where clients' assets were deposited, placing a lien, charge or encumbrance is prohibited.

7. 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?

Pursuant to the Act on Real Name Financial Transactions and Guarantee of Secrecy, unless there is an exception, the disclosure of clients' information is strictly prohibited. Exceptions include: (1) client gives written consent to request for disclosure, (2) pursuant to a court order, (3) required to submit tax data under tax-related Acts, etc.

8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

Client's asset protection laws/regulation/requirements cannot be waived. It is applicable to all clients.

9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:

Financial investment entities are required to submit their business report which includes the deposited assets of all of its clients to the regulators(FSC/FSS).

- a. Does the Investment Firm report where client assets are held?

Unless an exception applies, client assets are held in KSD and/or financial securities companies.

- b. Does the Investment Firm or depository report the protections applicable to such client assets?

No. As protections of client assets are mandated by the relevant laws and regulations.

- c. Does the Investment Firm or depository report the amount of assets that are held?

Yes. Financial investment entities are required to submit their business report which includes the deposited assets of all of its clients to the regulators(FSC/FSS). These include the total amount of assets held by the investment firm/depository.

In each case, are such reports provided on request or periodically? If periodically, with what frequency?

The reports are to be submitted periodically – monthly and quarterly.

10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify

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Regulators may inspect and examine the business/operation of KDS and financial securities companies.

- a. Where Client Assets are held?
  - b. The amount of Client Assets held at a depository?
  - c. The safeguards applicable to Client Assets held at a depository?
11. Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify

N/A.

- a. The amount and/or value of such Client Assets?
  - b. The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?
12. 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 FSCMA Art.418, in a case falling under any of the following subparagraphs, a financial investment firm shall report thereon to the Financial Services Commission in accordance with Presidential Decree:

1. Where the trade name is changed;
2. Where any material matter prescribed by Presidential Decree in the articles of incorporation is changed;
3. Where any executive is appointed or dismissed (including resignation);
4. Where the largest shareholder is changed;
5. Where the portion of stocks held by a major shareholder or its specially-related persons is changed in excess of 1/100 of the total number of outstanding stocks with voting rights;
6. Where part of the financial investment services falling under any of Articles 6 (1) 1 through 6 (1) 3 and 6 (1) 6 is transferred or acquired;
7. Where part of the financial investment services falling under any of Articles 6 (1) 4 and 6 (1) 5 is transferred or acquired;
8. Where part of the financial investment services falling under any of Articles 6 (1) 1 through 6 (1) 3 and 6 (1) 6 is discontinued;

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9. Where part of the financial investment services falling under any of Articles 6 (1) 4 and 6 (1) 5 is discontinued;

10. Where any branch or business office is newly established or closed;

11. Where the location of the head office is changed;

12. Where the business of the head office, branch, or any other business office is suspended or resumed; or

13. Others prescribed by Presidential Decree as necessary for the protection of investors or sound trade practice.

\* Article 6:

(1) The term financial investment business in this Act means activities conducted continuously or repeatedly for the purpose of earning a profit, which shall fall under:

1. Investment trading business;
2. Investment brokerage business;
3. Collective investment business;
4. Investment advisory business;
5. Discretionary investment business; or
6. Trust business.

\* Presidential Decree Article 371 (Matters Subject to Reporting)

(2) The term important matters specified by Presidential Decree in subparagraph 2 of Article 418 of the Act means matters falling under any of the following subparagraphs:

1. Matters concerning business purposes;
2. Matters concerning general meeting of shareholders and board of directors, and other matters concerning governance of the company;
3. Matters concerning stocks issued by the company; and
4. Other matters specified and publicly notified by the Financial Services Commission as those related to protection of investors.

(3) The term as prescribed by Presidential Decree in subparagraph 13 of Article 418 of the Act means cases falling under any of the following subparagraphs:

1. Where capital is increased;

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2. Where a financial investment business entity has been subjected to a punishment under Part X (Articles 443 through 449) of the Act;
3. Where a financial investment business entity becomes a party to a lawsuit that may significantly affect the business of the financial investment business entity;
4. Where an application for bankruptcy has been filed against the relevant financial investment business entity or where a cause of dissolution occurs;
5. Where an application for commencement of rehabilitation proceedings under the Debtor Rehabilitation and Bankruptcy Act is filed, a decision on commencement of rehabilitation proceedings is made, or a decision on commencement of rehabilitation proceedings becomes ineffective;
6. Where a financial investment business entity has been subject to a disposition against default on tax payment or to a punishment on account of violation of a taxation-related Act and subordinate statutes;
7. Where a financial investment business entity has made a direct overseas investment under the Foreign Exchange Transactions Act or installed an overseas sales office or any other overseas office;
8. Where a financial investment business entity has established or closed down a domestic office (applicable only to a domestic office of a foreign financial investment business entity);
9. Where a financial investment business entity defaults on payment for cheques or bills issued by it or current account transaction with banks are suspended or banned;
10. Where a cause or event specified and publicly notified by the Financial Services Commission occurred in relation to an overseas local corporation, an overseas branch, an overseas office, etc. of a financial investment business entity;
11. Where a cause or event specified and publicly notified by the Financial Services Commission occurred in relation to the head office of a foreign financial investment business entity (applicable only to a foreign financial investment business entity that has installed a domestic branch or any other domestic sales office); and
12. Where there occurred any other cause or event specified and publicly notified by the Financial Services Commission as one that may significantly affect business management, property, etc. of a financial investment business entity.
13. 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?

Pursuant to the Act on the Structural Improvement of Financial Industry Art 10., regulators may make a timely corrective measure.

\* Act on the Structural Improvement of Financial Industry Art. 10 (Timely Corrective Measures)

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(1) Where any financial institution's financial status falls short of the standards referred to in paragraph (2), such as its equity ratio failing to meet the specified standards, or it is deemed evident that a financial institution's financial status falls short of the standards referred to in paragraph (2) due to the occurrence of any major financial scandal or accrual of non-performing loans, the Financial Services Commission shall recommend, request or order the financial institution concerned or the executives of such financial institution to take the following measures or order it to furnish its implementation plan in order to prevent insolvency, and promote the sound management of such financial institution:

1. Admonition, warning, reprimand or salary reduction in relation to the financial institution concerned and its executives and employees;
2. Capital increase or capital deduction, disposal of property holdings or reduction in stores and downsizing;
3. Ban on acquisition of high-risk assets, such as non-fulfillment of obligations or price fluctuations, or restriction on the receipts at exorbitantly high interest;
4. Suspension of executives' performance of duties or appointment of management supervisors acting for executives' duties;
5. Amortization or consolidation of stocks;
6. Suspension of all or part of business;
7. Merger or third-party takeover of the financial institution concerned;
8. Transfer of business or contracts related to financial transactions, such as deposits or loans (hereinafter referred to as "transfer of contracts");
9. Other measures equivalent to those listed in subparagraphs 1 through 8, which are deemed necessary to improve any financial institution's financial soundness.

(2) Where the Financial Services Commission intends to take measures pursuant to paragraph (1) (hereinafter referred to as "timely corrective measures"), it shall in advance determine and notify the standards and details thereof.

(3) Where it is found that any financial institution temporarily falling short of the standards referred to in paragraph (2) can meet the standards within a short period or it is deemed that any ground equivalent thereto exists, the Financial Services Commission may delay the timely corrective measures for a specified period.

(4) In determining the standards referred to in paragraph (2), the Financial Services Commission may take the following measures likely to cause serious property damage to a financial institution or its stockholders, only where the financial institution is insolvent, its financial status falls grossly short of the standards referred to in paragraph (2), and it is deemed evident that good order in credit or the rights and interests of depositors are likely to be impeded:

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1. Suspension of all business;
2. Transfer of all business;
3. Transfer of all contracts;
4. Order to amortize the total stocks;
5. Other measures equivalent to those under subparagraphs 1 through 4.

### **Post-Insolvency**

14. 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 law/regulation and process in which a financial investment business entity enters into the status of “insolvent” or “bankruptcy” is the same as that of a non-financial investment company. Once a petition is filed with the court, whether or not the entity satisfies the requirements to enter into such status is reviewed and a court decree is issued accordingly.

15. 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 appoints the Administrative Officer. Under the law, there is no specific qualification requirement for the Administrative Officer. Also, once a lawyer/counselor is appointed, the financial investment business entity may appoint a financial expert recommended by the Financial Services Commission.

16. What are the duties of the Administrative Officer?

Fiduciary duty, duty to be neutral, duty to report, etc. and if a loss occurs the administrative officer may be subject to joint liability.

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

N/A

- 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?

Breach of its duty may lead to the administrative officer being jointly liable for any losses or harm caused by such breach.

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

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Any bankrupt/ insolvent entity is solely under the supervision of the bankruptcy court. However, a bankrupt/insolvent financial investment business entity may be required to notify or submit statements to the Financial Services Commission.

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

N/A. Please refer to the answers above.

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

N/A. Please refer to the answers above.

18. What are the requirements, if any, governing the segregation and treatment of Client Assets *during* the insolvency of an Investment Firm?

Unless there is priority ownership (collateral, etc.) among assets or the relevant laws/regulations specifically provides for the segregation of the assets, client assets may be mixed with other assets.

19. 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?

N/A

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

N/A

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

N/A

20. 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 that were lawfully returned are not subject to avoidance power.

21. 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).

To deal with cases where client's deposits cannot be returned fully, the financial investment business entity is required to separately deposit assets in the amount equaling to that of client's deposits in a financial securities company. The Korea Deposit Insurance Corporation provides protection to client's deposits up to 50 million won.

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22. 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.

N/A

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

N/A

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

The executive of a financial investment business entity may be subject to the following measures taken by the FSC:

1. Request for dismissal;
2. Suspension from office for up to six months;
3. Disciplinary warning;
4. Cautionary warning;
5. Caution; or
6. Other measures prescribed by Presidential Decree as necessary to correct or prevent violation.

The Financial Services Commission may demand a financial investment business entity take any of the following measures against any of its employees responsible:

1. Removal;
2. Suspension of his/her duty for six months or less;
3. Salary reduction;
4. Reprimand;
5. Warning;
6. Caution; or
7. Other measure prescribed by Presidential Decree as necessary for correcting or preventing such violation.

When the Financial Services Commission takes a measure against an executive or employee of a financial investment business entity or demands such a financial investment business entity to take a measure against any of its executives or employees, it may also take another measure against a person responsible for control and supervision or demand such a measure: Provided,

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That such measure may be mitigated or exempted if the person responsible for control and supervision has exercised reasonable care in control of and supervision over the executive or employee.

Specific clients are not treated differently.

25. 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?

Unless the client did not set its priority among other creditors, the assets are distributed pro-rata.

26. 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?

Unless it is a special bond which is given priority pursuant to the relevant laws/regulations, all creditors are subject to pro-rata distribution. Also, there is no differential treatment (*i.e.*, “rank”) between domestic and 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?

The laws and regulations provided in this survey refers to the Financial Services and Capital Market Act and its enforcement decree unless otherwise stated in the answers.

All the relevant laws and regulations, except for bankruptcy law, can be found in the English website of the Financial Supervisory Commission or Financial Supervisory Services:

FSC website: <http://www.fsc.go.kr/eng/lr/lr0101.jsp>

FSS website: <http://english.fss.or.kr/fss/en/laws/securities.jsp>

**Mexico**  
**2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

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(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 there is a complete protection scheme for deposits, regulated by special entity called Instituto de Protección al Ahorro Bancario (IPAB).

- a. How does your jurisdiction define the term “client assets?” If the jurisdiction uses an analogous term, please provide that term and its definition.

Actually Mexico doesn’t have a specific definition for client assets, but the following definition of securities can be used as an analogous term.

Securities, shares, stocks, debentures, bonds, warrants, certificates, promissory notes, bills of exchange and other negotiable instruments, or unnamed nominees, whether registered or not in the registry, which may circulate in the securities markets that referred to herein, which are issued in series or in mass and represent the social capital of a corporation, an aliquot of a good or participation in a credit union or any credit right individual, in terms of national legislation or applicable foreign.

- b. What is the nature of a client’s ownership rights with respect to its client assets placed with the investment firm?

Clients keep all the rights and benefits from the assets placed within the investment firm.

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- c. How does your jurisdiction define the term “client”? If the jurisdiction uses an analogous term, please provide that term and its definition.

Clients are defined in 3 categories: qualified, institutional and general public investor.

Qualified investor: the person who usually has the income, assets or the qualitative characteristics that the Commission established by general provisions.

Institutional investor, the person under federal laws such considered or financial institution, including when acting as trustees under trusts under the laws considered as institutional investors.

Public investor: the one that doesn't correspond to the previous categories.

- d. Please describe any notable exclusions from the terms “client” or “client assets.”

None notable exclusions are used for client or 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

- 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 (from now on 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:

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- 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

Ongoing requirements are related on the ratio of the capital of the Investment firm to the capital requirement. The regulator can require a deteriorating Brokerage firm to take or to abstain from taking multiple actions, including modification of business activities. Authorities could suspend or forbid activities if brokerage firms: a) don't have the infrastructure and internal controls to provide services and activities according to legal requirements, b) don't fulfill initial requirements to begin operations, c) make activities different to the one authorized in his social object, d) don't accomplish necessary requirements to realize specific operations defined in regulation, e) realized operations with possible conflict of interests in the detriment of them clients or operations forbidden by law or related regulation, f) frequently don't fulfill financial authorities requirements in his auditing faculties, g) operate with values not registered in National securities register, except in cases regulated in law, h) do operations with securities out of the market violating law, i) declared by authority in bankruptcy status and finally j) errors in accounting records or without records from the operations made by entity.

- 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:

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Yes, client assets must be maintained completely separated from other clients or investment firm's assets.

According to Mexican securities law the client assets must be registered in different accounts from the Investment Firm's assets account in an authorized Deposit securities institute.

- 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 global or Omnibus accounts are permitted, which are managed by: investment firms (broker dealers), banks, foreign entities and mutual funds, where transactions of different clients must be registered 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 depository institution or clearinghouse; each position is valued applying a price vector which is provided by an 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 other's.

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

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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? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

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. A debit balance could not be deducted from the total amount required to hold on deposit by the Investment Firm for net credit balances of other clients.

### 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 depository 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

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- 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 use, 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.

- i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?

Unless otherwise agreed, the investor keeps all ownership rights and benefits over its client assets, when the Investment Firm re-hypothecates or uses with his consent.

- ii. How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?

Through the performance of a contract, that must be part of the record that the Investment Firms holds for every client.

- iii. How are the ownership rights of a client over its client assets changed or affected when the investment firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (i.e. established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator)?

It is forbidden by Law for the Investment Firms, to dispose client's resources or his assets for other purposes than those ordered or contracted with him. The violation of this implies a penalty of five to fifteen years in prison, but if the Investment Firm compensates the damage caused to the client, there are significant reductions in the penalties outlined above.

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

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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 applies, if a sub-custody contract exists.

- 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?

Not regulated by current laws.

- c. If so, please provide details of those requirements.

N/A

5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)? If so,

- a. What protections are applicable to the Foreign Investment Firm’s Client Assets?

Have the same level of protection as any assets deposited in the Investment Firm.

- b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?

Not regulated by current laws.

- c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?

Not regulated by current laws.

6. 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 firms that act as custodian locally, then they need to establish an agreement with a depository 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.

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In order to organize and operate as depository 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 depository 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.

7. 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.

8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

There is no option to do it. 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 called IPAB.

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.

9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:

- a. Does the Investment Firm report where client assets are held?

In México there is only one institution performing depository activities named S.D. Indeval, S.A. de C.V., Institución para el Depósito de Valores (INDEVAL).

- b. Does the Investment Firm or depository report the protections applicable to such client assets?

Investment Firms must confirm that all securities they have transacted are effectively deposited in INDEVAL. Also, must inform the depository institution about the transactions held during the day.

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Investment Firms will always be responsible for the transaction performed by their clients.

- c. Does the Investment Firm or depository report the amount of assets that are held?

Investment Firms must send to the National Banking and Securities Commission a list with all the allocations of transactions carried out. The list must be sent in the day of their liquidation.

Indeval, Mexico's Depository Institute, must send every day to the National Banking and Securities Commission, the data base that includes the assets that are held.

In each case, are such reports provided on request or periodically? If periodically, with what frequency?

10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify:

- a. Where Client Assets are held?

There is only one institution performing depository activities in México, the S.D. Indeval, S.A. de C.V., Institución para el Depósito de Valores (INDEVAL). Therefore there is no need to verify where client assets are held.

Also surveillance visits are performed in order to verify the infrastructure and internal controls of the Depository Institute.

- b. The amount of Client Assets held at a depository?

In the National Banking and Securities Commission there are internal procedures to make sure that investors deposited tenure corresponds to the one that the Investment Firm is reporting in the statements.

- c. The safeguards applicable to Client Assets held at a depository?

Its CNBV responsibility the supervision through surveillance activities and the enforcement of preventive and corrective measures, as of requiring information to INDEVAL in order to examine it and verify if transactions carried out by Investment Firms and credit institutions satisfy the legal framework.

11. Where an Investment Firm based in a foreign jurisdiction (a "Foreign Investment Firm") deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify

- a. The amount and/or value of such Client Assets?

Based on the MOUs that have been signed, the foreign regulators may ask us for information regarding the amount and/or value of client assets, that information is requested to the Mexican Investment Firms and then provided to the foreign regulator to perform the verifications they consider appropriate

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- b. The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?

The surveillance activities carried out by this Commission are of general application, so there is no distinction based on the clients' origin, such as the segregation assets from the ones that the Investment Firm owns, reconciling them from those deposited in Indeval, and the bans about operating client assets for different purposes from the authorized by them.

12. 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 depending upon information, it can be in a daily, weekly, monthly or quarterly basis to relevant authorities.

In the case that the 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.

13. 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  $\leq 80\%$

Category 2, requirement capital ratio  $> 80\%$  but  $\leq 100\%$

Category 3, requirement capital ratio  $> 100\%$  and  $\leq 120\%$

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 most important:

- 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.

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- 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**

14. 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 for a revocation 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 firm’s, 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.

15. 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.

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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 a person is elected, it is necessary to comply with some requirements established by law such as experience, credit worthiness, etc.

### 16. 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.

### 17. 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?

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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 agenda 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 16, d).

18. What are the requirements, if any, governing the segregation and treatment of Client Assets *during* the insolvency of an Investment Firm?

Administrative Intervention: The regulator would supervise the inspector-manager, including any efforts that the inspector-manager makes to transfer Client Assets.

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.

19. 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 takes 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

20. 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?

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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.

21. 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.

22. 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.

23. 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.

24. 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.

25. 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.

26. 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 25. 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?

## The Netherlands

### 2013 Survey of Regimes for the Protection, Distribution and/or transfer of Client Assets

#### General introductory remarks

- The main rules for investment firms operating in the Netherlands to protect clients' assets (i.e. financial instruments and client money) are included in the Dutch Act on Financial Supervision ('Wet op het financieel toezicht'). More detailed rules on this topic are elaborated in secondary legislation ('Besluit gedragstoezicht financiële ondernemingen' and 'Nadere Regeling gedragstoezicht financiële ondernemingen') under the Act on Financial Supervision (FSA). The relevant articles pertaining to asset protection of these three layers of rules and regulations are attached as annex to this survey.
- In the further elaboration of client asset protection in Dutch financial law, as detailed below in our response, the detailed rules mainly apply to shares and bonds. At the moment no *specific* requirement exists in Dutch financial law beyond this general requirement for protection of clients with positions in derivatives as included in the Act on Financial Supervision.
- Please note that we will answer the following questions from the perspective of individual investors who buy or sell securities for their personal account, and not for another company or organization (also described as 'Retail Client' in Article 4 of the Directive 2004/39/EC of The European Parliament and of the Council of 21 April 2004 on markets in financial instruments (MiFID))
- We understand that the survey aims to collect information across jurisdictions of client asset protection at the level of intermediaries. Intermediaries may engage in the value chain in various capacities (as trading members, as clearing members and/or as admitted institutions to the central securities depository). Each of these capacities may require slightly different and/or additional rules and regulations pertaining to the protection of client assets. The focus of our response to this survey is on the capacity of intermediaries as trading members. From a European perspective this means that the MiFID-rules are a major point of reference for the way rules on the protection of client assets are implemented in Dutch financial law.
- Due to the functional split in the regulatory framework of responsibilities for financial supervision in the Netherlands, the AFM is responsible for supervision of conduct of business of all financial firms, operating in the Netherlands. De Nederlandsche Bank (DNB) is responsible for prudential supervision of all financial firms operating in the Netherlands. Where deemed appropriate in the responses to this survey, we explicitly refer to this role of DNB.

#### Context

- 1a) Client Assets can under Dutch law be described as Moneys and Financial instruments. The term Financial Instrument is used in Article 4, section 1 (17) of the Directive 2004/39/EC of The European Parliament and of the Council of 21 April 2004 on markets in financial instruments (MiFID):  
*Financial instrument: means those instruments specified in Section C of Annex I;*

Article 4, section 1 (17) and Section C of Annex 1 MiFID is implemented in Dutch law in the Financial Supervision Act (FSA).

#### **Article 1.1 FSA**

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

### *Financial Instruments:*

- (a) Transferable securities;
  - (b) Money-market instruments;
  - (c) Units in collective investment undertakings;
  - (d) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash;
  - (e) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event);
  - (f) Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market and/or an MTF;
  - (g) Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in C.6 and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are cleared and settled through recognised clearing houses or are subject to regular margin calls;
  - (h) Derivative instruments for the transfer of credit risk;
  - (i) Financial contracts for differences;
  - (j) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event), as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Section, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market or an MTF, are cleared and settled through recognized clearing houses or are subject to regular margin calls.
- 1b) In short the nature of the client's ownership rights can be described as follows:  
The client assets placed with the investment firm is a deposit of securities into a Wge pool, which results in the replacement of the investor's right of ownership with a right of co-ownership in the 'community of property'(gemeenschap), formed by the Wge pool.

More specifically: The majority of Dutch financial instruments are admitted to the system of securities custody of the *Dutch Securities Giro Transfer and Administration Act (Wge)*. The Wge created a three-tiered pyramid-shaped securities custody structure. The top of the pyramid is formed by the so-called 'giro pool' (girodepot), which is administered by the CSD. The CSD's participants are co-owners in that pool, in proportion to the securities of the same kind which they administer. Thus, securities of different issues form different pools, and as many (giro) pools exist as there are securities admitted to the system. The securities that are administered by the participants form so-called 'participant pools' (verzameldepots), the second tier of the pyramid. Pursuant to Article 12, section 2 Wge, investors are co-owners of these pools, in proportion to the securities to which they are entitled. They form the third and last tier of the Wge pyramid.

Especially for securities that are not eligible for admittance to the Wge system and securities that are located abroad, there is the so-called VABEF system of 'simplified administration and custody of securities'. The ownership of securities is transferred to a depository, a special purpose vehicle that is separated from the institution with which investors hold their securities accounts. The insolvency risk of that vehicle is minimized, as its articles of association exclude any form of commercial activity,

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while the account provider is liable for its administration. Moreover, the sole purpose of such a vehicle is holding the securities in the vehicle and the supervision of their functioning.

- 1c) Our jurisdiction (Article 1.1. FSA) does not use the term 'Client' (as used in Article 1, section 10 MiFID), but uses the term 'Consumer' which means any natural person, not acting in business or by profession, to whom an investment firm provides investment services.
- 1d) Under Dutch law derivatives are not eligible for admittance to the Wge system or the VABEF system. The consequence is that until now there is no system in the Netherlands that can preserve the retail investor's property rights with regard to derivatives that are placed with an Investment firm.

### **Pre-Insolvency**

- 2) First of all, an important distinction must be made between investment firms which also act as a credit institution (and therefore hold a license granted by the Dutch Central Bank) and investment firms which do not act as a credit institution.

Firms of the last category only advise customers with regard to their portfolios and pass transactions on. The actual holding of assets is done by a credit institution. In that perspective, credit institutions have additional requirements. This will be explained in more detail below.

#### Investment firms which are not credit institutions

In the applicable articles from our financial act (more specifically, 6:15 and 6:16 from the Further Regulations on the Supervision of the Conduct of Financial Enterprises pursuant to the Act on Financial Supervision) the following is stated:

Concerning the financial instruments and moneys of clients an investment firm will take such measures that the rights of those clients are adequately protected. The measures serve to prevent that financial instruments and moneys are used by the investment firm for own account transactions. An investment firm may comply with the requirement above if:

- a. the moneys and financial instruments belonging to a client and to which the services of the investment firm pertain, are held on one or more credit institution accounts in name of the client
- b. no money accounts or financial instruments accounts of the investment firm are used for the transactions performed in name of and for account of the client; and
- c. the written authorization given by the client to the investment firm is expressly limited to the authority to dispose of the moneys and financial instruments meant under a), to the extent necessary for providing the investment services to the client.

Furthermore, when an investment firm also takes care of the broker-activities, the financial instruments account of the client is only credited or debited, if the amount to be received or paid pursuant to the financial instruments note is simultaneously debited or credited to the designated money account of the client.

This means that an Investment Firm is not directly allowed to hold Client Assets. Only a credit institution (holding a license granted by the Dutch Central Bank) is allowed to hold Client Assets. The moneys and financial instruments belonging to a client and to which the services of the investment firm pertain, are held on one or more credit institution accounts in name of the client.

#### Investment firms which are credit institutions

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An investment firm holding a licence granted by the Dutch Central Bank (*de Nederlandsche Bank*) to conduct banking activities, complies with the requirement to protect the assets from clients in the case that

- an agreement with the client is made, stipulating at least that the financial instruments account of the client held with the credit institution is only credited or debited, if the amount to be received or paid pursuant to the financial instruments note is simultaneously debited or credited to the designated money account of the client
- the financial instruments are saved in one of the underlying two constructions:
  - a. the financial instruments are held and managed in accordance with the Securities Bank Giro Transactions Act.
  - b. the financial instruments are held by a depository and this depository fulfill additional requirements. One of the most important requirements is that this depository is not allowed to employ any other activity than keeping the financial instruments.

3a) **I** If an investment firm receives money from a client it is required to place it on a bank account with the central bank, a licensed bank or an authorized money market fund (article 165b of the *Besluit Gedragstoezicht Financiële Ondernemingen*). Investment firms are allowed to hold omnibus accounts in the Netherlands.

An investment firm offering investment services of order execution or asset management to clients, can comply with the principle of article 6:14 of the Act on Financial Supervision by entering into an agreement with its client, containing the following provisions at a minimum (article 6:16 of the *Nadere Regeling gedragstoezicht financiële ondernemingen*) :

- Client money and financial instruments, belonging to the client in the context of the services provided, are held in one or more accounts in the name of the client at a bank;
- Crediting and debiting of the client account, administrating the financial instruments, will only take place on a delivery-versus-payment-basis vis-à-vis the client account, administrating the client money;
- The investment firm is solely authorized to transfer client money and financial instruments if this is deemed necessary for conducting the investment services for the client.

**II** Article 165 of the *Besluit Gedragstoezicht Financiële Ondernemingen* requires every investment firm to keep all information and accounts related to a client up-to-date to enable the investment firm at any time distinguishing client money and financial instruments, held for a client, from client money and financial instruments for other clients and from its own money and financial instruments. The remainder of this article formulates additional measures for the investment firm to achieve the objective of administrative segregation.

3b) Investment firms have to administer information and accounts of clients in such way that they are always correct and correctly reflect the assets (money and financial instruments) of clients (article 165, paragraph 1, sub b of the). The investment firm is under the legal duty to review on a regular basis whether the money and financial instruments of clients, held by third parties, is aligned with the administration of the investment firm itself (article 165, paragraph 1, sub c – e of the).

Timing issue for reconciliation: The obligations, included in article 165, paragraph 1, sub c of the *Besluit Gedragstoezicht Financiële Ondernemingen* (i.e. review on a regular basis) refer to the timing issue for reconciliation.

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An investment firm is not permitted to maintain any of their own assets in a client asset account (article 165, paragraph 1, sub a and c of the *Besluit Gedragstoezicht Financiële Ondernemingen*).

- 3c) Articles 4: 87 of the Act on Financial Supervision require that the investment firm takes appropriate measures to protect the interests of each client. The investment firm enters into an (written) agreement with each client which will form the sole basis for providing its services (article 4:89 of the Act on Financial Supervision).
- 3d) We refer to the answer to question 22.
- 3e) The regime for central counterparties pertaining to segregation (and portability) of assets and positions vis-à-vis its clearing members and clients of these clearing members, is part of article 39 of EU Regulation 648/2012 on OTC derivatives, central counterparties and trade repositories (a.k.a 'EMIR') which came into force in August 2012, but will only become effective in early 2013. Upon request, the CCP shall offer clearing members the possibility to open more accounts in their own name or for the account of their clients. Subsequently, the clearing member shall offer its clients at least the choice between omnibus client segregation and individual client segregation.
- 4 Investment firms are permitted to transfer to or hold Client Assets in another jurisdiction. In general, a distinction can be made between assets that are kept in a Dutch 'giro' pool, administered at the CSD, and assets that are actually kept in foreign countries (at (sub)custodians).

In both cases there are two options to actually hold the assets, namely the system of the Dutch Securities Giro Transfer and Administration Act (Wge) and the system of depository.

This means that it is possible to scale foreign kept assets under the scope of the Dutch Securities Giro Transfer and Administration Act (Wge). Yet, this is only applicable when additional requirements are fulfilled. Therefore, common practice is to use the depository system.

We would like to remark that Client Asset protection is more difficult to guarantee, if not impossible, in the situation that the actual Assets are held in a foreign country because this is not in the span of control of the AFM (as a Dutch supervisor).

- 5 Investment firms are permitted to hold Client Assets in an Omnibus Account, including Client Assets deposited by Investment firms in other jurisdictions and Client Assets of domestic clients. In general, a distinction can be made between assets that are kept in a Dutch 'giro' pool, administered at the CSD, and assets that are kept in foreign countries (at (sub)custodians). The Dutch rules do not differ in protection for foreign clients and domestic clients.

In both cases there are two options to actually hold the assets, namely the system of the Dutch Securities Giro Transfer and Administration Act (Wge) and the system of depository.

This means that it is possible to scale foreign kept assets under the scope of the Dutch Securities Giro Transfer and Administration Act (Wge). Yet, this can only be applicable when additional requirements are fulfilled. Therefore, the more common way is to use the depository system.

- 6a) The regime in the Netherlands for the safe keeping of client assets by investment firms allows for these assets to be held by third party custodians, subject to certain (mandatory) conditions. This regime includes the option to keep client' assets with affiliates (see below).

Article 4:87, paragraph 1 of the Act on Financial Supervision requires any investment firm (among others) to take adequate measures to protect the client' rights pertaining to client assets

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and client money. Furthermore, this article requires investment firms to prevent the usage of client assets (for own account of the investment firm), provided explicit consent has been given by the client.

Article 4:87, paragraph 2 of the Act on Financial Supervision creates the legal basis for secondary legislation in the area of clients' assets protection.

Article 165a of the *Besluit Gedragstoezicht Financiële Ondernemingen* (secondary legislation under the Act on Financial Supervision) states that any investment firm, that holds client' assets with a third party, applies proficiency, carefulness and awareness in the selection, appointment and periodic review of the third party.

Article 6:14 of the *Nadere Regeling Gedragstoezicht Financiële Ondernemingen* (a third layer of secondary legislation) underlines the principle takes such measures that the rights pertaining to financial instruments and money of clients are sufficiently protected.

Articles 6:17 and 6:18 of this secondary legislation specify that safe-keeping of client' assets by investment firms and banks in the legal form of a Dutch subsidiary (either so-called securities giros and custody vehicles) is permitted, provided a number of conditions will be met pertaining to (a.o.): own capital, a limited scope of activities, re-conciliation, annual report, an explicit guarantee by the 'parent' investment firm and administrative organization requirements). Other forms of asset protection (including the ones with foreign vehicles) are subject to individual approval by the AFM, according to article 6:20 of the *Nadere Regeling Gedragstoezicht Financiële Ondernemingen*.

- 6b) For the specific requirements pertaining to the custody agreement between the intermediary and custodian, we refer to the explanation given under Q6a with regard to the articles 6:17 and 6:18 of the *Nadere Regeling Gedragstoezicht Financiële Ondernemingen*.
- 7) According to article 58b BGfo an Investment Firm that holds financial instruments or funds of the client (e.g. a credit institution) is obliged to give the client a brief description of the measures it has taken to protect these financial instruments or funds, as well as an outline of the guarantee scheme applicable to the firm.

Furthermore clients have to sign an agreement between the client, the investment firm and a credit institution in order to have their assets assigned to this credit institution. In addition an investment firm may lend financial instruments of clients, provided that the client gives his express written permission to do so, the investment firm informs the client of the risks and provides sufficient guarantees for the protection of the client.

- 8) There is no option for clients to differ among the amount of protection they get.
- 9) In article 165D *Besluit Gedragstoezicht financiële ondernemingen* (secondary legislation under the Act on Financial Supervision) is stated that a credit institution which holds client assets is obliged to send an annual report from an external auditor (an *assurance rapport*) to the Dutch Authority for the Financial Markets in which the topics concerning the protection of Clients Assets are addressed. This is a description on an abstract basis, and therefore it does not tell anything about the number of client assets that are held. The report is the proof that the credit institution is in control over the topics concerning the protection of Clients Assets. The external auditor needs to assess whether the business operations are in design and implementation in line with the rules concerning the protection of Clients Assets.

Such reports are provided annually.

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- 10) The protection of clients assets is part of the responsibilities of our supervision. The AFM takes measures on a risk-oriented basis. In that perspective, the current situation on the (European) Financial Markets increases the awareness at the AFM of the importance that investment firms comply with the rules of protection of Client Assets.

For that reason, all the investment firms acting under the supervision of the AFM are required to disclose information with regard to the protection of client assets. This information is gathered through a so-called self-assessment that each firm has to respond to. This self-assessment is an elaborate list of questions which provides information about these firms in a consistent manner.

As stated in question 2, an important distinction has to be made to investment firms which also act as a credit institution and the ones which do not. From our risk-oriented perspective, the first category requires more attention since these firms hold client assets for other investment firms as well as their own clients. If an investigation takes place, the following topics are addressed:

- How are the assets being held? Does the firm act in accordance with the Securities Bank Giro Transactions Act or does it use a depository. If so, does this depository meet the additional requirements (i.e. no additional activities are allowed other than holding the assets)?

- Does the credit institution comply with the requirement to protect the assets from clients by concluding an agreement with the client, stipulating at least that the financial instruments account of the client held with the credit institution is only credited or debited, if the amount to be received or paid pursuant to the financial instruments note is simultaneously debited or credited to the designated money account of the client?

- Does the credit institution possess an adequate administration, to the amount that individual assets can be related to individual clients?

- Does the bank distinguish between professional clients (non-depot clients, or clients who do can give orders without holding the actual securities) and non-professional clients (depot clients, clients who cannot give orders when they do not possess the actual securities)?

- 11) If a foreign supervisor wants to verify certain data or information at a branch of a foreign investment firm, operating in the Netherlands, the following is in order:

Chapter 1.3.2 of the Act on Financial Supervision covers the cooperation and exchange of confidential information with other EU supervisory authorities. The supervisor from another Member State can verify the data or information, needed for its supervisory role, after informing the AFM. The supervisor of the other Member State can request the AFM to verify data or information, needed for its supervisory role, in an on-site inspection. The AFM will do so or will invite the other authority to make the verification (articles 1:56 and 1:56b of the Act on Financial Supervision). The AFM may only refuse the request on a limited number of grounds (granting the request is against Dutch sovereignty/public order, existence of pending legal procedures or a final verdict for the same facts and in relation to the same entity).

Chapter 1.3.3 of the Act on Financial Supervision covers the cooperation with non-EU supervisory authorities for the exchange of confidential information. In this case, provision of confidential information is only permitted if equivalent safeguards exist in the non-EU jurisdiction with regard to confidentiality and the provision of information fits within the scope of supervisory tasks by the non-EU authority.

- 12) Both investment firms and credit institutions are under prudential supervision by the Dutch Central Bank (*De Nederlandsche Bank*). Both need to report to the Dutch Central Bank on regular bases about their financial position.

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Furthermore an investment firm is obliged to notify the AFM in the case that there has been an incident. Material changes in the financial position can be an incident (the term 'incident' is a principle and in the *Besluit Gedragstoezicht financiële ondernemingen* it is explained as follows: "action or event that poses a serious threat to the honest and ethical conduct of the business of a financial enterprise").

- 13) The AFM can take actions when they are notified (e.g. by the Investment Firm or by the Dutch Central Bank) that the financial situation is deteriorated. Both investment firms and credit institutions are under prudential supervision of the Dutch Central Bank. They report to the Dutch Central Bank on a regular basis.

The AFM can decide to oblige (give an instruction to) the Investment Firm to adhere to a particular line of conduct. The Dutch Central Bank may also issue an instruction to a financial institution where it detects signs of a development that may jeopardize the equity capital, solvency or liquidity of that financial enterprise. (Article 1:75 FSA).

Furthermore the AFM (or DNB) can decide to appoint one or more persons as Administrative Officer if the Investment Firm has failed to comply to a given instruction, or if the violation of the Investment firm seriously jeopardizes the adequate operation of the financial enterprise, or if the violation of the Investment Firm seriously jeopardizes the interests of clients (with the exception of professional investors).

The Dutch Central Bank may decide to appoint one or more persons as Administrative Officer with regard to all or certain bodies or representatives of a financial enterprise where it detects signs of a development that may jeopardize the equity capital, solvency or liquidity of that financial enterprise if the Investment Firm has failed to comply to a given instruction or if urgent intervention is required.

### **Post-Insolvency**

- 14) According to the Dutch Bankruptcy Act (*Faillissementswet*) bankruptcy (*faillissement*) can be petitioned for by one or more of the creditors of the debtor (involuntary filing), by the debtor himself (voluntary filing), or in the exceptional case the public interest requires it, by the public prosecutor. A bankruptcy proceeding can also be opened following a suspension of payments proceeding or a debt rescheduling scheme.

A bankruptcy can be petitioned in the Netherlands before the district court of (i) the place of the debtor's residence or domicile in the Netherlands, (ii) if the debtor has moved out of the Netherlands, the last known place of domicile of the debtor in the Netherlands and (iii) if the debtor does not have a place of domicile in the Netherlands, but does conduct a business or enterprise in the Netherlands, the place where the debtor has an office. (Companies are domiciled at the place of their incorporation and registration with the Commercial Register (*Handelsregister*). The official domicile of the company is designated in its Articles of Association.)

Any creditor, even a foreign creditor, may file a bankruptcy petition. All debtors, including natural persons, companies and other legal entities (such as foundations and associations) and commercial partnerships, may be adjudicated bankrupt.

There is no legal obligation for a debtor to file a bankruptcy petition. The legal ground for bankruptcy adjudication is that the debtor has ceased to pay his debts" (i.e. is in a state of "equitable insolvency"). A creditor requesting the bankruptcy of a debtor has to provide evidence of the fact that he has a claim against the debtor, that the debtor is unable to pay his debts and that

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there is at least one other creditor. At least one of the debts of the creditors has to be currently due and payable.

If a petition for bankruptcy is granted by the district court, the district court will appoint a bankruptcy trustee/Administrative Officer (*curator*) and one of the members of the courts as a supervisory judge (*rechter-commissaris*). The court order opening the proceeding must, without delay, be published by the Administrative Officer in the Official Gazette (*Nederlandse Staatscourant*). There is a legal assumption that after publication everybody is aware of the existence of the insolvency proceedings.

Besides the bankruptcy proceeding, there are two different types of proceedings which may be commenced under the Dutch Bankruptcy Act:

- Suspension of payments (*surséance van betaling*), whereby the debtor is given temporary relief against its creditors in order to reorganise and continue its business, and ultimately to satisfy part of the creditors' claims; this can be granted to most companies and legal entities and to natural persons carrying out a business or practising an independent profession. Suspension of payments can only be granted by the court at the request of a debtor, not at the request of a creditor. There is no legal obligation for the debtor to request a suspension of payments. The court automatically and immediately grants a provisional suspension of payments to a debtor who anticipates that he will not be able to continue to meet his liabilities as they become due. During the period of suspension of payments the debtor's business will be managed by the debtor and a court appointed administrator jointly.
- A debt rescheduling scheme (*schuldsanering*), in which the debtor's assets are liquidated for the benefit of his creditors and the debtor must make a maximum effort to generate funds to repay his creditors in a period of three years, with the objective to give the debtor the possibility of a 'fresh start'; this is only open to natural persons. If a debt rescheduling scheme is granted, the district court will appoint an administrator (*bewindvoerder*) and a supervisory judge (*rechter-commissaris*), who supervises the actions of the administrator.

- 15) An Administrative Officer (*curator*) is appointed by the district court. The Administrative Officer is usually a member of the local bar (i.e. lawyer). Accountants or other experts may assist the Administrative Officer (after consultation with the magistrate). The Administrative Officer acts under the general supervision of the supervisory judge.

Some Dutch regional courts have established guidelines for the appointment as Administrative Officer, by which is determined whether a lawyer can be placed on the list of eligible Administrative Officers in bankruptcy (*curatorlijst*). For example, the member of the local bar should be working as a lawyer for at least one year, should at least have successfully completed specific courses on bankruptcy law, and should have sufficient relevant experience level and affinity in bankruptcy.

- 16) The Administrative Officer is charged with the administration and liquidation of the bankrupt's estate. Immediately upon his appointment, the Administrative Officer must take any necessary steps to preserve the estate. All creditors' actions and claims are automatically stayed. After consultation with the supervisory judge, the Administrative Officer will decide whether or not he will temporarily continue any of the bankrupt's business. This is done only if clearly favourable business prospects exist. If the business activities are not continued, the Administrative Officer may sell the assets provided that this does not contravene any special security interests belonging to a creditor. The law provides that realisation of assets takes place by public auction, but that the Administrative Officer may realise assets by private contract with the approval of the supervisory judge (which the Administrative Officer usually does).

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The Administrative Officer has special statutory authority to terminate leases and employment contracts. He also has the power to invoke the *actio pauliana* if the rights of recourse on the debtor's assets have been prejudiced by legal acts performed by the debtor without obligation, and the right to institute a claim against the management board or directors of a bankrupt company.

Every three months the Administrative Officer must file a public report concerning the debtor's assets and liabilities at the court registry.

- 16a) The Administrative Officer is subject to the supervision of the supervisory judge. For certain acts, the Administrative Officer needs the authorisation of the supervisory judge, e.g. conducting legal proceedings, terminating employment and rental contracts and realisation of assets by private contract.

In certain cases the supervisory judge can, at the request of the debtor or a creditor, order the Administrative Officer to perform a specific act or to refrain from performing an intended act. The court has the power to dismiss the Administrative Officer at the request of the supervisory judge, a creditor or a debtor.

Furthermore, a working group of supervisory-judges in bankruptcy (RECOFA) has established some guidelines on bankruptcy and suspension of payment. These guidelines should ensure that the transparency of the activities of the Administrative Officer is increased.

- 16b) An Administrative Officer in bankruptcy can be personally liable – as opposed to being liable in capacity of trustee, which is in effect a liability of the estate – to a third party

who has suffered a loss due to the Administrative Officer's conduct in that capacity, if the Administrative Officer has acted contrary to the specific and objective care standard that 'a trustee should act in a way that can be reasonably expected of a sufficiently knowledgeable and experienced trustee who performs his task conscientiously and with dedication'.<sup>27</sup> The legal basis of such personal liability of the Administrative Officer vis-a-vis a third party is tort (*onrechtmatige daad*).

- 17) The Netherlands Authority for the Financial Markets (AFM) may – in derogation of its duty of confidentiality – supply confidential data or information obtained in the performance of its duties under the Financial Supervision Act to (in short) a judge, an administrator and a trustee in the case of a financial undertaking has been declared bankrupt.

There are, however, limitations. Firstly, confidential information cannot be provided in case it could become contrary to the interests that the Financial Supervision Act seeks to protect. Secondly, confidential information cannot be provided if the information is obtained from another supervisor or a foreign regulator and that supervisor or regulator disagrees with to provide the information.

Furthermore, in respect of its minimal role, the AFM has made documents available in order to help Administrative Officers within bankruptcy proceedings. For example, the AFM has provided a document by which the Administrative Officer can request the AFM to withdraw the license of a bankrupt Investment Firm. In its decision to withdraw a licence of an Investment Firm, the AFM may also stipulate that the financial enterprise must wind up its business, either fully or in part, within a period to be specified by the AFM. During the winding-up, whether or not

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<sup>27</sup> See e.g. Dutch Supreme Court's ruling of April 19, 1996 (*Maclau*) NJ 1996, 727, s. 3.6. In Dutch: "Een curator behoort te handelen zoals in redelijkheid mocht worden verlangd van een over voldoende inzicht en ervaring beschikkende curator die zijn taak met nauwgezetheid en inzet verricht".

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stipulated by the supervisor, the financial enterprise or the bankruptcy liquidator of the Investment Firm shall be classified as a 'licensed enterprise'.

17a) After a licence withdrawal, the AFM (in principle) does not continue to supervise the Investment Firm.

17b) The AFM is basically not involved in the process of (actual) returning Client Assets.

However, as stated above, The AFM supervises compliance with rules on the protection of Client Assets. Accordingly, in the case of the bankruptcy of *Van der Hoop Bankiers N.V.* (2005), the AFM stated that in respect of the shares and bonds the segregation was well organised. With respect to the derivative positions of clients of Van der Hoop the AFM believed that there was no adequate method for separation of the assets of Van der Hoop.

Furthermore, in the Van der Hoop case, Clients were, under the Deposit Guarantee Scheme (*depositogarantiestelsel*) of De Nederlandsche Bank (DNB), eligible for compensation up to a maximum of €20,000 and in fact received twice this protection from the scheme.

18) During the Insolvency of the Investment Firm the Administrative Officer is charged with the administration and liquidation of the bankrupt's estate and may take any necessary action to preserve the estate. View the answer to question 19.

19) The transfer of Assets from an Investment Firm which has become bankrupt or insolvent, to a solvent Investment Firm, also called 'porting', is not common practice within the Netherlands. However, with regard to derivatives the local Central Counter Party, LCH Clearnet S.A., has certain rules (Clearing Rule Book) which allows porting under French law. See article 4.5.2.4 (4) under (v) Clearing Rule Book which allows LCH Clearnet to take measures it deems necessary in case of an event of default:

(....)

*if LCH. Clearnet SA estimates that such measures are necessary as regards the need to act promptly, LCH. Clearnet SA will have the right, but not the obligation, to decide in accordance with French law:*

*to transfer to another Clearing Member the Non-House Positions registered in the name of the Defaulting Clearing Member, and/or (...)*

The steps to be taken to accomplish such a transfer depend entirely from the circumstances of the case. In any case, we believe such a transfer has to be accomplished very quickly because of the margins paid by the various parties that are involved and the obligation to provide (more) margin could be raised significantly during the day.

20) Clients could be at risk of having to return Client Assets in case of pauliana. See answer to question 16. The Administrative Officer has the power to invoke the action pauliana if the rights of recourse on the debtor's assets have been prejudiced by legal acts performed by the debtor without obligation.

21) Besides the asset separation scheme, there are two other protective measures in case of loss of Client Assets in the Netherlands: (i) the deposit guarantee scheme and (ii) the investor compensation scheme.

(i) The deposit guarantee scheme (*depositogarantiestelsel*)

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The Dutch Central Bank (DNB) fully guarantees 100,000 euro of savings per account holder per bank. This is the basis of the deposit guarantee scheme. If a bank, at which you have up to 100,000 euro in savings, goes bankrupt, the DNB will refund you the entire amount. In the case of joint accounts held by two people, this refund applies per person.

In order to be eligible for this refund, the deposit scheme does have to apply to your bank. Banks established in the Netherlands which have a licence from the DNB are covered by the deposit guarantee scheme. Banks which are established in the European Union, Norway, Iceland or Lichtenstein and which operate in the Netherlands from a branch are covered by the deposit guarantee scheme of their country of origin.

(ii) The investor compensation scheme (*beleggerscompensatiestelsel*)

The investor compensation scheme protects private individuals and 'small' businesses which, on the grounds of an investment service, have entrusted money or financial instruments (for example securities or options) to a licensed bank or investment firm. The investor compensation scheme provides for a refund to a maximum of €20,000 per person.

The AFM checks whether investment firms and banks comply with the rules for asset separation. These rules are intended to ensure that if an investment firm (for example a portfolio manager) or bank goes bankrupt, clients' investments and/or money are separated from the assets of the investment firm or bank. This avoids a situation in which clients' investments are lost in the bankrupt assets of the investment firm or bank. If an investment firm or bank does not observe the asset separation rules, the investor compensation scheme may apply.

- 22) In case of bankruptcy, re-hypothecation of client's financial instruments to a third party could be undesirable. A risk exists when a client has fulfilled its obligations with regard to the credit institution (by which his pledging will lapse); while at the same time the credit institution has re-pledged these financial instruments to a third party. The financial institution then has to fulfill its obligations in respect of the third party, before the pledge can become void. In this case, the client remains dependent on the credit institution, and in case of a bankruptcy of this credit institution problems could arise. In that case the credit institution will not be able to fulfill its obligations to a third party. The pledge will then be foreclosed by the third party (*separatist*) and in that case clients of the credit institution will not receive anything. The client will be treated as a general creditor under bankruptcy law. In case of unauthorized re-hypothecation, the client would have a claim against the Investment Firm for unauthorised use of its assets in violation of the agreement as stipulated by law. In most cases this risk does not appear due to the wording contained in the general conditions of services relating to financial instruments as agreed between the credit institution and its clients.

Accordingly, in the opinion of the AFM, the re-hypothecations of rights of the client by the credit institution is in principle not allowed, unless the client has explicitly authorized (in a separate clients agreement), the client has been pointed to the risks and the investment firm has provided sufficient safeguards for the protection of the client according to the (Dutch) rules on protection of Client Assets.

- 23) --

- 24) If an Investment Firm fails to comply with Client Asset Protection requirements it violates the Dutch Law, more specifically article 4:87 FSA, which can be reason for the AFM to, for instance, impose an administrative fine to the Investment Firm. Such a decision shall be made public by the AFM, if this has become irreversible by law, unless publication of the decision is or might be considered contrary to the object of the supervision of compliance.

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- 25) If there is a shortfall, under Dutch Law there is a pro rata distribution of Client Assets (art. 27 Wge).
- 26) Our insolvency regime does not rank domestic creditors above foreign creditors. In principal creditors rank equally. In the case that creditors are ranked above other creditors this is mainly for the reason that they hold security rights such as mortgage or pledge.

### **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?

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### Annex

#### Unofficial translation of relevant provisions from the Act on Financial Supervision (*Wet op het financieel toezicht*)

##### Section 4:87

1. An investment firm that holds financial instruments belonging to a client shall take adequate measures:
  - a. to protect the client's rights to those financial instruments; and
  - b. to prevent the use by the investment firm of those financial instruments for its own account, except with the client's express permission.
2. An investment firm that holds funds belonging to a client shall take adequate measures:
  - a. to protect the client's rights to those funds; and
  - b. to prevent the use by the investment firm of those funds for its own account.
3. Further rules may be laid down by or pursuant to a Decree in respect of:
  - a. the measures to protect the client's rights and to prevent the use of financial instruments or moneys belonging to the client; and
  - b. the manner in which the investment firm may obtain the client's permission to use the client's financial instruments for its own account.
4. A tied agent may not hold financial instruments or moneys belonging to a client.

##### Section 4:89

1. An investment firm shall open a file with regard to each client, containing documents describing the mutual rights and obligations of the investment firm and the client.
2. An investment firm shall conclude a contract with each client, which contract shall be recorded on paper or on another durable medium and be included in the file referred to in Subsection (1). This contract shall constitute the exclusive basis for the investment services which the investment firm provides to the client and shall in any event set out the mutual rights and obligations of the client and the investment firm.
3. Further rules shall be laid down by Decree as regards the content of the contract.
4. Subsections (2) and (3) shall not apply to the provision of investment services to professional investors.
5. The rights and obligations referred to in Subsections (1) and (2) may be described by means of a reference to other documents or pieces of legislation.

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### Section 4:90

1. An investment firm shall promote the interests of its clients in an honest, fair and professional manner when providing investment services or ancillary services, shall act in an honest, fair and professional manner when performing investment activities and shall refrain from actions that are detrimental to the integrity of the market.
2. Rules shall be laid down by Decree as regards the processing of orders and the payment or receipt of commission in providing investment services or ancillary services.

### **Unofficial translation of relevant provisions of the Dutch Decree on the Supervision of the Conduct of Financial Enterprises pursuant to the Act on Financial Supervision (*Besluit Gedragstoezicht financiële ondernemingen Wft*)**

#### Section 165

T1.T An investment firm:

- a. shall keep all the necessary records and accounts enabling it immediately at any time to distinguish the financial instruments and funds held for a client from financial instruments and funds held for other clients and its own financial instruments and funds;
- b. shall keep the records and accounts referred to in Subsection (a) in such a way, that they are always accurate and in any event reflect the financial instruments and funds held for clients;
- c. shall check at regular intervals whether the records and accounts referred to in Subsection (a) correspond to those of any third parties that may hold these financial instruments and funds;
- d. shall ensure that the financial instruments of clients that are held by a third party in accordance with Section 165a are distinguishable from the financial instruments belonging to the investment firm itself and from the financial instruments belonging to the third party, by means of differently titled accounts on the books of the third party or other equivalent measures that achieve the same level of protection;
- e. shall ensure that the client funds held in accordance with Section 165b are held in an account or accounts that is or are distinguishable from all the accounts used for holding funds belonging to the investment firm itself;
- f. shall take appropriate organizational measures in order to keep to a minimum the risk of loss or reduction of the financial instruments and funds of clients, or their rights to these financial instruments or funds, on account of misuse of financial instruments and funds, fraud, mismanagement, the keeping of inadequate information or negligence.

T2.T The Netherlands Authority for the Financial Markets shall lay down rules concerning:

- a. the measures to protect the client's rights and to prevent the use of the client's financial instruments or funds as referred to in Section 4:87(1) and (2) of the Act; and

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- b. the manner in which the client's consent as referred to in Section 4:87(1)(b) may be obtained for the use of the client's financial instruments by the investment firm at the latter's own expense.

### Section 165a

- T1.T An investment firm holding financial instrument for a client in an account with a third party shall apply the necessary competence, care and vigilance in the selection, designation and periodic review of the third party and of the regulations for holding and taking custody of the financial instruments concerned. In doing so, the investment firm shall take account of the expertise and market reputation of the third party involved, and of all the statutory obligations or market practices relating to the holding of these financial instruments that may have a detrimental effect on the client's rights
- T2.T If the custody of financial instruments at another person's expense is subject to specific regulations in a jurisdiction in which an investment firm wants to hold these financial instruments of clients with a third party, the investment firm shall not hold these financial instruments in that jurisdiction with a third party that is not subject to the supervision of compliance with these rules.
- T3.T An investment firm shall not hold financial instruments for a client with a third party in a non-Member State where the holding and custody of financial instruments at another person's expense is not subject to rules, unless:
  - a. the nature of the financial instruments or of the investment services relating to these instruments requires them to be held by a third party in that state; or
  - b. where it concerns financial instruments held for a professional investor, the latter requested the investment firm in writing to hold these instruments with a third party in that state.

### Section 165b

- T1.T An investment firm that receives funds from a client shall immediately pay these funds into one or more accounts with:
  - a. a central bank;
  - b. a bank that has been granted a license as referred to in the Recast Banking Directive;
  - c. a bank that has been granted a license in a non-Member State to conduct the business of a bank;
  - d. an approved money market fund.
- T2.T Subsection (1) shall not apply to investment firms that have been granted a license to conduct the business of a bank.

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- T3.T** For the purpose of Subsection (1), opening words and (d), an approved money market fund shall be understood to mean an approved money market fund within the meaning of Article 18(2) of the Directive implementing the Markets in Financial Instruments Directive.
- T4.T** If the investment firm does not hold funds with a central bank, it shall apply the necessary competence, care and vigilance in the selection, designation and periodic review of the bank or the money market funds where the funds are deposited, and of the regulations for holding the funds concerned. In any event the investment firm shall take account of the expertise and market reputation of the bank or the money market fund in order to protect the rights of its clients, and of all the statutory obligations or market practices relating to the holding of client funds that may have a detrimental effect on the client's rights.
- T5.T** An investment firm that intends to hold funds with an approved money market fund shall have an internal complaints procedure in place under which clients can object to this.

### Section 165c

- T1.T** An investment firm shall not enter into agreements regarding securities financing transactions in respect of financial instruments which it holds for a client, and shall not use such financial instruments in other ways at its own expense or at the expense of another of its clients, unless:
- a. the client has granted its express prior approval to the use of the financial instruments under specified conditions, which can be demonstrated in the case of a non-professional investor by means of the latter's signature; and
  - b. the financial instruments of this client's are used exclusively under the specified conditions with which the client has approved.
- T2.T** An investment firm shall not enter into agreements regarding securities financing transactions in respect of financial instruments which it holds for a client in an omnibus account with a third party, and shall not use such financial instruments in other ways at its own expense or at the expense of another client, unless, without prejudice to Subsection (1):
- a. the client has granted its express prior approval; or
  - b. the investment firm has systems and monitoring facilities in place which ensure that the financial instruments concerned belong to clients that have granted their express prior approval. Subsection (1)(a) shall apply accordingly to the granting of approval.
- T3.T** The investment firm's records shall include particulars about the client with whose approval the financial instruments were used, and about the number of financial instruments used belonging to every client that granted its approval, so as to ensure that any losses are allocated correctly.

### Section 165d

An investment firm as referred to in Section 4:87(1) and (2) of the Act shall provide the Netherlands Authority for the Financial Markets once a year with an external auditor's report on the investment firm's compliance with Sections 165 to 165c.

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### Unofficial translation of relevant provisions from the Dutch Further Regulations on the Supervision of the Conduct of Financial Enterprises pursuant to the Act on Financial Supervision (*Nadere regeling gedragstoezicht financiële ondernemingen Wft*)

#### § 6.5. Rules concerning the protection of the rights, financial instruments or moneys of the client

##### Section 6:14

1. Concerning the financial instruments and moneys of clients an investment firm will take such measures that the rights of those clients are adequately protected.
2. The measure meant in the first subsection serves to prevent that financial instruments and, insofar as it does not concern an investment firm which holds a license granted by the Dutch Central Bank (de Nederlandsche Bank) to conduct the business of a bank or a supervisory status certificate granted by the Dutch Central Bank to conduct the business of a financial institution, moneys are used by the investment firm for own-account transactions.
3. Contrary to the second subsection, an investment firm may lend financial instruments of clients, provided that the client gives his express written permission to do so, the investment firm informs the client of the risks and provides sufficient guarantees for the protection of the client.

##### Section 6:15

1. An investment firm which renders the investment service meant under a) of the definition of providing investment services in section 1:1 of the Act or investment management as meant under a) of the definition of investment management in section 6:1, may comply with the requirement meant in section 6:14, if:
  - a. the moneys and financial instruments belonging to a client and to which the services of the investment firm pertain, are held on one or more credit institution accounts in name of the client;
  - b. no money accounts or financial instruments accounts of the investment firm are used for the transactions performed in name of and for account of the client; and
  - c. the written authorisation given by the client to the investment firm is expressly limited to the authority to dispose of the moneys and financial instruments meant under a), to the extent necessary for providing the investment services to the client.
2. 'Written' in the first subsection, under c), is also taken to mean 'electronically' as meant in section 15d(3), Book 6, of the Dutch Civil Code, if:
  - the agreement is accessible to the parties;
  - the authenticity of the agreement is sufficiently guaranteed;
  - the time of conclusion of the agreement can be established with sufficient certainty, and
  - the identity of the parties can be ascertained with sufficient certainty.

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3. This section does not apply to investment firms which hold a licence granted by the Dutch Central Bank (de Nederlandsche Bank) to conduct the business of a bank or a supervisory status certificate granted by the Dutch Central Bank to conduct the business of a financial institution.

### Section 6:16

1. An investment firm providing an investment service as meant under b) or c) of the definition of providing an investment service in section 1:1 of the Act, may comply with the requirement meant in section 6:14 by concluding an agreement with the client that at least provides that:
  - a. the moneys and financial instruments belonging to a client and to which the services of the investment firm pertain, are held on one or more credit institution accounts in name of the client;
  - b. the financial instruments account of the client is only credited or debited, if the amount to be received or paid pursuant to the financial instruments note is simultaneously debited or credited to the designated money account of the client; and
  - c. the investment firm is only authorised to dispose of the moneys and financial instruments meant under a) to the extent necessary for providing the investment services to the client.
2. This section does not apply to investment firms which hold a licence granted by the Dutch Central Bank (de Nederlandsche Bank) to conduct the business of a bank or a supervisory status certificate granted by the Dutch Central Bank to conduct the business of a financial institution.

### Section 6:17

An investment firm which provides an investment service as meant under a) of the definition of providing an investment service in section 1:1 of the Act, may comply with the requirement meant in section 6:14, if an agreement is concluded under which the account meant under d) of the definition of providing an investment service in section 1:1 of the Act, and the money account held for the client are managed by an investors giro service which complies with the following conditions:

- a. the investors giro service is a legal entity under Dutch law;
- b. any person who represents the giro service pursuant to its articles of association or regulations or determines its day-to-day policy, will be sufficiently knowledgeable in connection with the conduct of the business of the giro service and must be sufficiently independent from the directors of the investment firm mentioned in the opening lines. The reliability of the persons meant in the preceding sentence and of the persons who are directly or indirectly authorised to appoint or dismiss those persons must also be beyond doubt.
- c. persons who perform work for the giro service may not be employed by the business unit of the investment firm that performs transactions in financial instruments or has such transactions performed;
- d. the giro service performs no other activities than holding the moneys and financial instruments belonging to the clients and managing the accounts meant at the beginning of this section;
- e. the sum of all cash claims and financial instruments of all the clients collectively equals the sum of the balances of the accounts held for the clients as mentioned at the beginning;

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- f. the moneys and financial instruments meant under d) are held in one or more accounts with a credit institution in name of the investors giro service, the giro service making a strict administrative distinction between the moneys meant at the beginning of this subsection and the moneys belonging to the giro service;
- g. transactions for the account of the client are only effected, if there is a sufficient balance on the account held in name of that client with the giro service;
- h. the Netherlands Authority for the Financial Markets may gather or order to gather all information from the giro service that is necessary for the proper performance of its statutory duties and powers;
- i. the giro service's compliance with the obligations is guaranteed by the investment firm.
- j. the giro service only acts in the interests of the clients of the investment firm on whose behalf financial instruments and moneys are held by the giro service;
- k. the investors' giro service is liable to the clients for any damage suffered by them, in so far as this damage was caused by imputable non-compliance with its obligations;
- l. the giro service provides for proceedings, should the giro service announce its intention to cease its operation;
- m. the giro service organises its operations in such a way that this guarantees a controlled and sound conduct of its business, in accordance with sections 31(1), (2) and (3), 31(b), 35(1), (2) and (4) and 165(1) a) to c) of the Supervision Decree;
- n. within six months of the end of the financial year the giro service will submit its annual accounts to the Netherlands Authority for the Financial Markets as meant in section 361(1), Book 2, of the Dutch Civil Code, accompanied by a statement concerning the fairness, issued by the auditor as meant in section 393(1), Book 2, of the Dutch Civil Code. The auditor is not in the employ of the giro service or the investment firm offering the accounts meant at the beginning;
- o. the giro service has an equity capital of at least 125,000 euros;

### Section 6:18

An investment firm holding a licence granted by the Dutch Central Bank (*de Nederlandsche Bank*) to conduct the business of a bank, may comply with the requirement meant in section 6:14 by concluding an agreement with the client, stipulating at least that the financial instruments account of the client held with the credit institution is only credited or debited, if the amount to be received or paid pursuant to the financial instruments note is simultaneously debited or credited to the designated money account of the client and:

- a. if the financial instruments are subject to the Securities Bank Giro Transactions Act, the financial instruments are held and managed in accordance with the Securities Bank Giro Transactions Act; or
- b. the financial instruments are held by a depository and the following conditions have been met:

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- the depository firm is a legal entity under Dutch law;
- any person who represents the depository firm pursuant to its articles of association or regulations or determines its day-to-day policy, will be sufficiently knowledgeable in connection with the conduct of the business of the depository firm. The reliability of the persons meant in the preceding sentence and of the persons who are directly or indirectly authorised to appoint or dismiss those persons must also be beyond doubt;
- persons who perform work for the depository firm may not be employed by the business unit of the investment firm, holding a licence to conduct the business of a bank granted by the Central Dutch Bank, that performs transactions in financial instruments;
- the depository firm performs no other activities than the safe keeping of financial instruments;
- the depository firm has an equity capital of at least 125,000 euros;
- the sum of the units in financial instruments held by clients equals the sum of the financial instruments held by the depository firm for clients;
- the fulfillment of the obligations of the depository firm is guaranteed by the investment firm;
- the Netherlands Authority for the Financial Markets can make all the enquiries at the depository firm, or have others make these enquiries, that in the opinion of the Netherlands Authority for the Financial Markets are necessary for the proper performance of its statutory duties and powers;
- the depository firm only acts in the interests of the clients of the investment firm on whose behalf financial instruments and moneys are deposited with the depository firm;
- the depository firm is liable to the clients for any damage suffered by them, in so far as this damage was caused by imputable non-compliance with its obligations;
- the depository firm provides for proceedings, should the depository firm announce its intention to cease its operation; and
- the depository firm organises its operations in such a way that this guarantees a controlled and sound conduct of its business, in accordance with sections 31(1), (2) and (3), 31(b), 35(1), (2) and (4) and 165(1) a) to c) of the Supervision Decree

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**Pakistan**  
**2013 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 both in advance of and 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" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

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(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.**

**a. How does your jurisdiction define the term “client assets?” If the jurisdiction uses an analogous term, please provide that term and its definition.**

The term Client Assets is not a defined term in our Jurisdiction, however the client securities and client cash are analogous terms used for Client Assets. The term “client asset” has however been used in General Regulations of Stock Exchanges the term clients’ assets have been used in the Regulation 41 of Stock Exchange General Regulations that deals with segregation of clients’ assets by the brokers/ investment firm.

Definition of securities as provided under the Securities and Exchange Ordinance 1969 is:

“security” includes-

(i) *any stock, transferable share, scrip, Modaraba Certificate, note, debenture, debenture stock, participation term certificate, bond, investment contract, forward or futures contract, and pre organization certificate or subscription, and, in general, any interest or instrument commonly known as a “security” and, any certificate of deposit for, certificate of interest or participation in, temporary or interim certificate for, receipt for, or any warrant or right to subscribe to or purchase, any of the foregoing but does not include currency or any note, draft, bill of exchange or banker’s acceptance or any note which has a maturity at the time of issuance of not more than twelve months, exclusive of days of grace, or any renewal thereof whose maturity is likewise limited;*

(ii) *any Government security as defined in the Securities Act, 1920*

(iii) *any bonus entitlement voucher issued by the State Bank of Pakistan in accordance with any scheme announced by the Commission*

**b. What is the nature of a client’s ownership rights with respect to its client assets placed with the investment firm?**

A client has full ownership right on any money/cash maintained by him with the investment firm. The Client Securities held by Investment Firm are registered in the name of the client, and clients retain beneficial ownership of these securities at all times. CDC ACT 1997 requires the Investment Firm to ensure that client securities are held in a segregated sub-account.

A sub-account is an account maintained, as part of the Main Account of a participant (Investment

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Firm), in the name of a sub-account holder (Client) so as to record the title of the sub-account holder to any book-entry securities entered in such sub-account. Even though the shares are placed in a participant sub account, it does not compromise any ownership rights/benefits of the shareholder, such as dividend, bonus etc.

These securities will be required to be put in segregation and be shown as such on the client's statement of account in order to protect the clients/customers from the Investment Firm using these securities for other purposes.

Furthermore, clause 18 of terms and conditions of the standardized account opening form for individual states that the Participant should ensure due protection to the Sub-Account Holder regarding rights to dividend, right shares or bonus shares etc. in respect of transactions routed through him and not do anything which may be harmful to the interest of the Sub-Account Holder with/from whom it may have had transactions in securities.

### **c. How does your jurisdiction define the term “client”? If the jurisdiction uses an analogous term, please provide that term and its definition.**

An analogous term for “Client” is defined in Investors' Protection Fund Regulations of stock exchanges of our jurisdiction that is reproduced hereunder:

*“Investor means a person, not being Member (Investment Firm), his agent or representative, who has purchased or sold any of the securities listed at the Exchange.”*

Further the term sub-account holder is also analogous to the term “Client” which is defined in the CDC Act, 1997 as any individual or entity that operates an account with the Investment Firm for custody of securities in demat form

*(28) “sub-account holder” means a person in whose name a sub-account is opened and maintained by a participant with a central depository and is operated by that participant. Moreover, the term “investor” has also been used for clients as stipulated in Default Regulations of the Exchange.*

### **d. Please describe any notable exclusions from the terms “client” or “client assets.”**

None

*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, an investment firm cannot deal in business of effecting transactions in securities unless it has acquired the membership of a stock exchange, is registered with the SECP and comply with the requirements of Brokers and Agents Registration Rules, 2001.

Further, to hold Client Assets an investment firm also needs to have Participant Account with the Central Depository Company of Pakistan Limited (CDC) that cannot be opened until such time the firm obtains Clearing Member (CM) status with National Clearing Company of Pakistan Limited (NCCPL)).

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

When a brokerage firm is registered with the SECP, the broker must comply with all the applicable laws/regime such as the Securities and Exchange Ordinance 1969, Securities and Exchange Rules 1971, Brokers and Agents Registration Rules, 2001, Regulations of the Stock Exchanges, Regulations of the National Clearing Company of Pakistan Limited, CDC Regulations and The Central Depository ACT, 1997.

The investment firm is required to renew its broker registration annually from the SECP on the recommendations/endorsement of concerned stock exchange. Investment firms or brokers are also required to provide biannually Net Capital Balance Certificate duly audited by the auditors to the Exchange as well as to SECP. Moreover, corporate investment firms having paid up capital more than Rs.7.5 million, are also required to submit annual audited accounts to SECP.

Furthermore, offsite and onsite surveillance and inspections of brokerage/Investment Firms are held regularly by SECP to ensure compliance with prevalent laws. Identification of any noncompliance to applicable rules and regulations, or any deteriorated financial position, to such an extent that the SECP is of the opinion that his continuance in securities business shall not be in the interest of investors; the SECP holds the right to cancel, suspend or decline renewal of the Investment Firm's registration.

- 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:**

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

Yes, the Investment Firms are required to ensure that the assets belonging to their clients are kept separated from the assets of the Investment Firms,, in separate sub-accounts maintained for each investor. CDC Regulations also requires holding these securities in a separate account.

*As per Regulation 4.19.2 of CDC Regulations Each Participant/Investment Firm are required to ensure that the Book-entry Securities owned by the Participant himself are not entered in any Group Account or Sub- Account(s) maintained by the Participant on the CDS.*

Also clause 6 of Standardized Account opening form (for individual) confirms that The Book entry Securities owned by the Sub-Account Holder shall be exclusively entered in the Sub-Account of such Sub-Account Holder.

Further, General Regulations of Karachi Stock Exchange provide as under;

### 41. SEGREGATION OF CLIENTS' ASSETS BY THE BROKERS

*(1) The Brokers shall ensure that the assets belonging to their clients are kept separated from the assets of the Broker. For this purpose, the Broker shall maintain;*

*(a) a separate bank account which will include all the fund deposits of their clients along with record/breakdown of clients' balances.*

*(b) separate sub-accounts under his Participant Account in Central Depository System (CDS) for each of his clients to maintain the custody of margins deposited by the clients in the form of securities and securities bought for clients.*

*(c) a Collateral Account under his Participant Account in CDS for all clients. This account shall be used exclusively for instances where outstanding payment has not been received from clients in respect of securities purchased on their behalf and relevant purchase obligation is to be settled.*

*In such cases, the Broker will be allowed to transfer the securities on the respective settlement date from the respective sub-account to the Collateral Account for a maximum period of three (3) settlement days only to the extent of the transaction volume for which the client's payment is outstanding for whatsoever reason and comply with relevant requirements contained in the CDC Regulations.*

*The Broker shall, in addition to the electronic reporting of such transfers through ways and means as specified by the Exchange report the Exchange in writing explaining the reason for utilizing the Collateral Account and / or for holding client's securities immediately after such transfer. The notice from the Broker will be accompanied with following documents:*

*(i) Non-payment notice served on the client through courier, personal delivery method, facsimile, email or properly recorded telephone line, advising him to make payment by the close of banking hours on the next business day after the settlement day and notifying that, otherwise the Broker shall have a right to dispose of the required securities to cover the shortfall in the client's account at client's risk and cost;*

*(ii) Client's sub-account and Collateral Account Activity Report of movement date and;*

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*(iii) Documentary evidence substantiating the genuineness and circumstances of the reason for non-payment by the client which may include failure of client to pay in time due to non-clearance of client's cheque, any natural calamity, law and order situation, non or delayed functioning of an automated procedure, e.g., NIFT.*

*Provided that for a particular client, the Broker is allowed to transfer securities from the subaccount of client to the Collateral Account only once in a calendar month.*

*(2) Except as permitted above, the clients' funds and securities shall not be used by the Broker for any purpose other than as authorized by the client in writing in the manner and procedure prescribed by the Exchange and/or CDC. The Broker shall be obliged to maintain and furnish documentary evidence to substantiate the compliance with the above regulations as and when required by the Exchange.*

*(3) On the basis of documents mentioned under Sub-Clause 1(c) above, the Exchange shall determine if the requisite documents substantiate the transfer of client's securities by the Broker and shall maintain a database of such transfers. Exchange may also carryout enquiry and/or special audit in relation to non-compliance with this regulation.*

*(4) In case of non-compliance on the part of the Broker, as mentioned in Sub-Clause 1(c) above, is established, after enquiry and providing opportunity of hearing, the Broker shall be liable to pay penalty of 1.0% of the market value of securities moved, subject to a maximum penalty of Rs. 50,000/.*

*Provided that warning may be issued once on the first instance of non-compliance by the Broker subsequent to implementation of automated settlement mechanism.*

*(5) Where non-compliance of sub-clause 2 and 3 by a Broker is established, the Exchange may, after providing an opportunity of being heard to the broker, impose penalty on such broker in the manner provided in sub-clause 4 above.*

Moreover, segregation of sub-accounts is ensured through system audits conducted by stock exchanges and inspection of the Investment Firms by the SECP. The SECP's inspection manual mentions that 'Select sample of Clients and ensure that separate CDC Sub Account have been opened by the Broker and margin payments to Brokers have been made through cross cheque in favor of "Clients Margin Account'

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

Yes, assets of each client are required to be maintained separately, as mentioned above.

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

No, the investment firms are not allowed to hold/maintain Omnibus Accounts. In Pakistan a Direct Holding System is functional where all securities are kept in the name of the beneficial owners. The Group account facility or omnibus accounts were discontinued in 2005.

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

Considering the unauthorized pledge of clients' securities against margin demands of other clients, the concept of client level margining was introduced in 2009 under which stock exchanges only accept pledge of securities from the sub-account of respective client to the extent of his/her exposure or proprietary accounts of Investment Firm.

In case of default of Investment Firm, securities pledged from sub-accounts of clients are utilized up to their respective exposures. Since the clients' securities are maintained in separate subaccounts, therefore, losses of one client would have no impact on the assets of other clients.

Further to cater for the irregularities in manual transfers of securities in settlement process of market based transactions by Investment Firms, automated clearing and settlement process was implemented in 2010 whereby securities are moved directly from sellers sub-account or house account (for client and proprietary trades respectively) to buyers sub-account or house account in the CDS.

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

No reconciliation is held between the Investment Firm and the Depository, however, Reconciliation is conducted on client by client basis by the investment firm at the end of the day and a daily transaction statement of each client is given to the clients respectively, reflecting their daily trade in the Market.

Furthermore, the client can have access to their trading details through SMS alert system of CDC and UIN Information System (UIS) of NCCPL.

Moreover, according to the CDC Regulations every Participant should send within 10 days of end of each quarter to all Sub-Account Holders maintaining Sub-Accounts under the control of such Participant Holding Balance statements showing the number of every Book-entry Security entered in every such Sub-Account as of the end of the preceding quarter.

There is no specific requirement for preparation of reconciliation by Investment Firm in respect of clients' assets, however, under the CDC Regulations 13.6.1 *"Each Account Holder shall, for each Business Day, verify the activity taking place during that Business Day with reference to any Handling of Book-entry Securities entered in any Holding forming part of the Account Family of the Account Holder and shall immediately report in writing any of his concerns in that regard to the CDC by the End of Day on the next succeeding Business Day."*

### **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?**

Currently there is no requirement of holding/calculation of particular amount/type of assets by an Investment Firm.

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

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Reconciliation is conducted on an aggregate basis by Investment Firm with respect to daily net settlement positions, however, daily transactions statement/trade confirmation of each client is given to the clients respectively, by the Investment Firm reflecting their daily trade in the Market.

In order to facilitate the sub-account holders to check their custody position, CDC also provides Interactive Voice Response, Internet/Web access and Short Messaging Service (SMS) services which allows investors to access their account related information.

According to the CDC Regulations, every Participant should send within 10 days of end of each quarter to all Sub-Account Holders maintaining Sub-Accounts under the control of such Participant/Investment Firm a Holding Balance statement showing the number of every Book entry Security (ies) entered in every such Sub-Account as end of the preceding quarter.

Such Holding Balance statements shall be generated from the CDS and shall be sent to the Sub-Account Holders including to the email addresses of the Sub-Account Holders notified to the Participants by them. CDC may, at its discretion, directly send Holding Balance statements to the Sub-Account Holders in the manner and to the extent that CDC thinks reasonably necessary from time to time.

**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? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?**

One client's net debit balances does not reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients. Investment Firm of each stock exchange is required to maintain minimum net capital balance at all times as determined in accordance with Securities and Exchange Rules, 1971 and this requirement is used to determine the maximum allowable exposure limit under the Risk Management Regulations of the respective stock exchange. While computing net capital balance, debit balance of a client is not netted off with credit balance of another client.

The onus of collecting debts from its clients is delegated to the investment firm itself, hence if a client leaves a debit balance on its accounts it is solely the duty of the Investment Firm to collect it from the client or liquidate the holdings of that client in order to maintain the margin of the account, failure to collect the debit balance from the client, the investment firm is then obligated to pay the debit balance from its own funds.

### ii Timing issues:

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

Reconciliation is conducted daily on an aggregate basis and any clients/ account holder may reconcile his account balance statement that is required to be forwarded to the client on quarterly basis with the Investment Firm as and when he/she desires.

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

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Reconciliation is conducted by the day end by the Investment Firm. Under CDC Regulations, each investment firm will verify for each business day the activity taking place during that business day with reference to any handling of book-entry securities.

**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, Clearing and settlement requirements are applicable to the broker and in case of no payment by the client, the broker is liable to pay from its sources as and when required. Payment made by the investment firm on behalf of the client to the clearing company would be considered as Client Money by the clearing company.

**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, an investment firm cannot use client securities of one client to meet obligations of another, due to the reason that client securities are required to be held in segregation and cannot be used for such purposes.

**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 use, the Client Assets? If so, please describe.**

Yes, investment firm is restricted to invest, lend, pledge/handle or otherwise use client assets unless it is authorized by the client through the Standardized Account opening form to carry out the pledge/handling in favor of respective stock exchange against exposure on his/her behalf or through a specific authorization in writing to do so. CDC Act 1997 mentions that a participant will not create any pledge over any book-entry securities in any account of its client without the authorization of the sub-account holder/client concerned. Section 24 of CDC Act prohibits mishandling of clients assets including pledging.

**i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client’s consent?**

The client retains its beneficial ownership rights on the pledged securities, however, the only compromise that he will not be able to freely transfer or move the pledge securities, as the securities are locked in a pledge account

**ii. How is a client’s consent to permit an Investment Firm to use or rehypothecate Client Assets demonstrated? In other words, what evidence of a client’s consent must an Investment Firm have in order to use or re-hypothecate Client Assets?**

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The consent of the client is demonstrated through signing a specific authorization or the agreement which is part of the standardized account opening form with the investment firm, allowing the investment firm to pledge the client's securities on its behalf. The evidence of a client's consent given to the investment firm for pledging of its securities is in the shape of a contractual agreement, which is also referred to as an Investor Account Opening Form prescribed under General Regulations of the Karachi Stock Exchange.

**iii. How are the ownership rights of a client over its client assets changed or affected when the investment firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (i.e. established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator)?**

Not allowed, the said practice is strictly prohibited and if a broker is found non-compliant strict action is initiated under the applicable laws. CDC Act stipulates;

A participant is not allowed to create a pledge over any book-entry securities entered in any subaccounts maintained under his account with the central depository without the authorization of the sub-account holder concerned. Failure to comply with any provision of the CDC Regulations can result in fines and penalties, as mentioned below:

Under CDC Act 1997 Punishment and adjudication of fine or penalty.-

(1) A fine for any offence under, or contravention of any provisions of, this Act may be adjudged and imposed by any member of the Authority.

(2) The fine as aforesaid shall be imposed after giving the person concerned an opportunity to show cause why he should not be punished for the alleged offence or contravention and, if he so requests, after giving him a reasonable opportunity of being heard personally or through such person as may be prescribed in this behalf.

(3) Where imprisonment is provided for any offence under, or contravention of any provisions of, this Act, it shall be adjudged by a court not inferior to that of a court of session.

For redressal of the matter, the client may approach Securities and Exchange Commission of Pakistan (SECP) through the relevant stock exchange whose registered Investment firm has misused assets of such client. The SECP is authorized to request the court for taking cognizance of offences committed by the Investment firm. Alternately such client may directly approach court of law for breach of contract in respect of securities entrusted to the investment firm.

**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?**

Each client or sub-account holder is provided with a Unique Identification Number (UIN) that establishes a traceable link between the executed trades and the investor at the stock exchange as details of his/her sub-account are also available in UIN system. With the implementation of client level margining system, margin demands against exposures are calculated on the client level basis

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and system only accepts securities as collateral from the sub-account of such client to the extent of his/her respective exposure. This system prevents the misuse of clients' securities entered in sub-accounts by the Investment Firms.

- 4. Are Investment Firms in your jurisdiction 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:**

No investment firms are not permitted to hold or transfer Client Assets in any other jurisdiction.

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

Not applicable

- 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?**

Not applicable

If so, please provide details of those requirements.

- 5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions ("Foreign Investment Firms") in an Omnibus Account (that includes Client Assets from domestic clients)? If so,**

- a. What protections are applicable to the Foreign Investment Firm's Client Assets?**  
**b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?**  
**c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?**

- 6. 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?**

Foreign investors are allowed to trade in the securities quoted on the Stock Exchanges in Pakistan and they are required to open up a Special Convertible Rupee Account (SCRA) with any designated bank for this purpose. Foreign investors also open separate sub-accounts with designated banks for the custody of securities issued in demat form. Any banking company having minimum short term

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credit rating of A3 within the meaning of the Banking Companies Ordinance, 1962 may apply for admission as custodian clearing member (CCM) with the NCCPL.

- 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 stated above, custodians only get registered with NCCPL and trades executed by Investment Firm on behalf of foreign investors are shifted to respective CCM through institutional delivery system for clearing and settlement of such trades. As such no agreement is executed between Investment Firm and CCM.

- 7. 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?**

An Investment Firm is required to provide information relating to custody and movement of securities to the respective client only. However clients information may also be disclosed to any person authorized under CDC Act 1997 (please refer section 20 and 21 of CDC Act 1997).

- 8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?**

The terms and condition of account opening form stipulate the client protection rights and are standardized for all participants and clients, and therefore cannot be changed or waived.

- 9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:**

- a. Does the Investment Firm report where client assets are held?**

No

- b. Does the Investment Firm or depository report the protections applicable to such client assets?**

No

- c. Does the Investment Firm or depository report the amount of assets that are held?**

No

**In each case, are such reports provided on request or periodically? If periodically, with what frequency?**

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If any information is required the regulator has the authority to call for such information at any point of time.

- 10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify**
- a. Where Client Assets are held?**
  - b. The amount of Client Assets held at a depository?**
  - c. The safeguards applicable to Client Assets held at a depository?**

The stock exchange-SRO monitors investment firm's compliance to the requirement for protection of client assets through system audit of the firms. Further, the SECP also undertake inspection of investment firms to ensure their compliance to the client asset protection regime.

Below is a sample of some of the relevant inspection checks:

- Check order has been placed by the Client from telephonic recording or other media
- Order confirmation has been issued to him within 24 hours
- Pledge have been marked from Client's CDC Account
- Mark to Marked margins have been deposited by the Clients from "Clients' Margin Bank Account
- Margin call has been initiated in writing
- Settlement has been taken place into Client's CDC Account and/or Client Bank Account
- Contract Name has been issued in the name of client and not the agent

Further Chapter 13 of the CDC Regulation mentions that, if any information is required by CDC from a Participant or, as the case may be, CDC is required to inspect the Records of any Participant, CDC may, by notice, require such Participant to provide such information or, as the case may be, permit CDC to inspect any Records.

- 11. Where an Investment Firm based in a foreign jurisdiction (a "Foreign Investment Firm") deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify**

- a. The amount and/or value of such Client Assets**

Not applicable

- b. The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?**

Not applicable

- 12. Under what circumstances, if any, is an Investment Firm required to notify the regulators, or the market generally, of material changes in their financial**

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**position or ability to continue to carry on business? What is the nature of such required disclosures?**

An investment Firm specifically does not have to report any information regarding its inability to continue its business or any other material changes in its financial position. However, the concerned stock exchange is constantly monitoring the Investment Firms compliance with the Exposure Limits and the availability of Margin pursuant to its regulations. Furthermore, it is obligatory upon Investment firms to get their accounts and Net Capital Balance audited by a certified chartered accountant and submit the report to SECP bi-annually. Moreover, as mentioned at Para-2(a) above the Corporate Brokerage House/Investment Firm having paid up capital of at least Rs.7.5 million are required to submit their audited financial statements to SECP.

**13. 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 at any point of time, the Net Capital Balance of an Investment Firm falls below a certain threshold (Rs. 2.5 million) the membership of an Investment Firm to carry out brokerage business will be suspended and will remain suspended until the net capital balance is increased. The reason for doing so is to safeguard the client securities in the sub-accounts of the Participant. The SECP is also empowered to suspend the registration of an Investment firm where its financial position has deteriorated to such an extent that the SECP is of the opinion that its continuance in securities business shall not be in the interest of investors.

### **Post-Insolvency**

**14. 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?**

Under Chapter 19 of the NCCPL Regulations, an Investment Firm will be treated as Insolvent:

- (a) If the Investment Firm fails to perform its obligations or determines that it is unable to do so;
- (b) in the event of the entry of a decree or order by a Court having jurisdiction in the premises adjudging the NCC Participant bankrupt or insolvent or approving as properly filed a petition seeking reorganization, arrangement, adjustment (otherwise than by way of amalgamation) or composition of or in respect of the NCC Participant under or any applicable Federal or Provincial law or appointing a receiver, liquidator, assignee, trustee, (or other similar official) of the NCC Participant or of any substantial part of his property or ordering the winding up or liquidation of the NCC Participant or of his affairs, or
- (c) the institution by the NCC Participant of proceedings, as the case may be, to be wound-up or to be adjudicated as bankrupt or insolvent, or

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(d) Upon the consent by Investment Firm to the institution of bankruptcy, insolvency or winding up proceedings against it, or

(e) Upon the filing of a petition or consent in seeking reorganization or relief under or any applicable Federal or Provincial law, or

(f) Upon the consent to the filing of any such petition, or to the appointment of a receiver, liquidator, assignee, trustee, (or other similar official) of the NCC Participant or of any substantial part of its property, or

(h) the admission by Investment Firm in writing of its inability to pay its debts generally as they become due, or

This process of insolvency of an Investment Firm is different from the process used for other entities. The investment firm initially goes through the process of default as referred in the Default Management Regulations of the Exchange, whereas any other entity has to follow the procedure laid down in Part XI of the Companies Ordinance 1984.

Under the Default Management Regulations a Default Management Committee is constituted by the concerned stock exchange. The Committee recovers all moneys, securities and other assets due or deliverable to the Defaulter by any other Member (in respect of any transactions), securities and/or Cash/Bank Guarantee remained unutilized with NCCPL after squaring-up initiated, membership card and office(s) within the Exchange premises, if any, in the control of the Exchange.

After the assets of the investment firm are liquidated and distributed, the Investment Firm can still be taken up for winding up, under Part XI of the Companies Ordinance 1984. The said winding up may be done either-

- (i) by the Court; or
- (ii) voluntary; or
- (iii) subject to the supervision of the Court.

### **15. 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 such there is NO such concept of appointing an Administrative Officer during insolvency or when a member of stock exchange defaults, however when a firm/company is required to file for winding up under provisions of the Companies Ordinance 1984, a liquidator is appointed by the Court, from amongst persons recommended by the Commission, a panel of persons from whom it shall appoint a provisional manager or official liquidator of a company ordered to be wound up by the Court. However, in case of Investment Firm voluntary winding up liquidator is appointed by the company in general meeting.

### **16. What are the duties of the Administrative Officer?**

Since there is NO Administrative Officer, a liquidator appointed by the court has the following duties:

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(a) to institute or defend any suit, action, prosecution or other legal proceeding, civil or criminal, in the name and on behalf of the company;

(b) to carry on the business of the company so far as may be necessary for the beneficial winding up thereof;

(c) to pay any classes of creditors in full;

(d) to make any compromise or arrangement with creditors or persons claiming to be creditors, or having or alleging themselves to have any claim, present or future, certain or contingent, ascertained or sounding only in damages against the company, or whereby the company may be rendered liable;

(e) to compromise all calls and liabilities to calls, debts and liabilities capable of resulting in debts, and all claims, present or future, certain or contingent, ascertained or sounding only in damages, subsisting or supposed to subsist between the company and a contributory or alleged contributory or other debtor or person apprehending liability to the company, and all questions in any way relating to or affecting the assets or the winding up of the company, on such terms as may be agreed, and take any security for the discharge of any such calls, debt, liability or claim and give a complete discharge in respect thereof;

(f) to sell the movable and immovable property and things in action of the company by public auction or private contract, with power to transfer the whole thereof to any person or company or to sell the same in parcels

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

Not Applicable

**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?**

None

**17. 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?**

Yes, the concerned Stock Exchange nominates eligible candidates to be part of the Default Management Committee, once the Committee is formed they are in charge of liquidating and disposing off the insolvent members assets and then distributing those assets amongst clearing houses, exchanges, members and clients.

*The Default Management Regulation Stipulates that:*

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*(d) While disposing of the collaterals, in the form of margin eligible securities, cash and/or bank guarantee, of clients of a Member kept as margin, the Exchange shall have the absolute discretion to liquidate such collaterals in preference to others to meet the obligations of Exchange/ NCCPL.*

*Upon receipt of copy of NCCPL Final Notice, the Exchange shall serve a final notice to the suspended Member calling upon the suspended Member to pay the liabilities stated in the NCCPL notice within the time allowed in said notice.*

### **18. What are the requirements, if any, governing the segregation and treatment of Client Assets during the insolvency of an Investment Firm?**

The Investment Firm is prohibited from using the services of CDS, which means that the firm has no access to any accounts including house account and/or any of its client's sub-account. The reason for barring the investment firm from any sort of control over its account is to safeguard the sub-account holders/clients.

### **19. 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 CDC offers its sub-account holders to transfer their securities from sub-account of a restricted Participant account to a sub-account of any other Participant account or even move it to an investor account. Subject to conducting verification and authentication of the sub-account

*Chapter 15 of CDC Regulations mention that a Sub-Account Holder, having a Sub-Account controlled by the Participant, by notice to CDC in terms of and in accordance with the Procedures requires that the Book-entry Securities entered in the Holding Balance of his Sub-Account be moved to the Holding Balance of his Sub-Account controlled by another Participant or to his Investor Account with CDC, as the case may be, then CDC may, in accordance with the Procedures, upon giving seven (7) Business Days' notice to such Participant of CDC's intention to do so, comply with the notice received from the Sub-Account Holder.*

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

To make such a transfer, the client need to send an application to the CDC, requesting it to transfer securities from his sub-account to another sub-account of a different Participant account. As mentioned in the clause above it should primarily take 7 days to make the transfer, after the sub-account holder imitates the request.

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

The factor that would affect the above mentioned time period would be conducting investigations on the authenticity of the sub-account holder. As per General Regulations of the Exchange this procedure would involve a chartered accountant who would go through all the transactions ever made and other account details to confirm whether the sub-account holder is not related to the banned Participant or acted as an associate to the Participant.

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**20. 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?**

None

**21. 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).**

Karachi Stock Exchange (KSE) maintains Investors' Protection Fund (IPF) for providing maximum relief to the investors and allows disbursement of Rs. 75 million per investment firm from IPF for satisfaction of claims of aggrieved investors in case of default/expulsion of such Firm. In case claims of investors determined against the defaulting Member exceed the amount available (Rs.75 million) for settlement of such claims of investors shall be satisfied on a pro-rata basis.

The Default Regulations also specifies that in case the investors' claims admitted by the Exchange against a Member/investment firm are more than the amount of surplus as mentioned in this Regulation, all the claims will be satisfied on pro-rata basis. The claims still remaining unsatisfied after pro-rata sharing will then be paid from the Investors Protection Fund in accordance with the KSE Investors Protection Fund Regulations.

Furthermore, Regulations relating to Investors Protection Fund prescribe as under:

*In case the investors' claims admitted by the Exchange against a Member are more than the amount available out of sale proceeds of assets under control of the Exchange in accordance with the relevant Regulations, all the claims will be paid on prorata basis. The claims still remaining unsatisfied after pro-rata sharing will then be paid from the Fund by utilizing up to aggregate amount of Rs. 75 million, in the following order of priority, whereby the per claimant distribution shall, in any case, not exceed the amount of claim:*

*(a) Initial Disbursement of up to a maximum of Rs. 500,000/- equally per claimant among all claimants by utilizing 50% of maximum allowable contribution i.e. Rs. 37.5 million. Such disbursement shall either be made to satisfy all claims or, if insufficient to settle all claims, be disbursed equally among all the claimants.*

*(b) Remaining amount to be disbursed by utilizing balance 50% of maximum allowable contribution i.e. Rs.37.5 million plus any unutilized portion of Fund as stated at (a) above. In case, such amount of Fund is insufficient to satisfy all such claims in full, then pro-rata distribution will be made.*

**22. 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.**

Clients are not treated differently based on permissions they have granted pre-bankruptcy. As discussed above, securities pledged from sub-accounts of clients are utilized up to their outstanding

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

exposures and losses of clients cannot be allocated to other clients of defaulted investment firm. The clients who have authorized the investment firm in writing may lose right to reclaim such securities. The claims still remaining unsatisfied after pro-rata sharing will then be paid from the Investor Protection Fund by utilizing up to aggregate amount of Rs. 75 million in accordance with methods and procedures prescribed in the Regulations relating to Investor Protection Fund.

**23. 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

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

If any investment firm is found indulged in misuse of clients assets, stock exchange and SECP have powers to suspend/expel such investment firm after carrying out an investigation/ enquiry. All clients are treated equally, in case the investors' claims admitted by the Exchange against a suspended/expelled investment firm are more than the amount of proceeds of its assets, all the claims will be satisfied on pro-rata basis. (Default Management Regulations)

**25. 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 case the investors' claims admitted by the Exchange against an investment firm are more than the amount of surplus as mentioned in the Default Management Regulation, all the claims will be satisfied on pro-rata basis. The claims that still remain unsatisfied after pro-rata sharing will then be paid from the Investor Protection Fund in accordance with the KSE Investors Protection Fund Regulations. (Default Management Regulation)

**26. 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?**

No, all clients local and foreign are treated equally according to the procedure mentioned above. (Default Management Regulation)

### 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?

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- Securities and Exchange Ordinance 1969  
<http://www.secp.gov.pk/corporatelaws/pdf/SEORDINANCE1969-amended-%20till-2012.pdf>
- SECP ACT 1997 [http://www.secp.gov.pk/corporatelaws/pdf/secpact1997\\_2012.pdf](http://www.secp.gov.pk/corporatelaws/pdf/secpact1997_2012.pdf)
- Brokers and Agents Registration Rules 2001  
[http://www.secp.gov.pk/corporatelaws/pdf/BrokersAndAgentsRegistrationRules2001\(2\).pdf](http://www.secp.gov.pk/corporatelaws/pdf/BrokersAndAgentsRegistrationRules2001(2).pdf)
- National Clearing Company Limited Regulations  
[http://www.nccpl.com.pk/about\\_us/pdf/20-07-2012-NCCPL%20Regulations-SECP%20Letter-July%202023,%202012.pdf](http://www.nccpl.com.pk/about_us/pdf/20-07-2012-NCCPL%20Regulations-SECP%20Letter-July%202023,%202012.pdf)
- Central Depository Act 1997 [http://www.secp.gov.pk/corporatelaws/pdf/1997\\_1.pdf](http://www.secp.gov.pk/corporatelaws/pdf/1997_1.pdf)
- Central Depository Company Regulations  
<http://cdcpakistan.com/Downloads/CDCPL%20REGULATIONS.pdf>
- Default Management Regulations of the Stock Exchange <http://www.kse.com.pk/>
- General Regulation of the Stock Exchange <http://www.kse.com.pk/>
- Risk Management Regulation <http://www.kse.com.pk/>
- Standardized Investor Account Opening Form  
<http://www.cdcpakistan.com/Downloads/Investor%20Account%20Opening%20Package%20-%20Individual.pdf>
- Margin Trading Regulation <http://www.kse.com.pk/>

**Poland**  
**2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

(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.
  - a. How does your jurisdiction define the term “client assets?” If the jurisdiction uses an analogous term, please provide that term and its definition.

**ANSWER: There is no legal definition of client asset however client asset are composed of the account of the financial instruments and the client funds.**

- b. What is the nature of a client’s ownership rights with respect to its client assets placed with the investment firm?

**ANSWER: The issue of ownership rights is not per se defined however the ownership rights with respect to client assets are guaranteed by the Act on Trading in Financial instruments and the appropriate decree of the Ministry of Finance. Under the a. m Regulation as a general rule an investment firm holding client asset is not allowed to use for its own account or the account of the third party client asset. The matter of ownership is explicitly regulated by the general rules resulting from Civil Code. In terms of the rules of interest rate of the client money hold by an investment firm it s to be stated that it is regulated by the agreement between client and the investment firm.**

- c. How does your jurisdiction define the term “client”? If the jurisdiction uses an analogous term, please provide that term and its definition.

**ANSWER: The term Client is defined under the decree of the Ministry of Finance on the terms and conditions of providing investment services (...) as individual, legal person or an entity which does not legal personality which has concluded with investment firm an agreement for conducting of the investment services. The category of clients are also defined in the Act on Trading in Financial Instruments. The categorisation reflects the client categories as mentioned in MIFID Directive i.e. professional client, retail clients and eligible counterparty.**

- d. Please describe any notable exclusions from the terms “client” or “client assets.”

**ANSWER: does not concern**

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*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)*

**ANSWER: The ownerships rights are guaranteed both for the financial instruments account belonging to client as well as for the client funds.**

(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?

**ANSWER: 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?

**ANSWER: Investment firm which is going to provide custodian services (safekeeping and administration of financial instruments for the account of client) is obliged to meet the conditions regarding the capital requirements, regulatory requirements, fit and proper test, technical and organizational solutions, scope of activities (detailed), providing business plan.**

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

**ANSWER: Does not concern**

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?

**Answer: Yes**

- i. Are Investment Firms allowed to hold Omnibus Accounts? Yes

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

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

**ANSWER: The regulatory measures (i. e Regulation of the Ministry of Finance on the term and conditions for providing of investment services by investment firm ...) has been enacted particularly to protect client assets. Under this Regulation an investment firm is not allowed to use the client funds and the financial instruments on his own account or on the account of the other clients. The same concerns also the investment firm which provides custodian services.**

- b. Please describe any requirement that an Investment Firm must reconcile the Client Asset account. For example: Point b requires clarification.
  - 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? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

**Answer: No**

- 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?

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

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

**ANSWER: 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 use, the Client Assets? If so, please describe.

**ANSWER: Investment firm generally cannot use (invest, encumber) the client asset (client funds). However it is possible after receiving prior written (retail clients) or explicit (professional client) consent to use its financial instruments by investment firm . It concerns the transactions mentioned in art. 2 point 10 of the Commission Regulation 1287/2006.**

- i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent? Point i requires clarification.
- ii. How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets? Answer in point d)
- iii. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (*i.e.*, established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator?)

**Answer: Primarily the commission is able to impose some sanctions on investment firm for violation rules in terms of client assets and it is proportionate to the scale of the violation.**

**In terms of client rights the clients are able to demand from firm any compensation for damages suffered under general rules implying from civil law.**

- 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?

**Answer: There is accounting system allowing on the separation of the concrete positions held by the members of the clearinghouses but not includes the clients of the members of the clearinghouses.**

4. Are Investment Firms in your jurisdiction permitted to transfer to, or hold Client Assets belonging to clients in your jurisdiction in, another jurisdiction?

**Answer: Yes**

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If so, does the Regime in your jurisdiction require Investment Firms to preserve the separate identification of:

**Answer: There is such possibility provided that a foreign entity provide custodian services in a country which legal system regulates custodian services on the account of the third party and provided that in particular a foreign entity possess some appropriate experience, knowledge and licenses allowing the provision of safekeeping and administration of financial instruments for the account of client) .**

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

**Answer: Yes, however if the conditions regarding the standard of the holding of client asset (i.e. separate holding and administration of the client asset from the asset of investment firm and asset belonging to the third party) are not fulfilled the client must be informed about it and give the express written consent for that.**

- 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?

**Answer: there is additional other provision as indicated in point a above.**

If so, please provide details of those requirements.

**Answer: There is under § 27.1.5 of the Regulation of the Ministry of Finance on term and conditions of providing of investment services by investment firm requirement that holding of client assets including financial instruments and client money by the other entity takes into account provided that this entity ensure holding and administering of the client asset separately from the asset of the entity and the asset of an investment firm.**

5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)? If so,

**YES within an omnibus account.**

- a. What protections are applicable to the Foreign Investment Firm’s such Client Assets?
- b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?
- c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

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

**Answer: There is a special category of the custodian banks which under art. 119 of the act on trading in financial instruments are allowed to provide custodian services after obtaining special permission granted by Polish Financial Supervision Authority. The bank providing custodian services is obliged to submit in particular application for authorization which include personal detail of a members of management board and supervisory board, information on the amount of own funds,.**

**The client asset may be kept by the entity having special license for providing such activity e.g. investment firm , foreign investment firms, custodian banks etc.**

- 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.
7. 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?

**Answer: An investment firm is obliged to provide to clients information regarding measures on investor protection (in particular client assets) and basis information on systems which guarantee security of the client assets.**

8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

**Answer: There is no existing regulation in this context.**

- Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets?

**Answer: The information concerning client asset are required under information regulation of the Ministry of Finance. The scope of the information is referring to the amount of the client assets and the number of the account of the client. It is submitted monthly.**

- Does the Investment Firm report where client assets are held?

**Answer: No, however there is strictly limited by the Act on Trading in Financial Instruments number of category of institutions where client assets (client money) can be deposited.**

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

- b. Does the Investment Firm or depository report the protections applicable to such client assets?

**Answer: On annual basis there is submitted to the PFSA a report on the way of execution requirements on protections on client assets. It is provided by an independent auditors which evaluate a completion of standard with regard to protection of client assets.**

- c. Does the Investment Firm or depository report the amount of assets that are held

**Answer: Yes**

In each case, are such reports provided on request or periodically? If periodically, with what frequency? There are provided periodically. It includes monthly or annually period.

10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify
  - a. Where Client Assets are held?

**Answer: It is conducted through desk based inspections and basically through on site inspections.**

- b. The amount of Client Assets held at a depository?

**Answer: It is conducted through desk based inspections and basically through on site inspections.**

- c. The safeguards applicable to Client Assets held at a depository?

**Answer: It is conducted through desk based inspections and basically through on site inspections.**

11. Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify
  - a. The amount and/or value of such Client Assets?
  - b. The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?
  - c. Foreign regulator can request an investment firm

**Answer: Foreign regulator can request our regulator provided that there is some suitable MOU on exchange of information between regulators.**

12. 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

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

ability to continue to carry on business? What is the nature of such required disclosures?

**Answer: An investment firm is obliged to provide to regulator monthly report on financial positions, completion of capital requirements, client's assets on the accounts and the investment firms' assets on the account.**

13. 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?

**Answer: There is a few possibilities: regulator is able to limit or to ban the activity provided by an investment firm when investment firm does not meet the financial provisions regarding the conducting of investment services . In some particular circumstances there is also possible to block the of the account of investment firm under art. 39 of the act on capital market supervision dated on 29 July 2005.**

### **Post-Insolvency**

14. 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?

**Answer: Generally with regard to the post insolvency process there is the provision of the act on trading in financial instruments which states that in case of insolvency of an investment firm the client money deposited at an investment firm in connection with a providing of investment services are not a part of bankrupt estate. Moreover the client asset including also financial instruments is protected by the compensation scheme.**

**An investment firm enters the status of insolvent or bankrupt under the insolvency law which as such is outside of the remit of PFSA. However PFSA is to be notified about the submitting to the insolvency court the file concerning the insolvency of the investment firm. Investment firm is also required to submit to PFSA report concerning opening of the winding up procedure of the investment firm.**

15. 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?

**Answer: This matter is outside of the PFSA'S remit. Insolvency procedure in conducted within the remit of insolvency court.**

16. 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?

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

- 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?
17. 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?
18. What are the requirements, if any, governing the segregation and treatment of Client Assets *during* the insolvency of an Investment Firm?
19. 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?
20. 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?
21. 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).
22. 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.
23. Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?
24. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?
25. 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?

## **2013 IOSCO Collated Responses to the Client Asset Protection Survey**

26. 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?

### **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?

**Romania**  
**2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

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(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.

## Response from the Romanian National Securities Commission (CNVM)

**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.
  - a. How does your jurisdiction define the term “client assets?” If the jurisdiction uses an analogous term, please provide that term and its definition.

**The term “client assets” is not explicitly defined in the Romanian capital market legislation, however it includes the funds (money) and the financial instruments belonging to the client.**

**Financial instruments means those instruments specified in Section C of Annex I of the Directive 2004/39/EC on markets in financial instruments (MiFID), implemented in the Romanian legislation in article 2 para. (1) point 11 of the Law 297/2004 on capital market with the following amendments:**

- a) Transferable securities;
- b) Money-market instruments;
- c) Units in collective investment undertakings;
- d) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash;
- e) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event);
- f) Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market and/or an MTF;
- g) Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in C.6 and not being

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are cleared and settled through recognized clearing houses or are subject to regular margin calls;

h) Derivative instruments for the transfer of credit risk;

i) Financial contracts for differences;

j) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event), as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Section, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market or an MTF, are cleared and settled through recognized clearing houses or are subject to regular margin calls.

b. What is the nature of a client's ownership rights with respect to its client assets placed with the investment firm?

In accordance with the provision of art. 24 para. (2) and (3) of the Law no. 297/2004 on capital market, with the following amendments, the creditors of an intermediary (investment firm or credit institution) may not use, under any circumstances, the investors assets, including in case of insolvency proceedings. An intermediary may not use the financial instruments of a client for the purpose of trading on own account or on account of another client, unless the client gives its prior written consent. A client's funds can be used to perform transactions on their own only by credit institutions.

The investor assets are exempt from the enforcement by seizure, if against the broker was started foreclosure proceedings

Also, in accordance with provision of art. 118 of the Regulation no. 32/2006 on investment services, with the following amendments:

”(1) ...where S.S.I.F. holds financial instruments or funds belonging to retail clients, it shall provide those retail clients or potential retail clients with the information specified in paragraphs (2) to (7) as is relevant.

(2) The S.S.I.F. shall inform the retail client or potential retail client where the financial instruments or funds of that client may be held by a third party on behalf of the S.S.I.F. and of the responsibility of the S.S.I.F. under the applicable national law for any acts or omissions of the third party and the consequences for the client of the insolvency of the third party.

(3) Where financial instruments of the retail client or potential retail client may, if permitted by national law, be held in an omnibus account by a third party, the S.S.I.F. shall inform the client of this fact and shall provide a prominent warning of the resulting risks.

(4) The S.S.I.F. shall inform the retail client or potential retail client where it is not possible under national law for client financial instruments held with a third party to be separately identifiable from the proprietary financial instruments of that third party or of the S.S.I.F. and shall provide a prominent warning of the resulting risks.

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(5) The S.S.I.F. shall inform the client or potential client where accounts that contain financial instruments or funds belonging to that client or potential client are or will be subject to the law of a jurisdiction other than that of a Member State and shall indicate the extent to which the rights of the client relating to those financial instruments may be affected.

(6) An S.S.I.F. shall inform the client about the existence and the terms of any security interest or lien which the firm 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 or funds. Where applicable, it shall also inform the client of the fact that a depository may have a security interest or lien over, or right of set-off in relation to those instruments or funds.

(7) An S.S.I.F., 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 S.S.I.F. with respect to the use of those financial instruments, including the terms for their restitution, and on the risks involved.”

In relation to assets held by an investment firm, clients retain beneficial ownership of the assets at all times, and they are protected in the ease of insolvency of the investment firm. 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).

Arrangement of measures 5/2008:

“The following actions are considered fraudulent practices:

- a) loan, pledge or collateral on behalf of an intermediary / client, while using a client financial instruments without his prior written consent;
- b) loan or collateral on behalf of an investment firm using funds belonging to a client;
- c) disposal or direct/indirect use of a client financial instruments or rights without the express written consent of the client;
- d) direct or indirect disposal of a client funds or rights made by an investment firm;
- e) obligations’ coverage arising from transactions made in the account of an intermediary / client using the financial instruments of a client without his prior express written authorization;
- f) obligations’ coverage arising from transactions in a client account / investment firm using funds belonging to a client. ”

c. How does your jurisdiction define the term “client”? If the jurisdiction uses an analogous term, please provide that term and its definition.

In accordance with the provisions of para. (2) art. 2, letters f)-h) of the CNVM Regulation no. 32/2006, with the following amendments:

- f) *client* – any natural or legal person to whom an S.S.I.F. provides investment and/or ancillary services;
- g) *professional client* – any client meeting the criteria laid down in Annex no. 8;

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*h) retail client* – the client who is not a professional client;

In accordance with the provisions of Annex no. 8 of the CNVM Regulation no. 32/2006, with the following amendments, professional clients means:

### Art. 1 – Categories of clients regarded as professional clients

(1) The professional client refers to the client who has the experience, knowledge and ability required to take investment decisions and assess the risks involved. In order to be regarded as professional client, the client shall be included in the categories referred to in paragraph (2) and shall meet the criteria mentioned at the same paragraph.

(2) The following categories of clients shall be regarded as professional clients for all investment services and financial instruments defined in accordance with Law no. 297/2004:

a) Entities which must be authorised and regulated to operate on financial markets. The following list includes all the authorised entities which carry out activities such as those mentioned above: entities authorised in Romania or in a Member State in accordance with a EU Directive, entities authorised or regulated in Romania or in a Member State which are not subject to a EU Directive and entities authorised and regulated by a non Member State:

1. credit institutions;
2. investment firms;
3. other financial institutions authorised or regulated;
4. insurance companies;
5. UCITS and their management firms;
6. pension funds and their management firms;
7. traders;
8. other institutional investors.

b) Firms which meet two of the following requirements:

1. aggregate balance sheet: EUR 20,000,000
2. net turnover: EUR 40,000,000
3. equity: EUR 2,000,000.

c) National and regional governments, public institutions which manage public debt, central banks, international and supranational institutions, such as the World Bank, the International Monetary Fund, the European Central Bank, the European Investment Bank and other similar international organisations.

d) Other institutional investors whose main activity refers to investing in financial instruments, including entities which deal with securing assets or with other financial transactions.

d. Please describe any notable exclusions from the terms “client” or “client assets.”

None

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*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?

**If an investment firm intends to provide the service of safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management it has to be authorized by CNVM. The initial capital of the investment firm will be at least 125.000 euro. Also, the investment firm shall draw up and submit to CNVM rules and procedures on the separate recording of client financial instruments and funds.**

- 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:

**In accordance with the provisions of art. 90 of the CNVM Regulation no. 32/2006, with the following amendments:**

**(1) The investment firm shall separately record in its accounting system the funds belonging to its clients and shall use with the settlement bank an account opened in its own name and an account opened on behalf of its clients. At the same time, the financial instruments of its clients shall be recorded in separate accounts from the accounts of the S.S.I.F.**

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(2) The investment firm shall not act in such a way so that to endanger or shall not be deemed to endanger or cause to endanger the funds and/or the financial instruments of its clients or the regulated market where it deals and shall ensure that its investment agents and other employees shall not act as such.

(3) Investment firms shall, under any conditions, meet the following requirements:

- a) to ensure the safekeeping of the financial instruments held on behalf of their clients;
- b) not to make use of any of the financial instruments held on behalf of their clients or of their associated rights and not to transfer these instruments without the express consent of their clients;
- c) to return to its clients, at the latter's request, the financial instruments and funds held on their behalf.

(4) The investment firm authorised to provide the investment service of "safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management" shall be responsible for the payments and settlements in connection with the financial instruments belonging to its clients."

In accordance with the provisions of article 6 para. (6) of the CNVM Regulation no. 5/2010, intermediaries authorized to perform the investment service of safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management should elaborate internal procedures and internal control mechanisms, to be reviewed annually, regarding:

- The use of robust back-office procedures, including the double entry system, according to which, for each credit/debit of the beneficiary account should be a corresponding operation of debit/credit of the counterparty account providing/receiving the securities, procedures which should identify at any time and without delay the securities' holdings of a personal client;
- Registration, record and necessary account keeping, in order to distinguish, at any time and without delay, between the assets held by a client and the assets held by any other client and from its own assets;
- Daily checking of their own records performed by the intermediaries in order to certify that the aggregate holdings of their customers correspond with the intermediaries registered positions in the global accounts open with other intermediaries or central depository systems;
- Daily reconciliation by participants in a central depository, of all customers' individual sub-accounts and house account, respectively the securities holdings and related tasks, highlighted in their own back-office systems with global accounts open in central depository systems;
- the adequate protection of the clients' assets, including the including situation in which securities are deposited through several intermediaries in a chain of custody and ensuring that those procedures, to the extent relevant, are applicable to all intermediaries that are in higher positions in the chain of custody.

Also, according to CNVM Decision no. 1075/21.11.2012, investment firms must withdraw on a daily basis the amount of money representing its commissions from the clients' accounts. The investment firm may keep certain amounts of money in the clients' accounts only if this money will be used to settle possible debit positions of the clients.

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

**The client's money is maintained in one or more bank accounts. The number of bank accounts opened by the intermediary in order to hold clients' money depends on the bank exposure indicator. At the level of back office and accounting papers, the intermediary maintains separately records of each client's assets.**

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

**Yes, investment firms are allowed to hold client assets in Omnibus accounts, but they have to keep records in their back-office system so that they are able, at any time and without delay, to identify the assets of a client from the assets of any other client and from their (investment firms) own assets.**

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

**In accordance with the provisions of article 94 of the CNVM Regulation no. 32/2006, with the following amendments:**

**The investment firm shall not enter into arrangements for securities financing transactions in respect of financial instruments held by it on behalf of a client, or otherwise use such financial instruments for its own account or the account of another client of the investment firm unless the following conditions are met:**

- a) the client must have given his prior express consent to the use of the instruments on specified terms, as evidenced, in the case of a retail client, by his signature or equivalent alternative mechanism;
- b) the use of that client's financial instruments must be restricted to the specified terms to which the client consents.

**The investment firm shall not enter into arrangements for securities financing transactions in respect of financial instruments which are held 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 its own account or for the account of another client unless, in addition to the conditions set out in the paragraph mentioned above, at least one of the following conditions is met:**

- a) each client whose financial instruments are held together in an omnibus account must have given prior express consent in accordance with the above mentioned paragraph letter a);
- b) the investment firm must have in place systems and controls which ensure that only financial instruments belonging to clients who have given prior express consent in accordance with the above mentioned paragraph, letter a) are so used.

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

For example:

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- 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 money that a firm is required to hold in bank accounts should exceed the sum of positive individual client balances and the additional margined transaction requirements. The amount the Investment Firm must offset the sum of negative individual client balances.**

	<b>Bank/Back-office</b>	(yy/mm/dd) 1	(yy/mm/dd) 2	...	(yy/mm/dd) j
A	(bank) <sup>1</sup> account				
B	(bank) <sup>2</sup> account				
	...				
I	(bank) <sup>i</sup> account				
J	<b>TOTAL in bank accounts</b>				
K	Difference 1: J-M				
L	Difference 2: K-N				
M	<b>total of positive individual client balances</b>				
N	<b>total of negative individual client balances</b>				

**if K is:**

- a positive number, then the company hold in these accounts all the clients money plus a part of its own money; the amount of money the company hold in the clients accounts must exceed the total of negative individual client balances;
- a negative number, then the company use the money of some clients to settle the trades of other clients; in our legislation this is considered fraudulent practice.

- 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. The financial instruments are fungible within asset classes (e.g. an ordinary share of a company didn't carry an identification number.**

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

**In accordance with the provisions of article 8 of the CNVM Regulation no.5/2010, the participants in the central depository system are required to daily reconcile all the individual customer sub-accounts and the house account, respectively the securities holdings and related tasks, highlighted in their own back-office systems with global accounts open in central depository systems, so as to comply with the following:**

**TOTAL FINANCIAL ASSETS PER ISIN = FINANCIAL ASSETS AFFECTED BY TASKS + FINANCIAL ASSETS FREE OF CHARGES.**

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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? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

**The amount the investment Firm is required to hold must offset the sum of negative individual client balances.**

**The total required funds on deposit for net credit balances clients cannot be reduced with one client's net debit balances.**

ii Timing issues:

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

**Participants in the central depository system are required to reconcile daily all the customers' individual sub-accounts and house account.**

**In accordance with the provisions of article 4 and 5 of the CNVM Arrangement of measures 5/2009, intermediaries are required to perform daily, into the computer record system, the reconciliation of funds or financial instruments holdings registered in each client account and on its own account by verifying the compliance between the obligations and the funds and/or financial instruments holdings recorded in the respective accounts.**

**Intermediaries are required to highlight in the IT system the balances of the clients accounts, including the settlement date.**

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

**With regard to financial instruments, CSD (central securities depository) participants have to reconcile the information registered in their back-office systems with the information registered in the CSD system on a daily basis, by the end of the settlement 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?

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

**Client's assets (financial instruments) can be used by an intermediary, investment firm or a credit institution in order to guarantee the transactions on own account or on other client's**

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**account only if there is a preliminary written agreement of the client whose financial instruments are used. This agreement should be concluded for each operation.**

**Client's assets (funds) can be used in order to guarantee the transactions on own account only by the credit institutions registered as intermediary in the CNVM Register.**

- 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 use, the Client Assets? If so, please describe.

**See response in c.**

- i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?

**If a client agrees to full title transfer of its assets to the firm in certain circumstances and the firm exercises its rights to take full ownership of assets in accordance with its client agreement, this will result in those assets being moved out of the client assets regime for the period during which the firm exercises full ownership rights. The consequence of this is that, if a firm fails during that period, the client will rank as a general creditor of the firm in relation to those assets.**

**However, a security financial collateral arrangement would usually mean that the client retains beneficial interest in the assets until such time as the condition in the agreement allowing the firm to exercise its security right is met.**

- ii. How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?

**In accordance with the provisions of article 16 of the CNVM Regulation no.5/2010, all operations regarding the securities lending will be based a standard contract and its additional acts. The additional acts shall be drafted as follows:**

- a) **preliminary to the introduction of the selling order into the trading system in case of application of the prevalidation mechanism of the financial instruments;**  
b) **the latest on the date of the settlement in accordance with the settlement term, in case of the mechanism without prevalidation of the financial instruments.**

**For the situations when the securities lending operations as well as the guarantee operations are carried out by an intermediary and its client or a client of another intermediary or between 2 clients of an intermediary/ies, a standard lending contract (made of a standard contract and additional acts) shall be used and drafted in accordance with the GMSLA standard lending contract adjusted to the Romanian legislation and in compliance with the following provisions:**

- a) **the standard contract shall contain at least clauses related to :**  
- **the parties of the contract;**

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- the object of the contract;
  - the rights and the obligations of the contract parties;
  - the volume/maximum value of the securities that can be lent to a client depending on the intermediary rules for risk administration;
  - the type of the guarantees that can be used for guaranteeing the securities lending;
  - the way of setting, assessment and execution of the guarantees;
  - the way of rendering the lent securities and guarantees;
  - the situation of non-reimbursement of the securities at the maturity;
  - the way of exercise, by the contracting parties, of the rights related to the ownership rights over the lent securities and, as the case may be, over the securities set as financial guarantee with ownership transfer;
  - provisions related to the way of closing the contract, inclusive the situations when the lent securities are excluded from the list of securities eligible for securities lending operations;
- b) for each operation of lending securities, an additional act will be drafted that will contain at least clauses regarding:
- the contracting parties;
  - the object of the contract;
  - the type, the number, the nominal value and the market value of the lent securities, by specifying the issuer and ISIN code;
  - the type and the value of the assets accepted for guaranteeing the lending;
  - the period of the securities lending;
  - the tariffs and the commissions paid by the beneficiary of the securities lending.

iii. How are the ownership rights of a client over its client assets changed or affected when the investment firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (i.e. established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator)?

As set out in our response to (i) above, where a client agrees to transfer full title to custody assets to a firm and firm has exercised its rights to take full ownership of custody assets in keeping with its client agreement (i.e. with the client's consent) the custody assets are removed from the client assets regime (and the protections thereof) for the period that the firm exercises those rights. It is that contractual agreement between client and firm that allows the client asset regime protections to be disappplied for that period. Therefore, if a firm takes full ownership over custody assets and uses them without the agreement of the client to whom the assets belong, in our view, the client asset regime should continue to apply to those assets. If the firm has used the assets as its own the client/insolvency practitioner may attempt a tracing exercise.

The intermediaries authorised to provide investment services and management companies, which manage individual investment portfolios, must be members of the Investment Compensation Fund.

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**The purpose of the Fund is to compensate investors, in compliance with the conditions set out in the Capital Market Law (Law no. 297/2004, with the following amendments) and with C.N.V.M. regulations, if Fund members fail to return the funds and/or the financial instruments owed by or belonging to investors, which have been held on their behalf for providing investment services or managing individual investment portfolios. “Investor” refers to any person which has entrusted a Fund member with funds or financial instruments in order to provide investment services.**

**The Fund shall compensate the investors in any of the following situations:**

**a) C.N.V.M. has acknowledged that, for the time being, from its point of view, an intermediary or a management company that manages individual investment portfolios, for reasons directly linked to their financial situation, is not able to meet its obligations resulted from investors’ claims and furthermore, there is no possibility for it to meet these obligations in the shortest time possible;**

**b) the competent legal authority, for reasons directly or indirectly linked to the financial situation of a Fund member, has issued a final decision that has as a result the suspension of investors from the possibility of exercising their rights as regards the resolution of their claims against the said company.**

**(2) The compensation shall be granted for the rights resulted from the failure of a Fund member to:**

**a) repay the investors’ funds held on their behalf in connection with their investment activities;**

**b) return to the investors any financial instrument that belongs to them and is held and managed on their behalf in connection with their investment activities.**

**The Fund compensates the investors equally and fairly up to 20,000EUR.**

- 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 accordance with the provisions of art. 152 of the CNVM Regulation no. 13/2005 on the authorisation and functioning of the central depository, the clearing houses and central counterparties:**

**The clearing house/central counterparty shall be organised so that to ensure the carrying out of the following operations:**

**a) registration to the margin accounts, in the name of the clearing members of the derivatives traded on regulated markets/alternative trading systems;**

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- b) keeping the records of the derivatives registered, of open positions, according to underlying assets and maturities; records are kept for each clearing member, to its own account, to the accounts of the non-clearing members for which it provides clearing and settlement and to the account of that clearing member's clients;
- c) daily carrying out of the transfer of premiums in the case of options registered, by crediting or and, respectively, debiting margin accounts;
- d) keeping the records of contributions to the guarantee fund;
- e) adjusting, during the session, margin accounts by recording the favourable or unfavourable differences resulted from marking to market;
- f) supervising margin maintenance for open positions;
- g) daily issuance and sending, for each clearing member, of a report on the derivatives registered, open positions existing on its name, the amount in the margin account, the balance, the profit or loss recorded, premiums paid and cashed, as well as commissions debited from the margin account for the operations performed as a result of marking to market, after the closing of the trading session but before the opening of the next trading session;
- h) sending, after each trading session, where appropriate, of the margin call for clearing members and monitoring the margin account updating;
- i) monitoring and ensuring the exercise of options and the closing of positions at maturity in accordance with the specifications of the derivatives;
- j) any other specific operations set out in its own regulations.

- 4. Are Investment Firms in your jurisdiction permitted to transfer to, or hold Client Assets belonging to clients in your jurisdiction 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.

**In accordance with the provision of article 92 of the CNVM Regulation no. 32/2006, with the following amendments:**

- (1) An investment firm may deposit the financial instruments held on behalf of its clients into an account or accounts opened with a third party. The investment firm shall act with competence, impartiality and professional diligence in the selection, appointment and periodic review of the third party and of the measures necessary for holding and safekeeping of those financial instruments.
- (2) In the application of the provisions mentioned on paragraph (1), the investment firm will take into consideration separately, the experience and market reputation of the third party and any legal requirements or market practices related to the holding of those financial instruments that could affect clients' rights.

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- (3) If the safekeeping of financial instruments belonging to the account of another person is an activity subject to regulation and supervision in a jurisdiction where the investment firm intends to use a third party for providing this service, the investment firm shall not delegate this activity to a third party that is not subject to regulation and supervision in that jurisdiction.
- (4) The investment firm cannot deposit financial instruments held on behalf of its clients to a third party from a non-member State which does not regulate the holding and safekeeping of the financial instruments belonging to another person, unless one of the following conditions is met:
  - a) the nature of the financial instruments or investment services in relation to those which must be deposited to a third party from a non-member State;
  - b) The financial instruments are held on behalf of a professional client, and the client requests to the investment firm, on writing, to keep the financial instruments to a third party from a non-member State.

The Romanian investment firms are permitted to transfer to, or hold Client Assets belonging to clients in another jurisdiction with the fulfillment of the above mentioned legal provisions.

5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)? If so,
  - a. What protections are applicable to the Foreign Investment Firm’s Client Assets?
  - b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?
  - c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?

As regard client assets protections rules there is no differentiation in the Romanian legislation between client assets held for domestic or overseas clients.

6. 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.

See response in point 4.

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7. 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 the provision of art. 118 of the Regulation no. 32/2006 on investment services, with the following amendments:**

**”(1) ...where S.S.I.F. holds financial instruments or funds belonging to retail clients, it shall provide those retail clients or potential retail clients with the information specified in paragraphs (2) to (7) as is relevant.**

**(2) The S.S.I.F. shall inform the retail client or potential retail client where the financial instruments or funds of that client may be held by a third party on behalf of the S.S.I.F. and of the responsibility of the S.S.I.F. under the applicable national law for any acts or omissions of the third party and the consequences for the client of the insolvency of the third party.**

**(3) Where financial instruments of the retail client or potential retail client may, if permitted by national law, be held in an omnibus account by a third party, the S.S.I.F. shall inform the client of this fact and shall provide a prominent warning of the resulting risks.**

**(4) The S.S.I.F. shall inform the retail client or potential retail client where it is not possible under national law for client financial instruments held with a third party to be separately identifiable from the proprietary financial instruments of that third party or of the S.S.I.F. and shall provide a prominent warning of the resulting risks.**

**(5) The S.S.I.F. shall inform the client or potential client where accounts that contain financial instruments or funds belonging to that client or potential client are or will be subject to the law of a jurisdiction other than that of a Member State and shall indicate the extent to which the rights of the client relating to those financial instruments may be affected.**

**(6) An S.S.I.F. shall inform the client about the existence and the terms of any security interest or lien which the firm 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 or funds. Where applicable, it shall also inform the client of the fact that a depository may have a security interest or lien over, or right of set-off in relation to those instruments or funds.**

**(7) An S.S.I.F., 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 S.S.I.F. with respect to the use of those financial instruments, including the terms for their restitution, and on the risks involved.”**

8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

**Clients may not choose to waive or reduce any of the client assets protection requirements.**

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:
  - a. Does the Investment Firm report where client assets are held?

**On a monthly/quarterly basis (depending on the level of their initial capital), investment firms must report to the Competent Authority the names of the banks where its client's money are held.**

**Also, during the enforcement proceedings, the investment firm is obliged to present to the representative of CNVM statements of account issued by the credit institutions where the client money are held and records of clients account.**

- b. Does the Investment Firm or depository report the protections applicable to such client assets?
- c. Does the Investment Firm or depository report the amount of assets that are held?

**See response to letter a) above.**

In each case, are such reports provided on request or periodically? If periodically, with what frequency?

10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify
  - a. Where Client Assets are held?
  - b. The amount of Client Assets held at a depository?
  - c. The safeguards applicable to Client Assets held at a depository?

**As regard the money, we request the audited entity to provide account statements issued by the bank where this firm open its accounts and compare them with the company's balance sheet. As for the financial instruments, we request the audited company to provide account statements issued by the custodian bank. As you can see, in all cases we use a third party confirmation.**

**In addition, CNVM also receive, on a periodic basis, the external / internal auditors reports and the compliance department reports which contain certain aspects on this issues.**

**We would like to mention also the provision of art. 2 para. (5) of the Law no. 297/2004, with the following amendments in accordance to which, in order to perform its supervisory activity, C.N.V.M. may:**

- **verify the modality of fulfilling the legal and statutory attributions and obligations of managers, directors, chief executive officers, as well as of other persons linked to the activity of the regulated or supervised entities;**
- **conduct controls at the premises of the entities regulated and supervised by C.N.V.M.;**
- **hear any person in connection with the activities conducted by the entities regulated and supervised by C.N.V.M.**

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

11. Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify
- The amount and/or value of such Client Assets?
  - The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?

**In this case the provisions of art. 56 to 63 of the Directive 2004/39/EC are applicable, as they have been implemented in the CNVM Regulation no. 32/2006, with the following amendments (title VI).**

12. 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 accordance with the provisions of article 9 of the Law no. 297/2004, with the following amendments, an investment firm must comply with the conditions for authorisation, with prudential and capital adequacy requirements as laid out by this law and by C.N.V.M. regulations, during the time it carries out its activities, and shall notify or first submit for authorisation, as the case may be, any change in its organisation and functioning in compliance with the provisions of C.N.V.M. regulations.**

**The intermediaries authorised by CNVM shall submit their financial statements as well as their periodic reports (article 23 of the above mentioned law).**

**In accordance with the provisions of article 153 para. (1), to the purpose of supervision by C.N.V.M. of the activities undertaken by the S.S.I.F., the latter shall submit to C.N.V.M. the following statements and documents:**

- monthly, quarterly or half-yearly financial statements, as appropriate, prepared and transmitted to C.N.V.M. in accordance with the regulations issued for the application of *Government Emergency Ordinance no. 99/2006 on credit institutions and capital adequacy*;**
- “report on borrowings, margin purchases and short sales” prepared in accordance with Annex no. 7, within maximum 10 days from the close of the reporting month or within maximum 24 hours from the request by C.N.V.M.;**
- “report on derivatives transactions” prepared in accordance with Annex no. 7, within maximum 10 days from the close of the reporting month or within maximum 24 hours from the request by C.N.V.M.;**
- half-yearly report, within the legal term set out by C.N.V.M. regulations, which shall include the half-yearly financial statements made up of balance sheet, profit and loss account, equity statement and cash flow statement;**
- annual report, within the legal term set out in C.N.V.M. regulations, which shall include:**
  - annual financial statements made up of balance sheet, profit and loss account, equity statement, cash flow statement, accounting policies and notes;**
  - management report;**

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

### 3. financial auditor report;

f) internal auditor report, which shall be transmitted together with the report referred to in point e);

g) report on the revenues of the S.S.I.F. (detailed on categories of investment services) and the purpose of expenses, as well as the report on revenues (detailed for each category of investment services) and the purpose of expenses for each secondary premises, which shall be transmitted together with the report referred to in point e).

13. 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 an investment firm financial situation is deteriorating the CNVM can take the following actions :**

- to require the firm to raise new capital,

- to require the firm to return client assets,

- to apply the following sanctions:

a) warning;

b) fine;

c) complementary sanctions, applied as the case may be:

1. suspension of authorisation;

2. withdrawal of authorisation;

3. temporary prohibition from carrying out certain activities and services.

- to enforce trustee in bankruptcy procedures if it has acknowledged that an authorised entity is about to become insolvent or if any of this entity's administrators, executive directors or auditors are guilty of:

a) breaching the provisions of this law or the regulations issued by C.N.V.M., which has caused or may cause significant damages or which jeopardises the well functioning of the capital market;

b) breaching any condition or restriction laid down in the authorisation;

c) inadequate management of financial instruments and funds belonging to investors.

If C.N.V.M. decides on the entity's winding up, the proceedings shall be applied.

### **Post-Insolvency**

14. 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?
15. 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?
16. What are the duties of the Administrative Officer?

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- 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?
17. 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?
18. What are the requirements, if any, governing the segregation and treatment of Client Assets *during* the insolvency of an Investment Firm?
19. 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?
20. 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?
21. 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).
22. 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.
23. Under what circumstances, if any, are clients affected by their permission previously given to allow their Client Assets to be held in another jurisdiction?
24. What happens if the Investment Firm fails to comply with Client Asset protection requirements? Are specific clients treated differently?
25. 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?

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26. 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 this case are applicable the provisions of TITLE IX "TRUSTEE IN BANKRUPTCY AND WINDING UP" of the Law no. 297/2004, with the following amendments:**

### **"Chapter I General provisions**

#### **Art. 264**

- (1) C.N.V.M. shall enforce trustee in bankruptcy procedures if it has acknowledged that an authorised entity is about to become insolvent or if any of this entity's administrators, executive directors or auditors are guilty of:**
- a) breaching the provisions of this law or the regulations issued by C.N.V.M., which has caused or may cause significant damages or which jeopardises the well functioning of the capital market;**
  - b) breaching any condition or restriction laid down in the authorisation;**
  - c) inadequate management of financial instruments and funds belonging to investors**
- (2) If it acknowledges major malfunctioning, C.N.V.M. may require the dissolution of the authorised entities' Boards.**

### **Chapter II**

**Trustee in bankruptcy procedures applied to the entities authorised by C.N.V.M.**

#### **Art. 265**

- (1) Trustee in bankruptcy procedures shall be carried out by a specialised natural or legal person appointed by C.N.V.M.**
- (2) The decision regarding the enforcement of trustee in bankruptcy proceedings shall be published in the C.N.V.M. Bulletin and in two national daily newspapers.**

#### **Art. 266**

- (1) The trustee is fully entrusted with the powers of the Board of the authorised entity under trustee in bankruptcy proceedings.**
- (2) The trustee shall establish measures for the preservation of the assets and the collection of claims to the interest of the investors and of other creditors.**
- (3) The voting rights of the shareholders as regards the appointment and revocation of administrators, the rights to receive dividends, the activity of the Board and of the internal auditors as well as the right to receive payment for their activity are suspended during trustee in bankruptcy proceedings.**

#### **Art. 267**

- (1) Within maximum 60 days from his appointment, the trustee shall submit to C.N.V.M. a written report on the financial situation of the authorised entity and shall annex documents on the valuation of the entity's assets and liabilities, the situation of the claims collection, the cost of asset maintenance and the situation of debt liquidation.**
- (2) Within 15 days from receiving the report of the trustee, C.N.V.M. shall decide, if necessary, on the extension of the trustee's activity, for a limited period of time.**

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(3) If his activity is extended, the trustee shall submit to C.N.V.M. the assessment of the authorised entity's financial situation, on a monthly basis.

### Art. 268

(1) If C.N.V.M. acknowledges, based on the report of the trustee, that the authorised entities have recovered from a financial point of view and meet prudential supervision requirements, according to C.N.V.M. regulations, the trustee in bankruptcy proceedings shall cease.

(2) The decision to cease trustee in bankruptcy proceedings shall be published in accordance with the provisions laid down in art. 265 paragraph (2).

### Art. 269

(1) If the conditions referred to in art. 268 are not met, C.N.V.M. shall not decide on the extension of the trustee's activity and the authorisation of the regulated entity shall be withdrawn, while C.N.V.M. may either start the winding up procedures or inform the competent court in order to open the legal reorganisation and bankruptcy proceedings.

If the legal reorganisation and bankruptcy proceedings are opened, the conditions laid down in Law no. 85/2006 regarding the insolvency proceeding.

(2) The court competent to settle the request of C.N.V.M. regarding the opening of the legal reorganisation and bankruptcy proceedings against authorised entities is the Tribunal of the district where that entity has its registered office.

(3) The provisions of Government Ordinance no. 10/2004 regarding the legal reorganisation and bankruptcy proceedings of credit institutions, to the extent of their compatibility, shall also be applied to the authorised entities under trustee in bankruptcy proceedings and whose authorisation has been withdrawn by C.N.V.M. The phrase "debtor credit institutions" in the law mentioned above refers to "entities authorised by C.N.V.M.", and the phrase regarding the "National Bank of Romania" refers to "C.N.V.M."

(4) For the purposes of this chapter "insolvency" means the situation of the authorised entity in one of the following situations:

a. inability to pay due debts by using own funds;

b. withdrawal of the authorisation of regulated entity, in accordance with this law and C.N.V.M. regulations as a result of the inability of the authorised entity under special trustee in bankruptcy proceedings to recover financially.

(5) The appointment of the trustee by the tribunal shall be made with the agreement of C.N.V.M.

(6) In order to perform their duties which involve the application of certain regulations issued by C.N.V.M., the tribunal, the bailiff and the trustee may require the opinion of C.N.V.M. as authority in charge of regulating and supervising the capital market.

(7) The bankruptcy proceedings shall be closed when the bailiff has approved the final report, when all the funds or the assets of the authorised entity undergoing bankruptcy have been distributed and the funds which have not been claimed were deposited with the State Treasury. Following a request by the bailiff, the tribunal shall decide on the closing of the legal reorganisation and bankruptcy proceedings. The decision shall be communicated in writing and/or via the press in at least two national daily newspapers, to all the debtor's creditors, to the Trade Register Office, to C.N.V.M. and to the trustee.

The amounts left, if any, shall be paid in to the state budget after 5 years.

**Chapter III**

**Winding up**

**Art 270**

**(1) If C.N.V.M. decides on the entity's winding up, the proceedings shall be applied in accordance with the procedure established by the legislation applicable to the dissolution and winding up of companies and by C.N.V.M.**

**(2) The trustee for the entity's winding up shall be appointed by C.N.V.M.”**

**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?

**Below is the links only to the law and regulations mentioned in our responses, for which an English version is available on the CNVM website. For the other regulations only the Romanian version is available.**

<http://www.cnvmr.ro/pdf/legi/en/Law-297-2004.pdf>

<http://www.cnvmr.ro/pdf/regulamente/en/Regulation-13-2005.pdf>

<http://www.cnvmr.ro/pdf/regulamente/en/Regulation-32-2006.pdf>

**Singapore**  
**2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

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(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 the Singapore Securities and Futures (Licensing and Conduct of Business) Regulations (Rg. 10) [“SFR”].

Under the 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 SFA include dealing in securities, trading in futures contracts, fund management and providing custodial services for securities [“Regulated Activities”].

a. How does your jurisdiction define the term “client assets?” If the jurisdiction uses an analogous term, please provide that term and its definition.

Section 103A of the SFA read together with regulation 15 of the SFR provides for the definition of Customer money and Customer assets. For the purposes of this survey, we have used the term “Client money” and “Client assets” to reflect “Customer money” and “Customer assets” respectively.

Client money refers to money received from, or on account of the client 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 client to the Investment Firm;
- money which is to be paid to the client or in accordance with the client’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.

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Client assets means securities and assets (other than money), including Government securities and certificates of deposits, that are beneficially owned by a customer of the Investment Firm.

b. What is the nature of a client's ownership rights with respect to its client assets placed with the investment firm?

The moneys and assets in the trust account and custody account, respectively, are held on trust by the Investment Firm for its clients.

c. How does your jurisdiction define the term "client"? If the jurisdiction uses an analogous term, please provide that term and its definition.

Under the SFA, for the purposes of Client assets, "customer" refers to (i) a person on whose behalf the Investment Firm carries on or will carry on any Regulated Activities; or (ii) any other person with whom the Investment Firm, as principal enters or will enter into transactions for the sale or purchase of securities or futures contracts, or in connection with leveraged foreign exchange trading. For the purposes of this survey, we have used the term "Client" to reflect "Customer".

However, "Client" does not include:

(a) the Investment Firm in carrying out any regulated activity for its own account;

(b) an officer, an employee or a representative of the Investment Firm; or

(c) a related corporation of the Investment Firm with respect to an account belonging to and maintained wholly for the benefit of that related corporation.

d. Please describe any notable exclusions from the terms "client" or "client assets."

Please refer to 1(a) and 1(c) above.

*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)*

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- (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 holds a capital markets services [“CMS”] licence under the SFA is permitted to hold Client Assets.

### **Client Moneys**

In particular, regulations 16 and 17 of the SFR provides that the Investment Firm 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. Regulation 18 provides that the Investment Firm 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 Investment Firm to the specified financial institution; and
- the account is designated as a trust account or customers’ account, which must be distinguished and maintained separately from any other account in which the Investment Firm deposits its own moneys.

### **Client Assets**

Regulations 26 and 27 of the SFR provide that the Investment Firm 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.

Regulations 17 and 27 of the SFR provide that subject to the client’s prior written consent, the Investment Firm may deposit moneys or assets received on account of

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its client which are denominated in a foreign currency in a trust or custody account maintained with a custodian outside Singapore. 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 Q1(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:
- a. Must the Client Assets of one client be maintained separately from those of other clients?

Pursuant to section 104 of the SFA read with regulation 16 and 26 of the SFR, an Investment Firm is required to segregate its own money and assets from its Client Assets. 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.

- 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.

Pursuant to regulation 23 of the SFR, the investment firm may advance sufficient money to a Client's trust account from its own funds to prevent the client's trust account from being under-margined or under-funded.

- (a) Pursuant to regulations 37 and 39(1) of the SFR, the Investment Firm is required to maintain separate records of the individual Client's interest in the moneys and assets that have been commingled. On a daily basis, for futures contracts and leveraged foreign exchange trading activities, the Investment Firm is required to compute and reconcile:

- (i) the total amount of moneys / assets deposited in its clients' trust / custody accounts;
- (ii) the total amount of its clients' moneys / assets required to be deposited in trust / custody accounts; and

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(iii) the amounts of the Investment Firm's residual interest in the trust / custody accounts.

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?

Client money which is deposited in an omnibus account would be fungible amongst all clients of the Investment Firm. As for Client assets, the Investment Firm is required to hold 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)?

Please refer to our response to Q2(a)(ii). Client Assets is computed and reconciled on a client-by-client basis even though Client money is deposited in an omnibus account.

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? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

The amount that the Investment Firm is required to hold as Client Assets exclude the amount that is owed by the Client to the Investment Firm including amounts used to defray the Investment Firm's brokerage and other proper charges.

ii Timing issues:

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

Daily computation and reconciliation of the Client moneys and Client assets maintained in trust and custody accounts is required of the Investment Firm conducting regulated activities in respect of trading in futures contracts and 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).

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The computation referred to in Q2(b)(ii)(A) above should be completed before noon of the 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?

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 at all times 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 Q2(a)(ii) and Q2(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 cannot use Client Assets of one Client to meet the obligations of another 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 use, the Client Assets? If so, please describe.

The Investment Firm may only deal with the Client moneys and Client assets as provided under regulations 20, 21, 31, 32, 33, 34 and 35 of the SFR. A summary is as follows:

1) Investment of moneys received on account of Clients:

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 Investment Firm normally transacts its business. The Investment Firm shall keep proper record of such transactions.

2) Withdrawal of Client assets from trust/custody account:

Withdrawal of Client moneys and Client assets from a trust or custody account is restricted to the specified purposes as provided under the SFR. Examples include making a payment to any other person or account in accordance with the written direction of the Client and defraying Investment Firm’s brokerage and other proper charges.

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### 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 Investment Firm.

i. How are the ownership rights of a Client over its Client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?

As hypothecation of Client assets is subject to agreements between the Investment Firm and its' Client, the rights of a Client will depend on the terms and conditions of his agreement with the Investment Firm.

ii. How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?

In respect of the lending of Client securities, the Investment Firm must explain the risks involved to the Client and obtain the Client's written consent. The Investment Firm is also required to disclose the terms and conditions of the loan arrangement to the Client.

iii. How are the ownership rights of a client over its client assets changed or affected when the investment firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (i.e. established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator)?

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If the Investment Firm uses Client assets without the Client's consent or where such use is not in accordance with the requirements of the SFA, the ownership of such Client assets (which should have been held in trust in favour of the Client under the requirements of the SFA) would rightfully be traced to 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?

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

In respect of the Client moneys and Client assets denominated in a foreign currency, the Investment Firm is permitted with the Client's prior consent, to deposit such moneys and assets in a trust or custodian account maintained with a foreign custodian. The foreign custodian must be licensed to conduct banking business or, in the case of the Client 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 for identification and protection of Client Assets apply to the Investment Firm regardless of whether the Assets are located in Singapore or other jurisdictions, or whether the Assets belong to Clients in Singapore or other jurisdictions.

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5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)? If so,

Investment Firms in Singapore are required to hold the Client Assets of Foreign Investment Firms in trust, and are permitted to hold them in Omnibus Accounts with other Client moneys/Client assets.

- a. What protections are applicable to the Foreign Investment Firm’s Client Assets? The regulatory requirements and protection under the SFA/SFR similarly applies to Client Assets of Foreign Investment Firms.
- b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?

If the Foreign Investment Firm is an affiliate of the Singapore Investment Firm, the Foreign Investment Firm would need to designate its account opened with the Singapore Investment Firm as a Client account that is not maintained for the benefit of that related Foreign Investment Firm. Please also refer to our response to Q1 on definition of “Client”.

- c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?

The SFA and SFR do not provide for a waiver of rights.

6. 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 Q1(a) above. Client 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 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

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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 Investment Firm 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.

7. 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 following requirements apply:

- (i) An 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;
- (ii) An 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;
- (iii) An Investment Firm which lends out Client securities as mentioned in the response to Q2(d) is required to explain the risks involved to the Client (unless the Client is an accredited investor) and obtain the Client's written consent; and
- (iv) An Investment Firm which rehypothecates client securities has to abide by the terms and conditions in the Client agreement and custody agreement;
- (v) An Investment Firm which deposits Client moneys and Client assets with a foreign custodian as mentioned in the response to Q4 is required to obtain the Client's prior written consent;
- (vi) An Investment Firm which provides futures trading and leveraged foreign exchange trading is required to furnish a risk disclosure statement to the Client prior to account opening on, amongst others, the need to familiarize himself with the protection accorded to the Client asset deposited for foreign transaction, particularly in a firm's insolvency.

8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

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In general, the SFA and the SFR do not provide for any situation or condition under which Clients may waive the requirements.

9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:

An Investment Firm which is the holder of a CMS licence must report on a quarterly basis, the amount of money segregated in a trust account.

The information to be reported includes the amount and location of segregated funds, and be found via the following link:

[http://www.mas.gov.sg/~media/resource/legislation\\_guidelines/securities\\_futures/for\\_ms/SF\\_FMR\\_Form\\_1.ashx](http://www.mas.gov.sg/~media/resource/legislation_guidelines/securities_futures/for_ms/SF_FMR_Form_1.ashx)

- a. Does the Investment Firm report where client assets are held?

Yes, please refer to response to Q8 above.

- b. Does the Investment Firm or depository report the protections applicable to such client assets?

No.

- c. Does the Investment Firm or depository report the amount of assets that are held?

Yes, please refer to response to Q8 above.

In each case, are such reports provided on request or periodically? If periodically, with what frequency?

Please refer to response to Q8 above.

10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify

- a. Where Client Assets are held?

- b. The amount of Client Assets held at a depository?

- c. The safeguards applicable to Client Assets held at a depository?

MAS has the power to inspect the books of an Investment Firm who is the holder of a CMS licence under the SFA. In addition, as part of the annual auditors' report, the external auditor of an Investment Firm who is the holder of a CMS licence is required to confirm, inter-alia that the licensee has complied with the trust account requirements under the SFA and maintained proper records in relation to the safe custody of Client securities and Client assets.

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11. Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify
- a. The amount and/or value of such Client Assets?
  - b. The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?

The foreign regulator may request assistance from the MAS and MAS may respond to the request subject to satisfaction of the conditions set out in the SFA.

The foreign regulator may also inspect the books of the CMS licensee, subject to the satisfaction of the conditions set out in the SFA.

12. 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 [“SF(FMR)R”], an Investment Firm which is the holder of a CMS licence must notify MAS and the approved exchange or designated clearing house of which the Investment Firm who is the holder of a CMS licence 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 Investment Firm is also required to immediately inform MAS of any matter which may adversely affect its financial position to a material extent.

13. 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 SF(FMR)R mentioned in Q10, MAS may direct the Investment Firm who is the holder of a CMS licence to, *inter-alia*, transfer all or part of any client’s positions, securities margins, collateral, assets and accounts to another Investment Firm who is the holder of a CMS licence; 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**

14. 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) [“CA”] apply to all companies in Singapore (unless expressly excluded), including Investment Firms. Our responses below focus on the requirements under the Singapore Companies Act and on the processes of liquidation and judicial management.

### Judicial Management

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.

### Winding up

A petition for winding up of the company can be filed by the company, its creditors or the company’s judicial manager.

15. 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 Singapore Court may reject the nomination of the applicant and appoint another person in his stead. The Minister in charge of the CA 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 Singapore Court or nominated by the Minister to act as a judicial manager that person need not be a public accountant.

### Winding up:

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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 CA to be approved liquidators for the purposes of that Act, may apply to the Minister to be approved as a liquidator for the purposes of that 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 that 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 Singapore 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.

16. 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 CA. 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

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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 Singapore 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.

17. 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.

18. What are the requirements, if any, governing the segregation and treatment of Client Assets *during* the insolvency of an Investment Firm?

The requirements set out in the SFA and the SFR, such as the deposit of customer's moneys in a trust account (regulation 16 of the SFR) would apply during the insolvency of an Investment Firm as long as the Investment Firm is still licensed under the SFA.

19. 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 SF(FMR)R, when MAS is notified by an Investment Firm who is the holder of a CMS licence or becomes aware that the base capital of an Investment Firm who is the holder of a CMS licence has fallen below the minimum requirement; or the financial resources of the Investment Firm who is the holder of a CMS licence have fallen below 120% of its total risk requirements, MAS may require the Investment Firm who is the holder of a CMS licence to transfer all or part of any

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client's margins, collateral, assets and accounts to another Investment Firm who is the holder of a CMS licence.

There will be close monitoring to ensure that the transfer is done without undue delay.

20. 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 CA 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.

21. 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\$50,000, net of the bank client's liabilities to the bank.

More information can be found at <https://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.

22. 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.

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23. 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 a liquidation of the Investment Firm, the liquidator would claim the assets back from the foreign custodian for distribution to the clients. The return of such moneys and assets are subjected to the relevant laws and regulatory requirements in those jurisdictions.

24. 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.

25. 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 Assets held in trust accounts belong to the customers, and creditors are not entitled to claim from the Client Assets. There is recent case authority which held in the particular winding up that the interim distribution of moneys to Clients be based on an equitable tracing principle. That is, a Client's entitlement to the available Client segregated moneys is determined on the basis of his respective contribution and interest in the available moneys as can be allocated and identified. As such, Clients whose moneys attributable to them but yet to be recovered by a liquidator would not receive any distribution as such unrecovered moneys would not be available in the Client accounts. Please note that decision of the High Court of Singapore which we have cited above would not be binding on subsequent cases of a failed investment firm and each case would be decided on its own facts and merits.

In the winding up of a company, the priority for payment of debts for creditors is expressly provided in the CA. Preferential creditors such as employees are paid ahead of other unsecured debts. All creditors of equal rank are paid *pari passu* in equal proportions.

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26. 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 Q24 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/Regulations-and-Financial-Stability/Regulations-Guidance-and-Licensing/Securities-Futures-and-Funds-Management.aspx>

#### **Website:**

- 1) Singapore Deposit Insurance Corporation

<https://www.sdic.org.sg/>

## Spain

### 2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

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(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.
  - a. How does your jurisdiction define the term “client assets?” If the jurisdiction uses an analogous term, please provide that term and its definition.

Client assets is not a defined term in the Spanish Securities Markets Act (Ley 24/1988, del Mercado de Valores). Client assets are both, financial instruments and client money. Client money is any currency that a firm receives or holds for, or on behalf of, a client in connection with its investment business. Article 2 of Spanish Securities Markets Act establishes a definition of financial instruments as:

“1. Transferable securities issued by public or private persons or entities and grouped in issues. A transferable security will be defined as any patrimonial right, regardless of its name, which, because of its own legal configuration and system of transfer, is susceptible to being traded in a generalised impersonal way in a financial market.

For the purposes of this Act, the following will be considered to be transferable securities:

- a) Shares of companies and transferable securities equivalent to shares, and any other type of transferable security giving entitlement to acquire shares or securities equivalent to shares through conversion or exercise of the rights inherent to them.
- b) Participation shares (“*cuotas participativas*”) of savings banks and “association participation shares” of the *Confederación Española de Cajas de Ahorros*.
- c) Bonds, debentures and similar securities representing part of a debt claim, including those which are convertible or exchangeable.
- d) Mortgage covered bonds, mortgage bonds and mortgage participations.
- e) Asset-backed securities.
- f) Units and shares in UCITS.
- g) Money market instruments, i.e. categories of instruments which are normally traded on the money market, such as treasury bills, certificates of deposit and commercial paper, except those issued on a unique basis and excluding instruments of payment deriving from preceding commercial transactions that do not involve the capture of repayable funds.

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- h) Preference shares.
  - i) Territorial covered bonds.
  - j) Warrants and any other derivative transferable security giving the right to acquire or sell any other transferable security or giving the right to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities, credit risk or other indices or measures.
  - k) Any others which the law or regulations define as a transferable security.
  - l) Bonds of internationalization<sup>28</sup>.
2. Options, futures, swaps, forward rate agreements and any other derivative contract relating to securities, currencies, interest rates or yields, or other derivative financial instruments, financial indices or financial measures which may be settled physically or in cash.
  3. Options, futures, swaps, forward rate agreements and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event).
  4. Options, futures, swaps, and any other derivative contract relating to commodities that can be settled by physical delivery provided that they are traded on a regulated market and/or a multilateral trading facility (MTF).
  5. Options, futures, swaps, forward rate agreements and any other derivative contracts relating to commodities that can be settled by physical delivery not otherwise mentioned in the preceding section of this article and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard, inter alia, to whether they are cleared and settled through recognised clearing houses or are subject to regular margin calls.
  6. Derivative instruments for the transfer of credit risk.
  7. Financial contracts for differences.
  8. Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event), as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in the preceding sections of this article, which have the characteristics of other derivative financial instruments, having regard, inter alia, to whether they are traded on a regulated market or an MTF, are cleared and settled through recognised clearing houses or are subject to regular margin calls...”

- b. What is the nature of a client’s ownership rights with respect to its client assets placed with the investment firm?

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Custody assets held by a firm may be registered in the name of the client, or the name of the firm when the assets are recorded in jurisdictions where “omnibus” accounts are permitted, but clients retain beneficial ownership of the assets at all times.

In the event of a firm insolvency, the Spanish Act 32/2011 has introduced a new article 12 bis within the Securities Markets Act about the right of withdrawal in the event of insolvency of the entities responsible for book-keeping or participants in the record-keeping system, and the pro rata rule.

In the event of insolvency of an entity responsible for the accounting of securities represented by book entries or of an entity participating in the record-keeping system, the holders of securities recorded in those registers will have the right to withdraw the securities registered in their name and to request their transfer to another entity.

The insolvency judge and the insolvency administrators will safeguard the rights deriving from the settlement operations under way at the time that the entity responsible for the accounting of securities by book entries or the member entity of the record-keeping system declares insolvency, according to the rules on clearing, settlement and record-keeping.

In any case, when the securities with the same International Securities Identification Number (ISIN) separated from the estate of the insolvent party are insufficient to completely fulfil the rights of the registered holders of the securities with the same ISIN, the shortfall will be distributed pro rata among all holders without prejudice to their right to claim for indemnity from the entity for the value of the part not paid in securities, which must be paid in money.

Where there are limited rights or liens of any other kind on the securities, and without prejudice to agreements between the guarantor and the beneficiary of the guarantee, once the pro rata rule has been applied, such liens shall be understood to be apply to the result of the pro rata rule and the debt claims for the part not paid in securities.

- c. How does your jurisdiction define the term “client”? If the jurisdiction uses an analogous term, please provide that term and its definition.

Client is not a defined term in the Spanish Securities Markets Act but it means a person, individual and legal to whom a firm (which includes banks and investment firms) provides, intends to provide or has provided a services.

- d. Please describe any notable exclusions from the terms “client” or “client assets.”

None

*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).*

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### *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, because apart from banks, there are four types of investment firm: a) Sociedades de valores (Broker-dealers), b) Agencias de valores (Brokers), c) Sociedades gestoras de carteras (Portfolio management companies) and d) Empresas de asesoramiento financiero (Financial advisory firms) and the last two (Portfolio management companies and Financial advisory firms) cannot provide the ancillary service of safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management.

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

Apart from the types of licenses abovementioned, there is not special authorization required. Investment Firms that meet capital requirements (minimum initial capital of 300.000 euros and ongoing requirements foreseen in Capital Requirements Directive) can hold clients money and financial instruments, if that investment services are authorized. The Investment Firm must have adequate and proportionate internal procedures to control clients assets.

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

Standard procedures are applied by the Spanish Securities Commission to review clients assets, such a confirmation by financial intermediaries, clients, reconciliations, etc.

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?

Client Assets have to be maintained separately from the assets of the Investment Firms. If client assets are hold in "omnibus" accounts, MiFID requires to ensure that client assets are kept

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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. Investment firms 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 70 ter of Spanish Securities Markets Act provides:

1. "f) 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.

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."

2. "c) Take the appropriate measures, in connection with the securities and funds entrusted to them by clients, to protect their rights and avoid improper use of the securities. 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."

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

As this regards and for the purposes of safeguarding clients' rights in relation to financial instruments and money belonging to them, investment firms must comply with the following requirements:

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

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

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

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

(e) they must take the necessary steps to ensure that client funds deposited in a central bank, a credit institution or a bank authorised in a third country or a qualifying money market fund are held in an account or accounts identified separately from any accounts used to hold funds belonging to the investment firm.

(f) they must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client assets, or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence.

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 may not be segregated from the rest of creditors and it may depend on the judge consideration. However, money accounts are covered by the 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).

- 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?

We do not need a calculation, the sum of total clients money and financial instruments must be held in separate accounts.

- 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?

See answer 1.b.

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

Both, on an aggregate and on 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?

Yes, this debit must be deducted.

- ii Timing issues:

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

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- 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?

Reconciliations must be performed as often as necessary.

- 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, total amount of clients assets must be held in segregated accounts. Apart from that, Investment Firms must maintain an additional 10 per 100 of all short term credits (liquidity coefficient).

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

See answer 3.a.

- 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 use, the Client Assets? If so, please describe.
  - i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client’s consent?
  - ii. How is a client’s consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client’s consent must an Investment Firm have in order to use or re-hypothecate Client Assets?
  - iii. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets without such client’s consent? What is the basis for that conclusion (*i.e.*, established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator)?

See answer 1.b.

- 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?

CCPS or CH must held recorded any collateral posted to any financial instruments.

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4. Are Investment Firms in your jurisdiction 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 must take the necessary steps to ensure that client funds or securities deposited in a third country are held in an account identified separately from any accounts belonging to the investment firm.

If the safekeeping of financial instruments for the account of another person is subject to specific regulation and supervision in a jurisdiction where an investment firm proposes to deposit client financial instruments with a third party, the investment firm cannot deposit those financial instruments in that jurisdiction with a third party which is not subject to such regulation and supervision. Additionally, investment firms cannot deposit financial instruments held on behalf of clients with a third party in a third country that does not regulate the holding and safekeeping of financial instruments for the account of another person.

5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets deposited in an Omnibus Account by Investment Firms in other jurisdictions (“Foreign Investment Firms”)? If so,
  - a. What protections are applicable to such Client Assets?
  - b. What steps, if any, must the Foreign Investment Firm take to secure such protections for such Client Assets?
  - c. What steps may the Foreign Investment Firm take that will reduce such protections? What is the impact if the Foreign Investment Firm takes such steps?

See answer 4.

6. 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.

See answer 4.

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7. 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?

If the investment firm holds clients financial instruments or money, they must provide retail clients or potential retail clients with such of the following information:

- a) A summary description of the steps which it takes to ensure their protection, including summary details of any relevant investor compensation or deposit guarantee scheme which applies to the firm.
- b) Inform the retail client or potential retail client where the financial instruments or funds of that client may be held by a third party on behalf of the investment firm and of the responsibility of the investment firm for any acts or omissions of the third party and the consequences for the client of the insolvency of the third party.
- c) Where financial instruments of the retail client or potential retail client may be held in an omnibus account by a third party, the investment firm shall inform the client of this fact and shall provide a prominent warning of the resulting risks.
- d) The investment firm shall inform the retail client or potential retail client where it is not possible under national law for client financial instruments held with a third party to be separately identifiable from the proprietary financial instruments of that third party or of the investment firm and shall provide a prominent warning of the resulting risks.
- e) The investment firm shall inform the client or potential client where accounts that contain financial instruments or funds belonging to that client or potential client are or will be subject to the law of a jurisdiction other than that of a Member State of the EU and shall indicate that the rights of the client or potential client relating to those financial instruments or funds may differ accordingly.
- f) An investment firm shall inform the client about the existence and the terms of any security interest or lien which the firm 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 or funds. Where applicable, it shall also inform the client of the fact that a depository may have a security interest or lien over, or right of set-off in relation to those instruments or funds.
- g) An investment firm, 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 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 firm with respect to the use of those financial instruments, including the terms for their restitution, and on the risks involved.

Investment firms must provide professional clients with the information referred in paragraph e) and f) in time, before the provision of the service concerned.

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8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? 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.

9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:
  - a. Does the Investment Firm report where client assets are held?
  - b. Does the Investment Firm or depository report the protections applicable to such client assets?
  - c. Does the Investment Firm or depository report the amount of assets that are held?

In each case, are such reports provided on request or periodically? If periodically, with what frequency?

On a monthly basis, Sociedades de valores (Broker-dealers) and Agencias de valores (Brokers) report information to the securities regulator about clients financial instruments. The report does not specify in which intermediaries are deposited the clients securities or cash, apart from the intermediary itself. The total amount of clients financial instruments and money are reported.

10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify
  - a. Where Client Assets are held?
  - b. The amount of Client Assets held at a depository?
  - c. The safeguards applicable to Client Assets held at a depository?

No Self-Regulatory Organizations have powers to conduct inspections, examinations or audits.

11. Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify
  - a. The amount and/or value of such Client Assets?
  - b. The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?

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Deposit of clients assets in Spain must be recorded on behalf of the client or clients, no “omnibus” accounts are permitted.

12. 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 Spanish Securities Market Commission of any material changes in their financial position or ability carry on business. This does not have to be communicated to the market. Investment Firms must apply for a recovery plan if capital fall below 20 per 100 of its capital requirements.

13. 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 Securities Market Commission will consider what is the appropriate course of action in the particular circumstance. The most usual orders are to require the firm to raise new capital, remove the firm’s licenses, require the firm to transfer business, return client assets or enter insolvency proceedings.

See answer 12.

### **Post-Insolvency**

14. 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 of the described persons, Investment Firm, Securities Market Commission or creditors can apply a judge for insolvent procedures.

15. 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 appointed by the Court based in the Securities Market Commission proposal and must have proper qualifications and experience on insolvency procedures.

16. 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 have to transfer clients assets, if it have not been made previously by Regulator, and have to propose to the Court a distribution of the remaining assets to creditors.

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- 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 who are appointed as administrators or liquidators have total personal liability.

17. 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 authorised person and is still subject to supervision by the Securities Market Commission till its license is revoked.

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

The Securities Market Commission is not directly involved in the process of returning Client Assets, that is the role for the administrator or liquidator. The Court may ask the Securities Market Commission advice on matters related to the securities market.

18. What are the requirements, if any, governing the segregation and treatment of Client Assets *during* the insolvency of an Investment Firm?

See answer 1.b.

19. 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?

Yes, see answer 1.b. The Securities Market Commission can order the transfer of Client Assets.

20. 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 Court is able to determine the date that looks back to the insolvency procedure.

21. 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 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 may not be not segregated from the rest of creditors and it may depend on the judge consideration. However, money accounts are covered by the Investors Compensation

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Scheme (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).

22. 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.

Investment firms cannot enter into arrangements for securities financing transactions in respect of financial instruments held by them on behalf of a clients, or otherwise use such financial instruments for their own account or the account of another client of the firm, unless the following conditions are met:

- (a) the client must have given his prior express consent to the use of the instruments on specified terms, as evidenced, in the case of a retail client, by his signature or equivalent alternative mechanism;
- (b) the use of that client's financial instruments must be restricted to the specified terms to which the client consents.

Additionally, investment firms cannot enter into arrangements for securities financing transactions in respect of financial instruments which are held 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, in addition to the conditions set out in the previous paragraph 1, the following conditions are met:

- (a) each client whose financial instruments are held together in an omnibus account must have given prior express consent in accordance with point (a) of previous paragraph;
- (b) the investment firm must have in place systems and controls which ensure that only financial instruments belonging to clients who have given prior express consent in accordance with point (a) of previous paragraph are so used.

The records of the investment firm shall include details of the client on whose instructions the use of the financial instruments has been effected, as well as the number of financial instruments used belonging to each client who has given his consent, so as to enable the correct allocation of any loss.

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

See answer 22.

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

See answer 1.b. pro rata criterion applies to instruments of the same category.

25. 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,

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are there priorities between classes of clients, is there a priority distribution ahead of the distribution of the general estate/distribution to unsecured creditors?

Pro rata distribution criteria is applied.

26. 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 not distinction about domestic or foreign creditors. Clients whose securities or money are not fully paid can apply to the ICS. If the amount held by the client is above 100.000 euros (amount covered by ICS) the client will be categorized as normal 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?

Securities Markets Act 24/1988.

Insolvency Law 22/2003.

**Turkey**  
**2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

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(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.

a. How does your jurisdiction define the term “client assets?” If the jurisdiction uses an analogous term, please provide that term and its definition.

*Client assets are defined as money, securities and positions which are held or controlled by authorized investment firms for investment purposes on behalf of their clients. Client assets include the cash and convertible foreign exchange in investors accounts and all the returns and rights gained through these accounts, as well as securities such as stocks, government bonds and treasury bills, participation certificates of mutual funds, gold and other valuable items having the determined standards, and assets those may be specified by the Board. All the positions related to the forex trading and derivative transactions are also included in the client assets.*

b. What is the nature of a client’s ownership rights with respect to its client assets placed with the investment firm?

*In our jurisdiction, most capital market instruments, including stocks, bonds, mutual funds and warrants are dematerialized and centrally registered at the level of beneficial owner in a central securities depository, named “Central Registry Agency” (CRA).*

*In this respect, investors open investment accounts in their names at Central Registry Agency participant investment firms in order to invest in capital market instruments, and the instruments they acquire as a result of their trades are deposited in the accounts opened by CRA. By this way, clients have the facility to control their accounts through the electronic system of the Central Registry Agency.*

*The ownership rights arising from the dematerialized instruments can be used by the participants and owners of capital market instruments through the services supplied by the CRA, such as dividend*

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

*distributions and redemptions, rights issues, participation to general assembly meetings, pledges.*

*Client assets in cash are hold in a bank account opened in the name of the investment firm, but these assets shall be kept separately from the assets of the investment firm. Every client has a cash account by the investment firm and client assets in cash are kept in these segregated accounts. The proceeds of the client assets in cash deposited in a bank account in the name of the investment firm shall be distributed to the accounts proportionately.*

- c. How does your jurisdiction define the term “client”? If the jurisdiction uses an analogous term, please provide that term and its definition.

*Clients are individuals or legal entities who open accounts by investment firms for investment purposes through signing contracts.*

*Currently, there is no final legislation or rule that have been adopted on client categorization; but the draft is underway. After the new Capital Markets Law enter into force, our related draft will be adopted. According to this regulation, clients will be separated into two groups as individual and professional depending on certain qualifications.*

- d. Please describe any notable exclusions from the terms “client” or “client assets.”

*There is no notable exclusion from the terms “client” and “client assets”. However, the payables to related persons even if they are clients, are subject to a different regime in the post-solvency period. The related persons are defined to include shareholders, members of the board of directors or board of auditors, personnel authorized to sign and their spouses, blood relatives and relatives by marriage including the third degree.*

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)

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- (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?

*According to the current regulations, investment firms which are licensed to conduct capital market activities by the CMB, do not need to be specifically authorized to hold client assets. However, in the draft Capital Market Law which is expected to enter into force in 2012, safekeeping and administration of client assets for the account of clients is defined as an investment service and will be subject to special authorization.*

- a. If special authorization is required, what requirements (both initial and ongoing) are 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?

*As mentioned above, in Turkey, most capital market instruments, including stocks, bonds, mutual funds and warrants are dematerialized and centrally registered at the level of the beneficial owner in a central securities depository, named "Central Registry Agency" (CRA). By this way, clients have the facility to control their accounts through the electronic system of the CRA.*

*Client assets as cash are deposited in a bank account by the investment firm in its own name but kept separately from its own assets and recorded to segregated client accounts within the investment firm.*

*Cash collaterals of clients related to derivatives traded on TURKDEX, forex transactions and collaterals related to borrowing and lending of securities for the transactions executed on Securities Lending and Borrowing Market which is operated by the ISE Settlement and Custody Bank (Takasbank) shall be kept in Takasbank on a client basis.*

*The accounts of investment firms are subject to independent auditing on a 6-month basis. Besides, general ledger and capital adequacy reports of the investment firms are audited in detail by the CMB every 6 months. These audits include the verification of availability of the client assets.*

*Furthermore, on the occasions of on-site inspections, the expert personnel of the CMB check the presence of client assets and the consistency of the records of the investment firm and those of the custodian.*

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

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of the process by which segregation is accomplished, and of the applicable requirements. Specifically:

*Yes, under our legal framework, client accounts must be clearly defined for the names of the clients and said accounts cannot be used for any other purposes by the investment firms. According to the Article 47 of the Capital Market Law, selling or creating a pledge or using in whatever manner for the benefit of someone other than the owner, capital market instruments, cash or other assets of any kind which are consigned or delivered physically or by registration to investment firms, is defined as a crime and the people accused to commit this crime shall be punished with a prison sentence of from two to five years and a heavy pecuniary fine.*

*For the details of the maintenance of client assets separate from those of the investment firm, see the answer given to the question 1-b.*

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

*As mentioned above, dematerialized instruments must be deposited in the accounts which are opened on a client-by-client basis by CRA. Therefore, these instruments are subject to a full-segregation. Every client may monitor her assets by checking her account by the CRA.*

*Client assets as cash are deposited in a bank account by the investment firm in its own name in a single account, however these assets must be recorded to segregated client accounts within the investment firm.*

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

*Investment firms are allowed to hold omnibus accounts only in activities as white labels of other investment firms, related to forex trading and intermediation to trading in foreign markets. According to our regulation on forex trading, investment firms may only be white labels of investment firms established in Turkey and authorized by the CMB.*

*In these activities, investment firms accept orders as representatives and transmit such orders to other institutions to be executed. The trades are recorded in an omnibus account opened by the market-maker institution, and distributed to client accounts opened by the white label investment firm.*

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

*Investment firms shall not use assets of a client for the benefit of another client, such as hypothecating a client's assets for the loan of another client. In this aspect, in the independent audits and on-site inspections executed by the CMB, distribution of proceeds of assets to client accounts,*

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*correspondence of loans used by clients and the assets collateralized for these loans are examined.*

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

*Investment firms are obliged to send monthly reports to their clients regarding their accounts. In these monthly reports, all trades, assets and/or liabilities and overall of the clients must be properly shown. Clients may object to the information laid in these reports.*

*In addition, according to our regulation on internal control systems of investment firms, Serial: V, No: 65 “Communiqué On Principles Regarding The Internal Auditing Systems Of Brokerage Houses”, investment firms shall determine a procedure about reconciling with their clients. In this procedure, issues such as the timing, manner and medium of reconciliations shall be specified.*

*Furthermore, if an investment firm’s capital market activities are permanently stopped by the Board at its own will, that investment firm is obliged to reconcile with its clients and return all of the client assets. Assets of the clients with whom the investment firm could not reconciled with, shall be kept in the Settlement and Custody Bank.*

- 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?

*As mentioned above, in Turkey, most capital market instruments, including stocks, bonds, mutual funds and warrants are dematerialized and centrally registered at the level of beneficial owner in CRA. By this way clients have the facility to control their accounts through the electronic system of the CRA.*

*Client assets as cash are deposited in a bank account by the investment firm in its own name but kept separately from its own assets and recorded to segregated client accounts within the investment firm.*

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

*Reconciliation is conducted on a client-by-client basis. Investment firms send reports to their clients in which the overall state of each client account is present. Clients examine these reports and confirm the information laid in the reports; they sign them and send back to the investment firm.*

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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? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

*For the cash accounts, netting can be made only on a client-by-client basis. For the margin accounts, also this netting is forbidden.*

*No, a client's debit balance would not reduce the firm's obligations with respect to the total required funds for credit balances of other clients. The netting cannot be made on total basis. For example, according to the provisions of the CMB of Turkey, investment firms shall keep the records of the monetary results of the transactions of the clients to a current account. However this account shall not be netted on total basis, in can only be netted on client basis that, the debit balance of this account reveals the amount clients owe to the investment firm and the credit balance of it reveals the investment firm's obligations to the clients. Investment firms are obliged to keep the amount equal to the credit balance of such account as liquid assets, to be able pay to the clients when demanded.*

ii Timing issues:

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

*The timing of the reconciliation shall be specified in the internal control procedures of the investment firms and may be stated in the framework agreement concluded between the investment firm and the client.*

*On the other hand, account statements shall be sent to clients monthly.*

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

*Account statements shall be sent to the clients in seven days following the related 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?

*In the case of an existence of a deficiency in client assets due to the fault of the investment firm, investment firm may be required to make good the deficiency. Such a decision can be taken by the arbitrators or the Court.*

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- 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 assets of the investment firms and those of the clients shall be separated. Investment firms are not required or encouraged to maintain any of their own assets in a client asset account.*

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

*No, investment firms cannot use client assets for meeting obligations of another 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 use, the Client Assets? If so, please describe.

*According to Serial:V,Number:46 “Communiqué On Principles Regarding Intermediary Activities and Intermediary Institutions” client assets shall be kept separately from the assets of the investment firm and investment firms cannot use the capital market instruments and the cash assets of a client for their own benefit or for the benefit of third parties.*

- i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client’s consent?

*In our regime, in the case of a client’s giving consent to an investment firm permitting re-hypothecation of his/her assets, general provisions of property law pertinent to encumbrances apply.*

*To illustrate, upon the consent of a client, if an investment firm hypothecates the stocks of its client as collateral for a loan for own benefit and fails to repay the loan, the creditor may exercise its rights arising from the property law on hypothecated assets.*

*However, if the consent of the client is for borrowing and lending operations of the capital market instruments, special provisions apply.*

*According to the Serial: V, No: 65 “Communiqué on Principles Regarding the Internal Auditing Systems Of Brokerage Houses”, investment firms can undertake borrowing and lending of capital market Instruments by signing a contract with their clients.*

*Within the borrowing and lending period, if the issuing corporation pays dividend or interest for the borrowed capital market instruments prior to their delivery, related payments shall be made to the lender by the borrower within the framework of the provisions of the contract of*

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*engagement. Prior to delivery of shares sold short to the lender, if rights issues and bonus issues of shares due to capital increase by the issuing corporation occur, the obligations of parties shall be determined freely under the provisions of the contract of engagement.*

- ii. How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?

*A client's consent to permit an investment firm to use her assets must be stated in a written form. In borrowing and lending of capital market instruments a contract of engagement shall be signed between the parties.*

- iii. How are the ownership rights of a client over its client assets changed or affected when the investment firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (i.e. established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator)?

*Pre-insolvency or bankruptcy, where a client consents to the investment firm's re-hypothecating his/her assets, general provisions of property law related to encumbrances will apply.*

*Generally, where an investment firm hypothecates a client's stock as collateral for repayment of the investment firm's loan (and subsequently fails to repay the loan), the creditor may exercise rights arising from the property law on hypothecated assets.*

*However, upon the complaint of the client or recognition of the state by the CMB, the investment firm would be inspected in the frame of the Article 47-A-5 of the Capital Market Law, on capital market institutions' using client assets for own benefit. According to the Article 47-A-5 of the Capital Market Law, authorized persons of investment firms who sell or create a pledge or use in whatever manner for the benefit of themselves or someone else, client assets shall be punished with a prison sentence and a heavy pecuniary fine.*

*A client, whose assets are used or re-hypothecated without his/her consent, may file a debt case against the investment firm and his/her loss would be remedied with the decision of the court.*

- 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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*In Turkey, for the derivative instruments which are traded on the Turkish Derivatives Exchange, TURKDEX, Takasbank is assigned as the Clearing House. Takasbank executes clearing and settlement by a Mark to Market Process which is performed daily on related account basis. So as a central counterparty, Takasbank collects and values collaterals client-by-client and interrelates the trades and the collaterals on an account basis.*

*In forex transactions, Takasbank does not act as a central counterparty, however investment firms are obliged to keep the collaterals of the clients in the segregated accounts opened by Takasbank.*

*Furthermore, collaterals related to borrowing and lending of capital market instruments for the transactions executed on Securities Lending and Borrowing Market which is operated by Takasbank are also deposited in Takasbank.*

4. Are Investment Firms in your jurisdiction permitted to transfer to, or hold Client Assets belonging to clients in your jurisdiction 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?
  - c. If so, please provide details of those requirements.

*According to the Article 52 of the Communiqué on Principles Regarding Intermediary Activities and Intermediary Institutions, investment firms can undertake intermediation of securities and other capital market instruments in foreign markets of either by becoming member of an exchange or an organized market abroad or through intermediary institutions authorized in accordance with the legislation of the related country.*

*Within the scope of the intermediation in trading in foreign markets, investment firms may hold client assets in a foreign investment firm authorized by the competitive authority of the related jurisdiction. In this case, clients must fully be informed of the state and the legislation and protection they are subject to.*

5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)? If so,
  - a. What protections are applicable to the Foreign Investment Firm’s Client Assets?
  - b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?

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- c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?

*In Turkey, foreign investment firms open omnibus accounts with the domestic investment firms and the Central Registry Agency to trade on the Istanbul Stock Exchange (ISE) and TURKDEX.*

*Foreign investment firms are required to provide written confirmation that they will provide information on the identities of the customers on behalf of whom the transactions are to be made.*

*However, foreign investment firms avoid giving information on details of the identity of their clients.*

*Omnibus accounts are subject to protection on a total basis.*

*A foreign regulator with jurisdiction over foreign investment firms holding client assets in Turkey may request information on such client assets from investment firms in Turkey or the CMB within the frame of Memorandum of Understanding signed between the authorities if it exists, or on the grounds of reciprocity.*

6. 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.

*As mentioned above, in Turkey, most capital market instruments, including stocks, bonds, mutual funds and warrants are dematerialized and centrally registered in CRA.*

*Client assets as cash are deposited in a bank account by the investment firm in its own name but kept separately from its own assets and recorded to segregated client accounts within the investment firm.*

*Cash collaterals of clients related to derivatives traded on TURKDEX, forex transactions and collaterals related to borrowing and lending of securities shall be kept in Takasbank on a client basis.*

*Takasbank is a user-owned, sector specific, non-deposit taking investment bank, with the ISE as the largest shareholder and regulated and supervised by the CMB on the basis of Capital Market Law.*

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*The Central Registry Agency is a private legal entity established under the CML. CRA provides registry and post trading services for equities, corporate debt securities, warrants, ETFs and mutual funds for all beneficiary owners. The Central Dematerialized System (CDS) is the main system of the CRA.*

*Takasbank and the CRA has full creditworthiness.*

*A lien or encumbrance, on the client assets held in these institutions, can only be placed upon a court decision.*

7. 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?

*According to the Serial: V, No: 46 "Communiqué on Principles Regarding Intermediary Activities and Intermediary Institutions", investment firms must conclude a framework agreement with their clients prior to providing investment services as sales and purchase, portfolio management, investment consultancy, repo and reverse repo agreements, intermediation in sales of derivative instruments, margin trading, lending and borrowing of securities and short sales. The minimum aspects to be included in this agreement shall be determined by the Board. According to the Resolution of the Executive Board of CMB on framework agreements, these agreements must include disclosures related to the protection of clients assets.*

*If the client assets are hold in a foreign jurisdiction due to trading in foreign markets, the rights and liabilities of the client as well as the scope of the protection in the involved foreign jurisdiction must be disclosed in the framework agreement.*

8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

*Currently, there is no final legislation or rule that have been adopted on client categorization but the draft legislation is underway and it will be adopted after the new Capital Markets Law enters into force. According to the draft regulation, clients will be separated into two groups depending on certain qualifications as individual and professional. Individual and professional clients will be subject to different protection requirements.*

9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:
- Does the Investment Firm report where client assets are held?
  - Does the Investment Firm or depository report the protections applicable to such client assets?
  - Does the Investment Firm or depository report the amount of assets that are held?

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In each case, are such reports provided on request or periodically? If periodically, with what frequency?

*According to “Serial No:V, No:34 Communiqué on Principles Regarding Capital and Capital Adequacy of Brokerage Houses”, investment firms are obliged to send their capital adequacy reports to the CMB in the periods determined by the Board. Currently, investment firms electronically send their general ledger and reports related to the capital adequacy requirements on a weekly basis. In these reports, the amount of the client assets and where they are held are shown.*

*Furthermore, the accounts of investment firms are subject to independent auditing on a 6-month basis. These audits include the verification of availability of the client assets.*

*On the occasions of the audits of the accounts of the investment firms in detail every 6 months and on-site inspections, the expert personnel of the CMB check the presence of client assets and the consistency of the records of the investment firm and those of the custodian.*

*Additionally, the custodian of the collaterals related to forex trading, the Takasbank sends periodical reports on forex accounts to the CMB.*

10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify
- Where Client Assets are held?
  - The amount of Client Assets held at a depository?
  - The safeguards applicable to Client Assets held at a depository?

*See the answer to the question 9.*

11. Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify
- The amount and/or value of such Client Assets?
  - The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?

*In Turkey, foreign investment firms open omnibus accounts by the domestic investment firms and Central Registry Agency in order to trade on Istanbul Stock Exchange (ISE) and TURKDEX.*

*According to our regulations on investment services and prevention of money laundering, investment firms are obliged to request from foreign investment firms*

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*to provide with a written commitment that they would provide information on the identities of the customers on behalf of whom the transactions are to be made. However, foreign investment firms avoid giving information on details of the identity of their clients.*

*In this case, omnibus accounts are subject to protection on a total basis.*

*A foreign regulator with jurisdiction over foreign investment firms holding client assets in Turkey may request information on such client assets from investment firms in Turkey or the CMB within the frame of Memorandum of Understanding signed between the authorities if exists, or on the grounds of reciprocity.*

12. 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?

*According to “Serial:V, No:34, Communiqué on Principles Regarding Capital and Capital Adequacy of Brokerage Houses” investment firms shall calculate, the risk provision envisioned in the and are obliged to prepare the mentioned tables in the calculation period determined by the Board, to submit these to the Board in the envisioned period and to file these in their headquarters.*

*In case own funds, initial capital or liquidity requirements fall below the minimum amounts mentioned in this Communiqué or in case the borrowing ratio surpasses the ratio envisioned in the Communiqué, they shall immediately notify the state to the CMB.*

13. 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?

*According to the Article 46 of Capital Market Law, The Capital Market Board is authorized to request the strengthening of the financial situations within a suitable period that shall be given in case it is determined that the financial structure of a capital market institution has become weakened significantly; to restrict or remove the signature authorities of the employees of such institution; to take the needed measures in case it is determined that the needed measures are not taken by these institutions within this period that is given or their financial situations have become weakened to the extent that they shall not be able to meet their commitments, to stop temporarily the operations of these institutions without giving any period of time or to stop them permanently and remove their authorities; to make a decision for gradual liquidations in case these measures do not produce results and to request direct bankruptcy without gradual liquidation or when needed following the conclusion of liquidation.*

## **Post-Insolvency**

14. 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?

*As mentioned in the answer of the previous question, The Capital Market Board is authorized to request the strengthening of the financial situations within a suitable period that shall be given in case it is determined that the financial structure of a capital market institution has become weakened significantly; to restrict or remove the signature authorities of the employees of such institution; to take the needed measures in case it is determined that the needed measures are not taken by these institutions within this period that is given or their financial situations have become weakened to the extent that they shall not be able to meet their commitments, to stop temporarily the operations of these institutions without giving any period of time or to stop them permanently and remove their authorities; to make a decision for gradual liquidations in case these measures do not produce results and to request direct bankruptcy without gradual liquidation or when needed following the conclusion of liquidation.*

*The objective of gradual liquidation is to liquidate the cash payments and the delivery obligations of capital market instruments to the customers due to the capital market operations carried out in the framework of the Capital Market Law by setting aside the amount obtained by transforming the assets to in kind or cash according to their attributes. Process is different from other financial institutions and in the decision and operations of gradual liquidation, the provisions related to liquidation in the Turkish Commercial Code, the Execution and Bankruptcy Law and the other legislation shall not be applied. The principles and method of application for gradual liquidation of intermediary institutions shall be set forth in a regulation promulgated by The Capital Market Board.*

*The assets of the capital market institutions, the authority of which has been permanently removed, shall not be transferred to third persons, or used as security, or listed as guarantees, and shall not be attached, and all the legal actions for collection of debts which have been started shall automatically be stopped from the date The Capital Market Board decides to remove the authority until it is announced that the gradual liquidation procedures have been completed and from the time of registration to the judgment by the court of the request for bankruptcy, in case direct bankruptcy is requested or following gradual liquidation, excluding transactions that shall be made by The Capital Market Board and the Investors' Protection Fund in the framework of gradual liquidation.*

15. 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?

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*A decision may be made by the Board for the gradual liquidation of investment firms, the authorities of which have been removed in accordance with subparagraph (h) of the first paragraph of Article 46 of the Capital Market Law. The liquidation operations of these institutions shall be carried out by the Investors' Protection Fund.*

*After a decision is made for gradual liquidation, the duties and authorities of the legal organs of the investment firm shall be carried out by the Fund until the liquidation is concluded.*

*The Investors' Protection Fund having legal entity has been established with the objective of meeting the liquidation expenses and to carry out the functions provided above in accordance with the principles envisioned in Capital Market Law with respect to intermediary institutions for which a gradual liquidation or bankruptcy decision is made and, on the condition that the provisions of the Banking Law are reserved, the banks in the scope of paragraph (a) of Article 50 of Capital Market Law the operations of which are stopped by a decree of the Council of Ministers, to cover the cash payment and share delivery obligations arising from share transactions for their customers due to capital market operations and transactions in which they engaged. All investment firms are required to participate in this Investors' Protection Fund.*

*The Fund shall be managed and represented by CRA that is in charge of keeping records of capital market instruments, in accordance with the provisions of the Capital Market Law. Decision making body of the Fund is the decision making body of CRA. The Fund-related activities and transactions shall be managed and executed by a separate unit to be organized in CRA.*

### 16. What are the duties of the Administrative Officer?

*Payments by the intermediary institution for which a gradual liquidation decision is made shall be stopped and as of the date of this decision all its assets may be used only by the Fund. The Fund shall determine the assets and liabilities of the intermediary institution. The cash debts in the scope of the obligations that should be liquidated shall be calculated over the total principal capital and accrued interests at the date of the decision of gradual liquidation; with respect to the obligation to deliver capital market instruments, in cases where it cannot be delivered in kind, the debt shall be calculated based on the market value on the date the delivery went into default otherwise the day that the decision is made for gradual liquidation. The rights and obligations arising from contracts with maturity dates after the date of the decision for the gradual liquidation of the intermediary institution shall be determined as of their maturity dates. Legal default interest shall be applied at the rate envisioned in the third paragraph of Article 2 of Law No. 3095 Related to Legal Interest and Default Interest as of the maturity date of term debts and as of the date of the gradual liquidation decision for the other debts. In accordance with the legislation, guarantees given by the intermediary institution are also taken into consideration in the assets account.*

*The Fund shall determine the real holders of rights and the amounts of their receivables which are in the scope of liquidation of the intermediary institution based*

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*on the records kept by the Board, the records of the intermediary institution, the records of other official and private institutions related to these organizations and other reliable information and documents. In case there is the existence of the conditions described in Articles 278, 279 and 280 of the Execution and Bankruptcy Law, an annulment lawsuit may be opened by the Fund.*

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

*See the answers to the questions 14-16.*

- 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 Investors' Protection Fund shall prepare and issue monthly reports containing a detailed breakdown of The Investors' Protection Fund properties and assets by types thereof, and information about intermediary institutions in liquidation process and the collections and payments in connection therewith, and shall submit these monthly reports to The Capital Market Board.*

*Furthermore, The Board is authorized to inspect and audit the accounts and transactions of the Fund and to request all kinds of information and documents from the Fund in relation therewith. Depending on the results of inspection and audit, the Board may request the Fund to take certain actions, and if required, may demand the Minister, to whom the Board reports, to transfer the Fund management to the Board.*

17. 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?

*After taking the decision of gradual liquidation of an investment firm, CMB notify to Central Registry Agency, Istanbul Stock Exchange, the Takasbank and to Investors' Protection Fund for initiation and conduct of the liquidation procedures.*

*Upon a gradual liquidation decision, all functions, duties and powers of legal bodies of the intermediary institution, such as general assembly of shareholders, board of directors and board of auditors, shall be assumed, performed and used by The Investors' Protection Fund in proxy until completion of the liquidation process. In the course of liquidation, no appointment shall be made by The Investors' Protection Fund to board of directors or to board of auditors of the intermediary institution, nor shall its general assembly of shareholders be convened during the progressive liquidation process. At the date of advertisement about completion of the progressive liquidation process, all legal bodies of the intermediary institution on duty as of the date of the progressive liquidation decision shall resume their functions, duties and powers, without any further formality or transaction.*

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

*The Investors' Protection Fund shall determine the real holders of rights and the amounts of their receivables which are in the scope of liquidation of the intermediary institution based on the records kept by the Capital Markets Board, the records of the investment firm, the records of other official and private institutions related to these organizations and other reliable information and documents.*

18. What are the requirements, if any, governing the segregation and treatment of Client Assets during the insolvency of an Investment Firm?

*As stated above, The Capital Market Board is authorized to request the strengthening of the financial situations within a suitable period that shall be given in case it is determined that the financial structure of a capital market institution has become weakened significantly; to restrict or remove the signature authorities of the employees of such institution; to take the needed measures in case it is determined that the needed measures are not taken by these institutions within this period that is given or their financial situations have become weakened to the extent that they shall not be able to meet their commitments, to stop temporarily the operations of these institutions without giving any period of time or to stop them permanently and remove their authorities; to make a decision for gradual liquidations in case these measures do not produce results and to request direct bankruptcy without gradual liquidation or when needed following the conclusion of liquidation.*

*So, during the insolvency period the investment firm cannot make any operation on the client assets.*

19. 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?

*For use in cash payments and in delivery of capital market instruments, The Investors' Protection Fund shall within 6 months at the latest following the date of the gradual liquidation decision, prepare and issue a schedule of creditors showing the names of creditors and the amounts of their receivables.*

*As of the 30th day following the advertisement date of the schedule of creditors, distribution of the capital market instruments kept in safe custody on behalf of the customers shall be started. To this end, the capital market instruments kept in safe custody on behalf of the customers shall be compared and reconciled separately in individual accounts, and as a result, shall be delivered to the rightful owners thereof solely for settlement of the outstanding obligations to those account holders or shall alternatively be transferred to their bank accounts upon and in line with their demands.*

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*A decision may be made by The Capital Market Board to transfer to another institution the management of portfolios that are managed by an intermediary institution which has become bankrupt or insolvent, including mutual funds and investment company portfolios. The process depends on the number and the size of the portfolios.*

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

*The factors can be stated as;*

- *Number of clients,*
- *Complexity of the Investment Firm and the degree of ease for collecting necessary data for making client asset list,*
- *Clients' application process for their assets to The Investors' Protection Fund,*
- *Process of deciding which client assets are in the scope of The Investors' Protection Fund and thus payable by The Investors' Protection Fund,*
- *In case of controversy between Investment Firm and creditors, money transfer can be blocked because of given customer assets as collateral by the Investment firm*

20. 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 our capital market legislation and legal insolvency proceeding, there is requirement for the clients to return assets (or the values thereof) that were distributed to the them prior to the insolvency proceeding.*

21. 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 above, The Investors' Protection Fund having legal entity has been established with the objective of meeting the liquidation expenses and to carry out the functions provided above in accordance with the principles envisioned in Capital Market Law with respect to intermediary institutions for which a gradual liquidation or bankruptcy decision is made and, on the condition that the provisions of the Banking Law are reserved, the banks in the scope of paragraph (a) of Article 50 of Capital Market Law the operations of which are stopped by a decree of the Council of Ministers, to cover the cash payment and share delivery obligations arising from share transactions for their customers due to capital market operations and transactions in which they engaged. All intermediary institutions are required to participate in this Fund.*

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*At the beginning of the gradual liquidation, first of all the capital market instruments shall be distributed to the holders of the rights in the customer settlement accounts. With this objective, the capital market instruments that are settled in the customer account are compared as of the separate accounts and shall be used only for meeting the obligations to these account holders. For the holders of settlement accounts who have enough to meet what is owed in the account or who do not have any shares, a total of 63,70.,00 Turkish Lira of their cash and share receivables (for the year 2012) shall be paid by the Fund without waiting for the conclusion of the liquidation. However, for those who appear to be creditors of the same institution in the opinion of the Fund who have acted together with the institution, payment is made in the proportion to their receivables provided that it does not exceed the above total. Advance payments shall not be made from the Fund to shareholders, members of the board of directors or board of auditors, personnel authorized to sign and their spouses, blood relatives and relatives by marriage including the third degree, who appear to be debtors of the intermediary institution subject to gradual liquidation. The total payment that shall be made in accordance with this paragraph shall be increased at the rate of the revaluation coefficient that is announced every year.*

22. 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.

*After the gradual liquidation process begins, all of the payments of the investment firms are stopped and nobody other than the Investors Protection Fund has the power of disposal on the assets of the investment firm. The purpose of the gradual liquidation is to liquidate cash payments and the delivery obligations of capital market instruments to the clients due to the capital market activities. In this process, all of the client assets, not differing for the clients' who have granted permission to the investment firm are subject to the same regime.*

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

*As mentioned in the answer to the question 4, within the scope of the intermediation in trading in foreign markets, investment firms may hold client assets in a foreign investment firm authorized by the competitive authority of the related jurisdiction.*

*In this case, clients must fully be informed of the state and the legislation and protection they are subject to.*

*Currently, client assets which are held in foreign jurisdictions for the purposes of trading in foreign markets are not in the scope of the Investors Protection Fund. These assets are subject to the provisions of the relevant jurisdiction.*

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

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*According to the Article 47 of the Capital Market Law, selling or creating a pledge or using in whatever manner for the benefit of someone other than the owner, capital market instruments, cash or other assets of any kind which are consigned or delivered physically or by registration to investment firms, is defined as a crime and the people accused to commit this crime shall be punished with a prison sentence of from two to five years and a heavy pecuniary fine.*

25. 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 case the assets of the Fund are not sufficient to meet the needs, then dues that shall be paid for subsequent years shall be paid on account up to one per thousand of the monetary amount of the share transaction volumes for the previous year shall be paid temporarily. If the dues received from intermediary institutions are not sufficient to meet the needs, then an advance shall be given to the Fund by the Istanbul Stock Exchange for the remaining portion.*

*The Fund, after making the advance payments, shall continue the gradual liquidation of the intermediary institution. The liquidation balance of the receivables from the holders of the rights in the scope of the objective of the liquidation shall be used for the payment of the receivables which are not completely met. However, if the liquidation balance is not sufficient to meet all of these receivables, then payments shall be made by pro rata distribution. After all of these receivables are met, then from the remaining portion, first of all the public receivables and from the remaining amount, the receivables arising from the advances made by the Fund and the liquidation expenses shall be paid. The balance is distributed to the other creditors. If the assets of the intermediary institution are not sufficient to meet the receivables of the holders of rights in the scope of the objective of liquidation, the payments made from the Fund and the liquidation expenses, then the Fund, with the concurrence of the Board, may request the bankruptcy of the intermediary institution.*

*According to the provisions of the Capital Market Law it is not envisaged a priority among classes of clients.*

26. 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?

*Claims of clients related to capital market activities are ranked prior to other creditors in the insolvency process. Insolvency regime does not differ between domestic and 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

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available copies. How might a person outside your jurisdiction most readily get access to such items? Are there treaties that would be useful for obtaining a general understanding of client asset protection in your jurisdiction?

### *Capital Markets Law*

*Serial:V, Number:46 “Communiqué On Principles Regarding Intermediary Activities and Intermediary Institutions”*

*Serial No:V, No:34 Communiqué on Principles Regarding Capital and Capital Adequacy of Brokerage Houses”*

*Serial: V, No: 65 “Communiqué On Principles Regarding The Internal Auditing Systems Of Brokerage Houses”*

### *Regulation on Investors Protection Fund*

*Regulation on Principles and Procedures of Progressive Liquidation of Intermediary Institutions*

*The regulations can be accessed from the website of the CMB. [www.cmb.gov.tr](http://www.cmb.gov.tr)*

**United Kingdom**  
**2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

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(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.

## Response from the UK’s Financial Services Authority (August 2012)

**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) sourcebook. 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”<sup>29</sup>. 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).

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<sup>29</sup> FSA Principle for Business 10

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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.

- a. How does your jurisdiction define the term "client assets?" If the jurisdiction uses an analogous term, please provide that term and its definition.

"Client assets" is not a defined term in the UK regime, however, it is generally used to mean both custody assets (as defined below) and client money (as defined below), unless otherwise specified.

Custody assets: (a) a security or contractually based investment (these categories are very wide and include for example, shares, units, options, futures, CFDs and interests in these investments) held for or on behalf of a client; (b) any other asset which is or may be held with one of the investments listed in (a) held for, or on behalf of, a client.

Client money: money of any currency that a firm receives or holds for, or on behalf of, a client in the course of, or in connection with, its investment business/agreements; and to which the client money rules apply.

- b. What is the nature of a client's ownership rights with respect to its client assets placed with the investment firm?

Custody assets: Broadly speaking, custody assets held by a firm may be registered in the name of the client, a nominee company, or even the name of the firm, but clients retain beneficial ownership of the assets at all times. In the event of a firm insolvency, the client has claim on specific assets, an insolvency practitioner can trace these assets.

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Any distribution of custody assets depends on the factual scenario. In the event of a shortfall, clients have a claim as unsecured creditors of the general estate, and, if eligible, would be able to claim against the Financial Services Compensation Scheme (FSCS) if they suffered loss.

Client money: client money is received and held by a firm on trust for its clients. In the event of a firm failure, all client money held by a firm on behalf of its clients is pooled. That pool of client money is then shared rateably amongst the clients with a claim on the pool in accordance with their interests in it.

Any shortfall in that client money pool (i.e. there is insufficient client money in the pool to meet all client claims) is shared rateably amongst the clients. Clients will have claims as unsecured creditors of the firm's general estate in relation to any shortfall and, if eligible, would be able to claim against the Financial Services Compensation Scheme (FSCS) if they suffered loss.

- c. How does your jurisdiction define the term "client"? If the jurisdiction uses an analogous term, please provide that term and its definition.

Client: a person (including an individual and legal person such as corporate entity) to whom a firm (which includes banks and investment firms) provides, intends to provide or has provided a service in the course of carrying on a regulated activity. The definition of 'Client' will also include other regulated firms, including affiliates or other group entities.

- d. Please describe any notable exclusions from the terms "client" or "client assets."

None

*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?

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- 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 firms intend to hold client money or client assets a firm has to 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 dash-board, 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

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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 clients 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.

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- 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, 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.

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(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:**

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

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? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

### 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.”

For the avoidance of doubt, one client's net debit balance (or an aggregate of client' net debit balances) cannot be used by the firm to reduce the total funds the firm is required to have on deposit for its clients collectively.

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.

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- 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?

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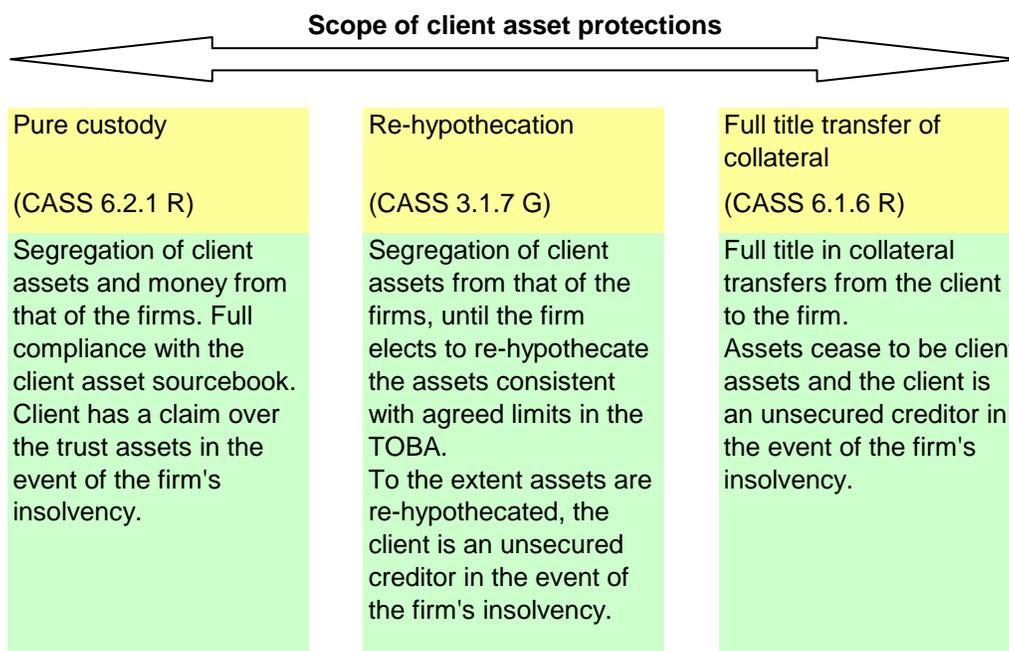
If it is prudent to do so to ensure that client money is protected, a firm may pay into a client bank account money of its own, and that money will then become client money for the purposes of the client money chapter of CASS.

- 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 use, 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.



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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).

- i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?

If a client agrees to full title transfer of its assets to the firm in certain circumstances and the firm exercises its rights to take full ownership of assets in accordance with its client agreement, this will result in those assets being moved out of the client assets regime for the period during which the firm exercises full ownership rights. The consequence of this is that, if a firm fails during that period, the client will rank as a general creditor of the firm in relation to those assets.

However, a security financial collateral arrangement would usually mean that the client retains beneficial interest in the assets until such time as the condition in the agreement allowing the firm to exercise its security right is met.

- ii. How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?

Investment firms must agree with their clients the terms on which they are to use their assets, or the conditions placed on full title transfer. This is a contractual agreement, and generally can form part of the terms of business or agreements clients sign-up to.

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New rules that came into force 2011, require prime brokers to set out clearly in a separate annex in the client agreements a summary of the agreed right to use of custody assets (CASS 9.3 prime brokerage agreement disclosure annex).

- iii. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (*i.e.*, established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator?)

As set out in our response to (i) above, where a client agrees to transfer full title to custody assets to a firm and firm has exercised its rights to take full ownership of custody assets in keeping with its client agreement (*i.e.* with the client's consent) the custody assets are removed from the client assets regime (and the protections thereof) for the period that the firm exercises those rights. It is that contractual agreement between client and firm that allows the client asset regime protections to be disapplied for that period. Therefore, if a firm takes full ownership over custody assets and uses them without the agreement of the client to whom the assets belong, in our view, the client asset regime should continue to apply to those assets, that is, they should still be held on trust by the firm for the client. If the firm has used the assets as its own the client/insolvency practitioner may attempt a tracing exercise.

Similarly, if a firm uses client money without the consent of the client to whom the money belongs, this money would still be subject trust and in the event of the firm's insolvency the client would be entitled to claim on the client money pool.<sup>30</sup>

In the event of the firm's insolvency, the client would usually be reliant on the insolvency practitioner to represent its interests in resolving issues relating to misuse of its assets and money. However, on a business as usual basis, in the event that the firm misused a client's assets and the client had suffered loss, the client could potentially sue the firm for breach of contract or negligence.

- 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.

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<sup>30</sup> The Lehman Brothers International (Europe) (In Administration) Supreme Court Judgment found that the requirement to pool all client money on the occurrence of a primary pooling event also applies to client money held in house accounts and that participation in the notional client money pool is not dependent on the actual segregation of client money.

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

Broadly speaking, yes an investment firm in the UK can hold assets belonging to UK clients in another jurisdiction. This is governed by 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.

This reflects a requirement from MiFID.

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

Firm are 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. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)? If so,
- a. What protections are applicable to the Foreign Investment Firm’s Client Assets?

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The UK client assets rules do not differentiate between client assets held for UK or overseas clients.

- b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?

NA (see response to 5(a))

- c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?

Foreign Investment Firm will be treated equally as all clients (see responses to 3(d) on right to use and rehypothecation).

6. 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.

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[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 6.3.5R and 6.3.6R below came into force on 1 April 2012:

CASS 6.3.5R: Subject to CASS 6.3.6 R, in relation to a third party with which a firm deposits safe custody assets belonging to a client, a firm must ensure that any agreement with that third party relating to the custody of those assets does not include the grant to that party, or to any other person, of a lien or a right of retention or sale over the safe custody assets, or a right of set-off over any client money derived from those safe custody assets.

CASS 6.3.6 R: A firm may conclude an agreement with a third party relating to the custody of safe custody assets which confers on that party, or on another person instructed by that party to provide custody services for those assets, a lien, right of retention or sale, or right of set-off in favour of that party or that other person only if that lien or right:

- (1) is confined to those safe custody assets held in an account with that third party or that other person and extends only to properly incurred charges and liabilities arising from the provision of custody services in respect of safe custody assets held in that account; or
- (2) arises under the operating terms of a securities depository, securities settlement system or central counterparty in whose account safe custody assets are recorded or held, and provided that it does so for the purpose only of facilitating the settlement of trades involving the assets held in that account; or
- (3) arises in relation to those safe custody assets held in a jurisdiction outside the United Kingdom, provided that:
  - (a) it does so as a result of local applicable law in that jurisdiction or is necessary for that firm to gain access to the local market in that jurisdiction; and

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(b) in respect of each client to which those assets belong, either:

- (i) the firm has taken reasonable steps to determine that holding those assets subject to that lien or right is in the best interests of that client; or
- (ii) where a client is a professional client, the firm is instructed by that client to hold those assets in that jurisdiction notwithstanding the existence of that lien or right.

7. 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.

8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? 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.

9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:
- a. Does the Investment Firm report where client assets are held?
  - b. Does the Investment Firm or depository report the protections applicable to such client assets?
  - c. Does the Investment Firm or depository report the amount of assets that are held?

In each case, are such reports provided on request or periodically? If periodically, with what frequency?

Rules introduced in 2011 require all firms that hold client money and/or custody assets in connection with investment business to be categorised as:

- CASS Large firm, where client money held exceeds £1 billion and/or custody assets exceeds £100 billion;
- CASS Medium firm, where it is not a CASS Large firm, but client money held exceeds £1 million and/or custody assets exceeds £10 million; and

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- CASS Small firm, where it is not a CASS Large or CASS Medium firm, but holds client money and/or custody assets.

Annual reporting is applicable to all of these firms and requires them at the start of each year to report their highest client money and assets holding for the previous year, or the highest projected client money and assets holdings if they have not previously held.

All CASS Large and Medium firms are required to provide a monthly Client Money and Assets Return - "CMAR" - that contains information on the following:

- Highest/lowest balances of client money and assets held
  - Auditor arrangements
  - CFTC Part 30 Exemption arrangements
  - Reconciliations – timings, methods used and discrepancies
  - Client money calculations – allocated/unallocated balances and discrepancies.
  - Segregation of client money and assets – segregation methods used/details of third parties
  - Record keeping & breaches – trust/acknowledgement letters, client money accounts and notifiable CASS breaches.
  - Outsourcing/offshoring arrangements – nature of arrangements, details of service providers.
10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify
- a. Where Client Assets are held?
  - b. The amount of Client Assets held at a depository?
  - c. The safeguards applicable to Client Assets held at a depository?

Firms are required to send out notification and receive acknowledgement letters from third parties where client money is placed (CASS 7.8.1 R and CASS 7.8.2 R). They are required to undertake regular external reconciliations (CASS 6.5.6 R and CASS 7.6.9R), and promptly rectify any discrepancy. If a firm is unable to rectify or make good a discrepancy, they are required to notify the FSA without delay (CASS 6.15.13 R and CASS 7.6.16 R).

In mid 2010, the FSA launched the a dedicated Client Assets Unit (around 40 individuals today and growing). The Unit is a multi-disciplinary specialist unit with risk, policy and supervision specialists focused on the client assets regime. The unit utilises a combination of firm self-reporting (including CMAR), external auditor reporting and whistle blowing to assess risks in firms and industry trends. It utilises a supervision inspection program, sector thematic reviews and independent specialist reviewers ('section 166 reviews') to examine firms.

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Furthermore, external independent auditors are required to provide to the FSA an annual reasonable assurance report on the adequacy of the client assets systems and compliance as at the period end.

Rules introduced in 2011, require investment firms to appoint an individual within their firm the responsibility for oversight of the firm's operational compliance with the client assets rules, and reporting to the firm's governing body and the FSA. For CASS Large and CASS Medium firms, this function is a 'controlled function' to be undertaken by an 'approved person' (would be subject to application to FSA and potential FSA interview). For CASS Small firms, the individual has to be a director or senior manager performing a significant influence function, though the function is not a controlled function. A significant influence function is, broadly speaking, a function which involves the person responsible for its performance exercising a significant influence over the conduct of a firm's regulated activities.

11. Where an Investment Firm based in a foreign jurisdiction (a "Foreign Investment Firm") deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify
  - a. The amount and/or value of such Client Assets?
  - b. The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?

Where there is an applicable memorandum of understanding between the relevant regulators, the foreign regulator could request information from the domestic regulator through that memorandum of understanding.

12. 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.

13. 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

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the firm's permissions, require the firm to transfer business, return client assets 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.

### **Post-Insolvency**

14. 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.

In February 2011 the Investment Banking Special Administration Regulations 2011 (the “SAR”) came into force. The SAR can be applied to UK incorporated firms that undertake investment business activity – specifically those which are authorised to deal in and/or safeguard and administer investments, and which actually hold client assets. A court can appoint an administrator over such an entity, on the application of various parties including the FSA or the investment bank's directors, if such entity becomes insolvent.

An administrator then has three objectives:

- To ensure the return of client assets as soon as is reasonably practicable;
- To ensure timely engagement with market infrastructure bodies (to facilitate the operation of their default rules) and the Authorities (to facilitate the Authorities taking action to minimise the disruption of businesses and the markets); and

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- To either rescue the investment firm as a going concern or wind it up in the best interests of creditors.

The FSA can direct an insolvency practitioner to prioritise one of these objectives over another.

15. 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, by the company or the FSA (in accordance with SAR). The administrators have to pass relevant joint insolvency examinations to become a licensed Insolvency Practitioner and be a member of the Insolvency Practitioners Association (IPA).

16. 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.

17. 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 authorised 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 however to ensure an efficient and orderly return of assets and, if the firm is subject to SAR, can direct the insolvency practitioner to prioritise one of the SAR objectives over another

18. What are the requirements, if any, governing the segregation and treatment of Client Assets *during* the insolvency of an Investment Firm?

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The client assets regime continues to apply to the Investment Firm during the insolvency - until it ceases to conduct regulated activities and its permissions are canceled.

19. 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.

20. 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.

21. 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 £50,000 per client per firm.

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22. 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 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.

23. 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.

24. 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 the client money pool as soon as the firm receives the client money.

The client assets should be traceable and returned to clients. If a firm misapplies, loses, or simply holds to few assets there will be a shortfall (see below).

In either case, the client would have a breach of trust claim against the firm.

25. 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 to the extent that an individual's assets cannot be traced. 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.

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26. 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>

**United States – CFTC  
2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

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(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.

#### **CFTC Overview:**

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.<sup>31</sup> 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 25 describes further below) for, *inter alia*, (1) clients trading domestic futures (*i.e.*, futures traded on a contract market designated as such by the CFTC), (2) clients trading foreign futures (*i.e.*, futures traded on contract markets located outside the United States), and (3) cleared swaps customer collateral. 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. 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.

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<sup>31</sup> As discussed below, slightly different requirements apply to Client Assets in accounts set aside for customers – *i.e.*, accounts for foreign futures.

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In 2012, pursuant to Section 724 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), the CFTC adopted final regulations which impose requirements on FCMs and derivatives clearing organizations (“DCOs”) regarding the treatment of cleared swaps customer contracts (and related collateral), and made conforming amendments to the CFTC’s Bankruptcy Rules<sup>32</sup> for FCMs under the Commodity Exchange Act (“Act”). Specifically, these rules (also known as the “Legally Segregated Operationally Commingled Model”) provide individualized protection for such collateral. They require that cleared swaps customer collateral be segregated from the FCM’s own property pre-bankruptcy. In addition, they permit the cleared swaps collateral of all FCM cleared swaps customers to be kept together pre-bankruptcy in one account. The rules, to the extent applicable, parallel the regulations governing the segregated accounts in which FCMs currently hold futures customer collateral pre-bankruptcy. However, they require DCOs to track the positions and related collateral attributable to cleared swaps customers on an individualized basis.

The rules also provide that following an FCM’s bankruptcy, where there is a shortfall in the cleared swaps customer account due to a cleared swaps customer loss that exceeds both the cleared swaps customer’s collateral and the FCM’s ability to pay, the DCO may only use the collateral attributable to the cleared swaps customers whose portfolios of positions at the DCO suffered losses to meet the loss, and then only to the extent of each such customer’s share of the loss. Thus, all collateral attributable to cleared swaps customers whose portfolios of positions gained or were “flat” (neither gained nor lost), and the remaining collateral attributable to cleared swaps customers whose portfolios of positions lost, would be immediately available for transfer. The compliance date for these regulations is November 14, 2012.

- a. How does your jurisdiction define the term “client assets?” If the jurisdiction uses an analogous term, please provide that term and its definition.

### **CFTC Response:**

Client Assets refers to customer funds, positions, securities, or other property held on behalf of clients by an FCM. These assets can be used to margin, secure and guarantee commodity futures and swaps transactions. The CFTC’s regulatory scheme distinguishes between “account classes” for (a) domestic and (b) foreign exchange-traded futures positions and associated

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<sup>32</sup> See 17 C.F.R. Part 190.

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collateral, and (c) cleared swaps customer contracts and related collateral.

- b. What is the nature of a client's ownership rights with respect to its client assets placed with the investment firm?

**CFTC Response:**

When a client places its assets with an Investment Firm, the client transfers title to those assets to the firm. However, if the Investment Firm becomes insolvent, all clients share pro rata, by account class, in Client Assets, based on the amount of each client's claim.

- c. How does your jurisdiction define the term "client"? If the jurisdiction uses an analogous term, please provide that term and its definition.

**CFTC Response:**

Client refers to a customer (i.e., any natural person, corporation, general partnership, limited partnership, limited liability company, trust or other legal organization whose commodity or swaps account is carried by an FCM).

- d. Please describe any notable exclusions from the terms "client" or "client assets."

**CFTC Response:**

The definition of "client" excludes the types of accounts included under the definition of proprietary account. Proprietary accounts include the firm's own account and so-called "noncustomer" (i.e., affiliated) accounts such as the accounts of an FCM's directors, stockholders, officers, account executives, certain other employees, certain relatives of the preceding persons, and affiliated companies.

*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:*

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- 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?

#### **CFTC Response:**

Yes, any Investment Firm holding Client Assets for the purpose of securing commodity futures and cleared swap transactions is an FCM, and pursuant to Section 4d(a)(1) (for futures) and Section 4d(f) of the Commodity Exchange Act (the "Act"),<sup>33</sup> 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").<sup>34</sup>

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

#### **CFTC Response:**

In order for an Investment Firm to operate as an FCM, it must meet minimum capital requirements. Pursuant to CFTC regulation ("Regulation") 1.17,<sup>35</sup> such Investment Firm must maintain, at all times, adjusted net capital equaling or exceeding the greatest of the following:

- \$1,000,000;

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<sup>33</sup> 7 U.S.C. §§6d(a)(1), 6(d)(f).

<sup>34</sup> 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.

<sup>35</sup> 17 C.F.R. §1.17.

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- 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
- 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

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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 or cleared swaps, 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?

**CFTC Response:**

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:

**CFTC Response:**

Yes.

- *Futures.* Section 4d of the Act and Regulation 1.20<sup>36</sup> require that an Investment Firm segregate (i) proprietary assets from (ii) Client Assets

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<sup>36</sup> 17 C.F.R. §1.20.

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securing commodity futures transactions (“Futures”) executed on a designated contract market (“DCM”).

- *Foreign Futures.* Regulation 30.7<sup>37</sup> 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 25 and 26, 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.
- *Cleared Swaps.* Section 4d(f) of the Act and Part 22 of the Regulations<sup>38</sup> require that an FCM segregate (i) proprietary assets from (ii) Client Assets securing swaps cleared on a DCO (“Cleared Swaps”).
  - 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?

### **CFTC Response:**

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. As discussed above, Section 4d of the Act and Part 22 of the Regulations

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<sup>37</sup> 17 C.F.R. §30.7.

<sup>38</sup> 7 U.S.C. §6d(f), 17 C.F.R. §§22.1 *et. seq.*

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permit an Investment Firm to hold Client Assets securing Cleared Swaps on an omnibus basis. However, such assets are protected on an individual basis.

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

### **CFTC Response:**

- *Futures and Foreign Futures.* As Answer 25 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.
- *Cleared Swaps.* Although client assets securing cleared swaps may be held in an omnibus account, such assets receive individualized protection in bankruptcy. As discussed above in Answer 1, following an FCM's bankruptcy, where there is a shortfall in the cleared swaps customer account due to a cleared swaps customer loss that exceeds both the cleared swaps customer's collateral and the FCM's ability to pay, the DCO may only use the collateral attributable to the cleared swaps customers whose portfolios of positions at the DCO suffered losses to meet the loss, and then only to the extent of each such customer's share of the loss. Thus, all collateral attributable to cleared swaps customers whose

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portfolios of positions gained or were “flat” (neither gained nor lost), and the remaining collateral attributable to cleared swaps customers whose portfolios of positions lost, would be immediately available for transfer.

- 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?

### **CFTC Response:**

- *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 equalling 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

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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.

- *Cleared Swaps.* Pursuant to Section 4d of the Act and Part 22 of the Regulations, an Investment Firm is required, at all times, to have sufficient Client Assets, in specified locations and/or the Cleared Swaps Customer Account, to pay all clients transacting in Cleared Swaps with credit balances.

- 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?

**CFTC Response:**

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.<sup>39</sup>

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

**CFTC Response:**

Investment Firms perform reconciliations on an aggregate basis.

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<sup>39</sup> 17 C.F.R. §190.08(d).

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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? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

**CFTC Response:**

No. If a client has a debit balance, the Investment Firm must maintain in the relevant Omnibus Account or Cleared Swaps Customer 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).

**CFTC Response:**

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).

**CFTC Response:**

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?

**CFTC Response:**

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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 or Cleared Swaps Customer 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.<sup>40</sup> As a practical matter, all Investment Firms maintain a cushion of their own assets in the Futures Omnibus Account, the Foreign Futures Omnibus Account, and the Cleared Swaps Customer 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?

### **CFTC Response:**

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?

### **CFTC Response:**

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 22.2(d)(1) provides a similar prohibition regarding the use of Client Assets of a Cleared Swaps Customer.<sup>41</sup> Regulation 30.7 does not contain a similar prohibition, because Regulation 30.7 does not, at this

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<sup>40</sup> 17 C.F.R. §1.12(h).

<sup>41</sup> 17 C.F.R. §22.2(d)(1).

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time, 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 use, the Client Assets? If so, please describe.

### **CFTC Response:**

Investment Firms are permitted to (a) post customer collateral upstream, with a central counterparty (specifically, for Futures and Cleared Swaps, a DCO) or an upstream clearing broker, and (b) rehypothecate or invest, pursuant to CFTC regulation, collateral or Client Assets posted by customers, so long as the requisite value of collateral remains in segregation at all times. In the latter case, the Investment Firm is permitted to change the *form* of customer collateral that is protected, not the value.

### **Restrictions on Use and Rehypothecation of Client Assets**

- *Futures Omnibus Account.* Pursuant to Section 4d of the Act, an FCM 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<sup>42</sup> 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

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<sup>42</sup> 17 C.F.R. §1.25.

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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 FCM to invest Client Assets in the Foreign Futures Omnibus Account. However, the FCM has an incentive to invest such Client Assets conservatively, because the FCM is required to immediately make good and to report a deficiency in such Client Assets.
- *Cleared Swaps.* Regulation 22.2(e)(1)<sup>43</sup> permits an FCM to invest Client Assets or other property constituting Cleared Swaps Customer Collateral in accordance with Regulation 1.25. Such collateral is treated the same as Client Assets subject to segregation pursuant to Section 4d(a) of the Act.

- i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?

### **CFTC Response:**

As stated above, an Investment Firm is permitted to rehypothecate or invest Client Assets in a limited set of instruments so long as the Firm maintains in segregation the value necessary to repay all clients with positive (i.e., credit) balances in full. However, this does not result in any change to the client's ownership rights: In the event of insolvency, the client remains entitled to a pro rata share of the Client Assets, based on the client's allowed claim.

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<sup>43</sup> 17 C.F.R. §22.2(e)(1).

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- ii. How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?

**CFTC Response:**

Not Applicable.

- iii. How are the ownership rights of a client over its client assets changed or affected when the investment firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (i.e. established by statute or regulation, established by prior judicial decision, based on interpretation of the regulator)?

**CFTC Response:**

Pursuant to Section 766(h) of the Bankruptcy Code, a client remains entitled to a pro rata share of the value of its Client Assets (*i.e.*, the client's allowed claim) in an Investment Firm insolvency.

- 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?

**CFTC Response:**

- *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

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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 DCO 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 FCMs, which assets are segregated in accordance with Section 4d of the Act and Regulation 1.20;
  - the DCO 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 FCMs, (ii) are being held to support Futures, and (iii) are being held in accordance with Section 4d of the Act and Regulation 1.20.
- *Cleared Swaps Customer Collateral.*

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- Similar requirements apply pursuant to Section 4d(f) of the Act and Part 22 of the Commission's Regulations for Cleared Swaps Customer Collateral. Specifically, a DCO 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 "Cleared Swaps Customer Collateral", which assets are segregated in accordance with Section 4d(f) of the Act and Part 22 of the CFTC's Regulations; and
  - obtain a written acknowledgment from its third-party depository,<sup>44</sup> whether located in the United States or in another jurisdiction, confirming that such depository was informed that such Cleared Swaps Customer Collateral (i) belong to clients of FCMs, (ii) are being held to support Cleared Swaps, and (iii) are being held in accordance with Section 4d(f) of the Act and the regulations thereunder.
- Further, Regulation 22.3(c) prohibits Cleared Swaps Customer Collateral from being commingled with the money, securities, or other property belonging to the DCO and any FCM and other categories of funds received from an FCM on behalf of clients, including Client Assets in the Futures and Foreign Futures Omnibus Accounts.<sup>45</sup>
- *Foreign Futures Omnibus Account.*

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<sup>44</sup> An acknowledgment letter need not be obtained from a DCO that has made effective, pursuant to the section 5c(c) of the Act and regulations promulgated thereunder, rules that provide for the segregation of Cleared Swaps Customer Collateral, in accordance with all relevant provisions of the Act and the regulations thereunder. See 17 C.F.R. §22.5(c).

<sup>45</sup> 17 C.F.R. §22.3(c).

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- 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 5 states, Regulation 30.7 does require:
    - each FCM to deposit such Client Assets with a third-party depository, including a DCO, 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 FCM 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 FCM, (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 in your jurisdiction permitted to transfer to, or hold Client Assets belonging to clients in your jurisdiction in, another jurisdiction? If so, does

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the Regime in your jurisdiction require Investment Firms to preserve the separate identification of:

### **CFTC Response:**

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; (ii) Regulation 30.7 with respect to Client Assets in the Foreign Futures Omnibus Account, and (iii) Regulation 22.9 with respect to Client Assets in the Cleared Swaps Customer Account.<sup>46</sup>

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

### **CFTC Response:**

- a) *Futures Omnibus Account.* Pursuant to Regulation 1.20, the Investment Firm must:
- deposit Client Assets with a permitted 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, confirming that such depository was informed that such Client Assets (i) belong to clients of the Investment Firm, (ii) are being held to support Futures, and (iii) are being held in accordance with Section 4d of the Act and Regulation 1.20.

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<sup>46</sup> 17 C.F.R. §§1.49, 30.7, 22.9.

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- Pursuant to Regulation 1.49(e),<sup>47</sup> each Investment Firm that has either transferred Client Assets to, or held Client Assets from the Futures Omnibus Account in, another jurisdiction must, as of the close of each business day, have sufficient Client Assets, in specified locations, to meet all obligations to clients from the Futures Omnibus Account.
  - Pursuant to Regulation 1.32,<sup>48</sup> 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.
- b) *Foreign Futures Omnibus Account.* Pursuant to Regulation 30.7, where the FCM holds Client Assets of foreign futures customers with a third-party custodian, the FCM must:
- deposit Client Assets with a permitted 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 FCM, (ii) are being held to support Foreign Futures, and (iii) are being held in accordance with Regulation 30.7; and

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<sup>47</sup> 17 C.F.R. §1.49(e).

<sup>48</sup> 17 C.F.R. §1.32.

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- perform a daily reconciliation of the amount of Client Assets in the Foreign Futures Omnibus Account.
- c) *Cleared Swaps Customer Account.*
- Where an Investment Firm holds Client Assets of Cleared Swaps Customers, the 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 “Cleared Swaps Customer Collateral”, which assets are segregated in accordance with Section 4d(f) of the Act and Part 22 of the CFTC’s Regulations; and
    - obtain a written acknowledgment from its third-party depository,<sup>49</sup> whether located in the United States or in another jurisdiction, confirming that such depository was informed that such Cleared Swaps Customer Collateral (i) belong to clients of the Investment Firm, (ii) are being held to support Cleared Swaps, and (iii) are being held in accordance with Section 4d(f) of the Act and the regulations thereunder.
  - Pursuant to Regulation 1.49, as incorporated by Regulation 22.9, each FCM that holds Cleared Swaps Customer Collateral must, as of the close of each business day, have sufficient Client Assets, in specified locations, to meet all obligations to clients from the Cleared Swaps

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<sup>49</sup> An acknowledgment letter need not be obtained from a DCO that has made effective, pursuant to the section 5c(c) of the Act and regulations promulgated thereunder, rules that provide for the segregation of Cleared Swaps Customer Collateral, in accordance with all relevant provisions of the Act and the regulations thereunder. See 17 C.F.R. §22.5(c).

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Customer Account. The FCM must hold sufficient United States dollars, held in the United States, to meet all United States dollar obligations; sufficient funds in either United States dollars or in money center currencies held in either the United States or money center countries to meet obligations in money center currencies; and sufficient funds in either United States dollars, money center currencies, or the currency of the obligation to meet obligations in other currencies.

- Pursuant to Regulation 22.2(g),<sup>50</sup> each FCM must perform a daily reconciliation of the amount of Cleared Swaps Customer Collateral, on a currency-by-currency basis.

- 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.

### **CFTC Response:**

Yes. Section 4d(a) 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. Similarly, Section 4d(f) of the Act and Part 22 of the Regulations would require that such Client Assets be placed in the Cleared Swaps Customer Collateral account. 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).

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<sup>50</sup> 17 C.F.R. §22.2(g).

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5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions (“Foreign Investment Firms”) in an Omnibus Account (that includes Client Assets from domestic clients)? If so,

**CFTC Response:**

Yes

- a. What protections are applicable to the Foreign Investment Firm’s Client Assets?

**CFTC Response:**

Such Client Assets are entitled to the same protections as those Client Assets of U.S. customers held by Investment Firms in the United States.

- b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?

**CFTC Response:**

None.

- c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?

**CFTC Response:**

None. Such protections cannot be reduced.

6. 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?

**CFTC Response:**

- a) *Futures Omnibus Account.*

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- Pursuant to Regulation 1.49(d)<sup>51</sup>:
  - 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 DCO.
  - If an FCM 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 more than \$1 billion of regulatory capital; (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.

### *b) Foreign Futures Omnibus Account.*

- Pursuant to Regulation 30.7, an Investment Firm may hold the Foreign Futures Omnibus Account in any of the following: i) a bank or trust company located outside of the United States; (ii) a member of any foreign board of trade; or (iii) the designated depository of such member or a DCO, as well as in the third-party depository in which it may hold the Futures Omnibus Account.
- The Investment Firm may hold the Foreign Futures Omnibus Account with an affiliate.

### *c) Cleared Swaps:*

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<sup>51</sup> 17 C.F.R. §1.49(d).

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- Pursuant to Regulation 22.4,<sup>52</sup> if an Investment Firm holds Cleared Swaps Customer Collateral, 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) a collecting FCM<sup>53</sup> registered as an FCM with the Commission (but only with respect to a depositing FCM<sup>54</sup> providing Cleared Swaps Customer Collateral); or (iii) a DCO.
  - Pursuant to Regulation 1.49(d), as incorporated by Regulation 22.9, if an Investment Firm holds Cleared Swaps Customer Collateral with a third-party depository located outside of the United States, such depository must be: (i) a bank or trust company that has more than \$1 billion of regulatory capital; (ii) an FCM registered as such with the Commission; or (iii) a DCO.
  - The Investment Firm may hold Cleared Swaps Customer Collateral 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.

### **CFTC Response:**

- *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

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<sup>52</sup> 17 C.F.R. §22.4.

<sup>53</sup> A collecting FCM is defined as an FCM that carries Cleared Swaps on behalf of another FCM and the Cleared Swaps Customers of the latter FCM, and as part of carrying such Cleared Swaps, collects Cleared Swaps Customer Collateral. 17 C.F.R. §22.1.

<sup>54</sup> A depositing FCM is an FCM that carries Cleared Swaps on behalf of its Cleared Swaps Customers through another FCM and, as part of carrying such Cleared Swaps, deposits Cleared Swaps Customer Collateral with such FCM. 17 C.F.R. §22.1.

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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.
- *Cleared Swaps.* Regulation 22.2(d)(2) states that “[a] futures commission merchant may not impose or permit the imposition of a lien on Cleared Swaps Customer Collateral.”<sup>55</sup>

7. 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?

### **CFTC Response:**

Prior to opening a transactional account for a client, an Investment Firm is required to provide each client (except for certain “institutional customers” as defined in Regulation 1.3(g)<sup>56</sup>) specific disclosures pertaining to (i) the protection of Client Assets in the Futures Omnibus Account (pursuant to Regulation 1.55),<sup>57</sup> (ii) the protection of Client Assets in the Foreign Futures Omnibus Account (pursuant to Regulation 30.6),<sup>58</sup> and (iii) the governing provisions relating to the use of Cleared Swaps Customer Collateral (pursuant to Regulation 22.16).<sup>59</sup> Such disclosures emphasize that:

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<sup>55</sup> 17 C.F.R. §22.2(d)(2).

<sup>56</sup> 17 C.F.R. §1.3(g).

<sup>57</sup> 17 C.F.R. §1.55.

<sup>58</sup> 17 C.F.R. §30.6.

<sup>59</sup> 17 C.F.R. §22.16.

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- 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.
8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

### **CFTC Response:**

The Act and the regulations promulgated thereunder do not permit clients to choose a lesser level of protection for Client Assets than the level that (i) Section 4d(a) and (b) of the Act and Regulations 1.20 to 1.30<sup>60</sup> afford to Client Assets in the Futures Omnibus Account, (ii) Regulation 30.7 affords to Client Assets in the Foreign Futures Omnibus Account, and (iii) Section 4d(f) of the Act and Regulations 22.1 *et. seq.* afford to Cleared Swaps Customer Collateral.

9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:
- a. Does the Investment Firm report where client assets are held?
  - b. Does the Investment Firm or depository report the protections applicable to such client assets?

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<sup>60</sup>

17 C.F.R. §§1.20-1.30.

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- c. Does the Investment Firm or depository report the amount of assets that are held?

In each case, are such reports provided on request or periodically? If periodically, with what frequency?

### **CFTC Response to a-c:**

FCMs are required to maintain evidence of the existence and amount of Client Assets held, including the Client Assets at each depository. They are also required to maintain in their records "confirmation" letters from each depository acknowledging that the assets (i) belong to clients of the FCM, (ii) are being held to support Futures, Foreign Futures or Cleared Swaps, and (iii) are being held in accordance with Section 4d of the Act or in the case of Foreign Futures, Rule 30.7. Such records are reviewed during (approximate) annual examinations conducted by the DSRO.

Moreover, an FCM must prepare a segregation statement daily showing Client Assets and obligations. The statement must be completed by noon for balances at the close of the previous business day. Such statements are included in a report that is filed monthly with the CFTC which provides an FCM's net capital position, statement of segregated assets, and other financial information, as well as in an FCM's annual audited financial statements. An FCM must immediately report, pursuant to Regulation 1.12(h), the existence of a deficiency in any omnibus account to the CFTC. Currently, the CFTC is considering additional and more real-time reporting regarding the holding of Client Assets.

10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify
- Where Client Assets are held?
  - The amount of Client Assets held at a depository?
  - The safeguards applicable to Client Assets held at a depository?

### **CFTC Response to a-c:**

As discussed in Answer 9, DSROs conduct annual compliance examinations of FCMs, which include the

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verification of Client Assets. Such verification includes a review of the “confirmation” letters maintained by the FCM.

Recently, NFA approved new rules, which would require futures brokerages to provide regulators with view-only Internet access to the segregated account information of customers. The newly approved requirements have been sent to the CFTC for approval.

11. Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify

- a. The amount and/or value of such Client Assets?

**CFTC Response:**

A foreign regulator could obtain confirmation directly from the Investment Firm in the U.S. Moreover, where there is an applicable Memorandum of Understanding (“MOU”), the foreign regulator could obtain information through that MOU.

- b. The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?

**CFTC Response:**

These Client Assets are entitled to the same protections as the Client Assets of U.S. customers as set forth in Section 766(h) of the Bankruptcy Code.

12. 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?

**CFTC Response:**

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:

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- 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 Client Assets; and
- an Investment Firm must provide the CFTC with immediate notice, if such Investment Firm determines that any commodity interest 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.

13. 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?

### **CFTC Response:**

If the CFTC ascertains, whether from the notifications described in Answer 12 or otherwise, 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.<sup>61</sup> The Investment Firm itself or its DSRO would actually arrange the transfer of Client Assets, and the CFTC would facilitate such transfer as necessary.

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<sup>61</sup> 17 C.F.R. §1.17(a)(4).

## **Post-Insolvency**

14. 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?

### **CFTC Response:**

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 three 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.
- Similarly, if an Investment Firm is also a broker-dealer, and that broker-dealer is approaching financial difficulty, the Securities Investors Protection Corporation (“SIPC”) may seek a protective decree from a federal court pursuant to Section 5 of the Securities Investors Protection Act, 15 U.S.C. §78eee.
- Finally, 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.<sup>62</sup> An Investment Firm is not eligible for reorganization under Chapter 11 of the Bankruptcy Code.

15. 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?

### **CFTC Response:**

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<sup>62</sup> 11 U.S.C. §109(d).

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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. If the Investment Firm is also a broker-dealer, the Administrative Officer would be designated by SIPC. In practice, the CFTC coordinates with the relevant United States Trustee or SIPC 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.

16. 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?

### **CFTC Response:**

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.<sup>63</sup>

Subchapter IV of Chapter 7 of the Bankruptcy Code<sup>64</sup> 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

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<sup>63</sup> 11 U.S.C. §704.

<sup>64</sup> 11 U.S.C. §§761-767.

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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?

### **CFTC Response:**

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.

17. 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?

### **CFTC Response:**

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?

### **CFTC Response:**

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,

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the Administrative Officer is responsible for such disbursements.

18. What are the requirements, if any, governing the segregation and treatment of Client Assets *during* the insolvency of an Investment Firm?

**CFTC Response:**

During the insolvency of an Investment Firm, a Trustee segregates Client Assets as part of the process of returning assets on a pro rata basis, proportional to allowed claims, to clients of the Investment Firm through transfer or distribution.

19. 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?

**CFTC Response:**

Yes, if an Investment Firm becomes subject to bankruptcy proceedings before it transfers Client Assets as described in Answer 13, the Administrative Officer must immediately use best efforts, pursuant to Regulation 190.02(e),<sup>65</sup> to transfer eligible Client Assets, as determined in accordance with Regulation 190.06(e) and (f).<sup>66</sup>

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

**CFTC Response:**

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 calendar 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,

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<sup>65</sup> See 17 C.F.R. §190.02(e).

<sup>66</sup> See 17 C.F.R. §§190.06(e)-(f).

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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?

### **CFTC Response:**

The key factor is the presence or absence of a shortfall in Client Assets. If such a shortfall exists, transfer becomes more challenging, though not necessarily impossible. For example, in the MF Global Bankruptcy, transfers of futures accounts were accomplished with only approximately 60 percent of Client Assets available for transfer. As Answer 25 discusses further below, the presence or absence of a shortfall is computed separately for each "account class."

20. 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?

### **CFTC Response:**

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),<sup>67</sup> the Administrative Officer cannot avoid the following pre-petition actions:
  - a transfer of Client Assets by the Investment Firm as described in Answer 13, 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

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<sup>67</sup> See 11 U.S.C. §764(b), 17 C.F.R. §190.06(g)(1), 17 C.F.R. §190.06(g)(3).

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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),<sup>68</sup> the Administrative Officer cannot avoid the following post-petition actions:
  - a transfer of Client Assets by the Administrative Officer as described in Answer 19, 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 seventh calendar day after the filing of the petition for bankruptcy with respect to the Investment Firm.

21. 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).

**CFTC Response:**

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.

22. 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.

**CFTC Response:**

No. The Act and the regulations promulgated thereunder do not permit clients to choose a lesser level of protection for Client Assets than the level that (i) Section 4d(a) and (b) of the Act and Regulations 1.20 to 1.30 afford to Client

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<sup>68</sup> See 11 U.S.C. §764(b), 17 C.F.R. §190.06(g)(2).

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Assets in the Futures Omnibus Account, (ii) Regulation 30.7 affords to Client Assets in the Foreign Futures Omnibus Account, and (iii) Section 4d(f) of the Act and Regulations 22.1 *et. seq.* afford to Cleared Swaps Customer Collateral.

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

### **CFTC Response:**

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 or Cleared Swaps.* 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 Futures collateral or Cleared Swaps Customer Collateral 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 collateral or Cleared Swaps Customer Collateral, respectively, in the jurisdiction with “sovereign loss” would have such portions exposed to such loss; and
  - if “sovereign loss” exceeds those portions of the Futures collateral or Cleared Swaps Customer Collateral referenced immediately above, then those clients that permitted, explicitly or implicitly, the Investment Firm to hold their portions of the Futures collateral or Cleared Swaps Customer Collateral, respectively, 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 25 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.

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

**CFTC Response:**

All clients would share *pro rata* in the event of losses resulting from such failure.

25. 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?

**CFTC Response:**

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) claims pertaining to Foreign Futures in another "account class" (*i.e.*, the Foreign Futures account class), and claims pertaining to Cleared Swaps in a third 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 23), and to the priority accorded to clients that are not affiliated with the Investment Firm (as further described in Answer 26). As a practical matter, if the Investment Firm becomes subject to bankruptcy proceedings due to a shortfall in one "account class," other clients with claims in that "account class" are exposed to 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.<sup>69</sup>

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<sup>69</sup> See 11 U.S.C. §766(j)(2).

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

26. 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?

### **CFTC Response:**

Client Assets in FCM bankruptcies can be, and have been, distributed in advance of other claims.<sup>70</sup>

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. Where the transfer of Client Assets and associated positions 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. However, such claims are subject to the priority accorded to clients that are not affiliated with the Investment Firm. Pursuant to Section 766(h) of the Bankruptcy Code and Regulation 190.08(b),<sup>71</sup> 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](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. §§ 761-767, available at <http://www.gpo.gov/fdsys/pkg/USCODE-2011-title11/pdf/USCODE-2011-title11.pdf>

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<sup>70</sup> See, e.g., Refco, LLC, Lehman Brothers, Inc., MF Global.

<sup>71</sup> See 11 U.S.C. §766(h); 17 C.F.R. §190.08(b).

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**Regulations (all references are found in 17 C.F.R.), and are available at: <http://ecfr.gpoaccess.gov>**

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 Regulations 22.1 to 22.16 (Cleared Swaps)

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  
2013 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 both in advance of and 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**" means Client Assets (or an analogous term) as defined in the responding jurisdiction, including, to the extent appropriate, 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.

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

(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 and Exchange Act of 1934 (Exchange Act), the SEC adopted Rule 15c3-3 to protect customer securities and cash held at a broker dealer.<sup>72</sup> As explained in more detail below, the Rule requires that customer securities be held free of lien in a good control location, customer cash be accounted for once a week, and forbids the use of “free credit balances” to finance a broker-dealer’s inventory or expenses. The Rule further requires the “locking away” of customer net credits held at a broker-dealer in a Reserve Account so that if a broker-dealer is liquidated, those customer securities and funds would be available to be returned to customers. Rule 15c3-3 requires broker-dealers to account for customer securities and cash 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. A trustee in a court-supervised proceeding under the Securities Investor Protection Act (“SIPA”) liquidates broker-dealers that cannot self-liquidate. 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. 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.<sup>73</sup>*

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<sup>72</sup> For purposes of this survey, the term “broker dealer” generally refers only to “clearing” broker-dealers that hold customer assets. Non-clearing firms do not hold customer assets.

<sup>73</sup> The Dodd-Frank Act amended certain sections of the Security Investor Protection Act of 1970 (“SIPA”), to, among other things, increase the amount of SIPC protection available for claims for cash from \$100,000 to \$250,000. See <http://www.sipc.org/Portals/0/PDF/Dodd%20Frank%20Amend%20%207-29-10.pdf>.

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*A broker-dealer is also subject to important reporting requirements (to the SEC) that are relevant to the protection of customer assets, as described in response to question 9, below.*

*Finally, in 2012, the SEC approved a rule of the Financial Industry Regulatory Authority (FINRA) to require each member firm to file certain additional financial or operational schedules or reports to supplement existing filing requirements.<sup>74</sup> While this FINRA Rule would not directly improve customer protection, FINRA has expressed its belief that the new rule will improve income and expense data, which would in turn improve the oversight of broker-dealers.*

*In addition to the above, the following rulemaking proposals are pending, which will impact the characteristics of the U.S. approach to protecting client assets:*

- *In June 2011, the SEC proposed amendments to Rule 17a-5,<sup>75</sup> which, among other things: (1) strengthen oversight of broker-dealer custody practices, including proposed amendments that would require a broker-dealer to file a report on a quarterly basis that contains information about whether and, if so how, it maintains custody of its customers' securities and cash; and (2) clarify and strengthen the rules governing audits of broker-dealers, including an auditor's examination of broker-dealer controls relating to the custody of customer assets.*
- *SEC's rulemaking to implement specified provisions of the Dodd-Frank Act is ongoing, including:*
  - *Proposals regarding the segregation of security-based swaps.*
  - *Rules applicable to systemically important broker-dealers. Specifically, under Title II of the Dodd-Frank Act, the FDIC may be appointed as receiver over a broker or dealer for which a determination has been made, under Section 203 of the Dodd-Frank Act, that the broker-dealer is systemically important. Section 205 of the Dodd-Frank Act, 12 U.S.C. S. 5385, prescribes, among other things, the manner in which customer property is to be treated in the resolution of a covered broker or dealer. Pursuant to Section 205(h) of the Dodd-Frank Act, 12 U.S.C. S. 5385(h), the FDIC and the SEC, in consultation with SIPC, are jointly to issue regulations implementing Section 205.*
    - a. **How does your jurisdiction define the term "client assets?" If the jurisdiction uses an analogous term, please provide that term and its definition.**

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<sup>74</sup>See SEC approval of FINRA Rule 4524, available at: <http://www.sec.gov/rules/sro/finra/2012/34-66364.pdf> (Feb. 9, 2012). See also description at: [http://www.granthornton.com/staticfiles/GTCom/Financial%20services/Financial%20Bulletin/Financial\\_Bulletin\\_Jun12\\_2012.pdf](http://www.granthornton.com/staticfiles/GTCom/Financial%20services/Financial%20Bulletin/Financial_Bulletin_Jun12_2012.pdf).

<sup>75</sup> Available at: <http://www.sec.gov/rules/proposed/2011/34-64676.pdf>. The report would establish a custody profile for the broker-dealer that examiners could use as a starting point to focus their custody examinations. SEC staff has evaluated comments received in response to this proposal and is working to finalize a recommendation.

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*Client Assets” would generally refer to customer funds or securities<sup>76</sup> held on behalf of customers by a broker-dealer. The responses below generally refer to the customer protection rules as they relate to customers of broker-dealers registered with the SEC, unless otherwise noted (such as references to implementing provisions of the Dodd-Frank Act with respect to security-based swaps and security-based swap dealers).*

- b. What is the nature of a client’s ownership rights with respect to its client assets placed with the investment firm?

*Exchange Act Rule 15c3-3 (“customer protection rule”) general governs the nature of a client’s ownership rights. For example, paragraph (a)(8) of Rule 15c3-3 generally defines the term “free credit balance” to mean liabilities of a broker-dealer to customers that are subject to immediate cash payment to customers on demand, whether resulting from sales of securities, dividends, interest, deposits or otherwise, excluding, however, funds in commodity accounts which are segregated in accordance with the Commodity Exchange Act or in a similar manner. In addition, paragraph (l) of Rule 15c3-3 states, with regard to the delivery of securities, that nothing stated in Rule 15c3-3 shall be construed as affecting the absolute right of a customer of a broker-dealer to receive in the course of normal business operations following demand made on the broker-dealer, the physical delivery of certificates for:*

*(1) Fully-paid securities to which he is entitled, and*

*(2) Margin securities upon full payment by such customer to the broker-dealer of his indebtedness to the broker-dealer; and, subject to the right of the broker-dealer under §220.7(b) of Regulation T [12 CFR 220.7(b)] to retain collateral for his own protection beyond the requirements of Regulation T, excess margin securities not reasonably required to collateralize such customer's indebtedness to the broker-dealer.*

- c. How does your jurisdiction define the term “client”? If the jurisdiction uses an analogous term, please provide that term and its definition.

*In accordance with Exchange Act Rule 15c3-3(a)(1), the term “client” refers to a “customer,” which is generally any person from whom or on whose behalf a broker-dealer has received or acquired or holds funds or securities for the account of that person. The “customer” also includes any other person to the extent that person has a claim for property or funds, which by contract agreement or understanding, or by operation of law, is part of the capital of the broker-dealer or is subordinated to the claims of creditors of the broker-dealer.*

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<sup>76</sup> The term “security” is defined term under Exchange Act section 3(a)(10).

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- d. Please describe any notable exclusions from the terms “client” or “client assets.”

*The term “customer” generally does not include a broker-dealer, a municipal securities dealer, or a government securities broker or government securities dealer.*

*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 of 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*

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*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 by both review of periodic and annual reports (filed by the broker-dealer), along with on-site inspections.<sup>77</sup> A broker-dealer's designated examining authority<sup>78</sup> monitors regularly compliance with capital levels. For example FINRA, through initial examinations, ensures 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.*

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?

*Broker-dealers are subject to strict financial responsibility requirements under the Exchange Act that are designed to protect and account for customer assets. These requirements include:*

- *The Customer Protection Rule (Exchange Act Rule 15c3-3).<sup>79</sup> Under this rule, broker-dealers are required to segregate customer securities and cash from the firm's proprietary business activities and in particular to obtain and maintain possession or control of customer fully paid and excess margin securities, so that if a broker-dealer*

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<sup>77</sup> See 17 CFR 240.17a-5(a).

<sup>78</sup> 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.

<sup>79</sup> 17 CFR 240.15c3-3.

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*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. This means the broker-dealer cannot lend or hypothecate<sup>80</sup> these securities and must hold them itself or, as is more common, in a satisfactory control location. Exchange Act Rule 15c3-3 also requires a broker-dealer to maintain a reserve account that contains (at least) the net dollar amount of cash the broker-dealer owes to its customers (in accordance with a prescribed formula). Customer securities and funds are not available to satisfy claims of general creditors of the broker-dealer.*

- The SEC’s Rules 8c-1 and 15c2-1,<sup>81</sup> commonly called the “Hypothecation Rules,” prohibit a broker-dealer from commingling customer securities with its own proprietary securities. They further require broker-dealers to obtain a customer’s written consent in order to hypothecate securities under circumstances that would permit the commingling of customers’ securities and to give written notice to a pledgee that, among other things, a security pledged is carried for the account of a customer.*
- The Quarterly Security Count Rule (Exchange Act Rule 17a-13). This SEC rule requires a broker-dealer on a quarterly basis to count, examine, and verify the securities it actually holds for customers and for itself — and compare that with the amounts of such securities it should be holding as indicated by its records. This process includes verifying the actual amount of securities located at sub-custodians such as the Depository Trust and Clearing Corporation (DTCC). If there are differences between the actual amounts held and the amounts that should be held, the broker-dealer must take capital charges until the differences are resolved.*

*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. These requirements are also designed to restore customer funds and securities quickly and to insulate the securities markets from disruption following the failure of broker-dealers.*

*Finally, the SEC staff is in the process of developing proposed segregation requirements for cleared and non-cleared security-based swaps pursuant to Section 763 of the Dodd-Frank Act (Section 3E of the Exchange Act) for security-based swap dealers and major security-based swap participants, to recommend for proposal. These requirements would affect broker-dealers only to the extent that they were required to also register with the SEC as security-based swap dealers*

*In response to question 3(a)(i) & (ii):*

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<sup>80</sup> But see Exchange Act Rules 8c-1 and 15c2-1, as described in the subsequent bullet.

<sup>81</sup> 17 CFR 240.8c-1 and 15c2-1.

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

- *A broker-dealer generally holds and segregates client assets in an omnibus basis. Most securities held at a central securities depository, such as DTCC, or a custodian bank, are held in an omnibus basis in the name of the broker-dealer. The bank must agree, however, that the account is held for the benefit of the broker-dealer's customers and not place any lien on the account. 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 under Rule 17a-3.*
- *In addition, all securities accounts are protected under the SEC's customer protection rules, margin rules, and under SIPA. For example, anytime a customer opens a margin account, the margin must be done individually. In addition, 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 other customers. In addition, the provisions of SIPA are intended to protect investors from the loss of securities or cash left with a failed broker-dealer.*

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? Would one client's net debit balances reduce the firm's obligations with respect to the total required funds on deposit for net credit balances of other clients?

ii Timing issues:

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

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- 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.<sup>82</sup> 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.<sup>83</sup>*

*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 Exchange Act Rule 15c3-3.<sup>84</sup> 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), 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. Broker-dealers calculate the Reserve Computation on an aggregate basis, so one client’s debit balance would reduce a broker-dealer’s obligations with respect to the total required funds on deposit with respect to net credit balances of other clients. Although the Reserve Computation is done on an aggregate basis, the Investment Firm must make and keep current ledger accounts itemizing separately each cash and margin account of every customer of the broker-dealer, as well as a stock record that reflects the positions of each client.<sup>85</sup>*

*Generally, a broker-dealer with a deposit requirement of \$1 million or more must compute its reserve requirement on a weekly basis. The weekly computation determines the required*

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<sup>82</sup> 17 C.F.R. 240.17a-3(a)(3).

<sup>83</sup> 17 C.F.R. 240.17a-3(a)(2).

<sup>84</sup> 17 C.F.R. 240.15c3-3a.

<sup>85</sup> 17 C.F.R. 240.17a-3(a).

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*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 with deposits less than \$1 million make their computations on a monthly basis if certain requirements are met. Broker-dealers are encouraged to maintain a buffer in the Reserve account and most do so.*

- 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 make margin loans to other customers. 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 well in excess of the amount of the customer's obligation to the broker-dealer. This means that a customer default on an obligation to the broker-dealer financed by the use of customer cash should not cause the broker-dealer 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 use, the Client Assets? If so, please describe.
- i. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets with such client's consent?
- ii. How is a client's consent to permit an Investment Firm to use or re-hypothecate Client Assets demonstrated? In other words, what evidence of a client's consent must an Investment Firm have in order to use or re-hypothecate Client Assets?
- iii. How are the ownership rights of a client over its client assets changed or affected when the Investment Firm uses or re-hypothecates such assets without such client's consent? Where such use or re-hypothecation is a violation of the relevant statute, rule or regulation, what is the impact on the client's right to its client assets (if any) and what remedies (if any) are available to the client? What is the basis for that conclusion (*i.e.*, established by statute or

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regulation, established by prior judicial decision, based on interpretation of the regulator)?

*Under Exchange Act Rule 15c3-3, broker-dealers are required to promptly obtain and maintain physical possession and control of all “fully paid” securities and “excess margin securities” carried by the broker-dealer for customers. Fully paid securities are securities held for customers in cash accounts as defined in the Federal Reserve’s Regulation T. The term also applies to margin accounts in which the customer is not running a debit balance. Margin securities are those securities carried for a customer in a margin account, with market value equal to (or less than) 140% of the account’s debit balance. Such securities are left available to the broker-dealer for purposes of financing the debit balance and may be used as collateral for bank loans or stock loans or repurchase agreements.<sup>86</sup> Excess margin securities are those securities that have a market value in excess of 140% of the aggregate debit balance in that customer’s account. Excess margin securities and fully paid securities may not be used by the broker-dealer and must be segregated in a lien-free environment.*

*In addition, under Exchange Act Rule 15c3-3, a credit balance in a customer’s account is considered a “free credit balance.” Generally, free credit balances are defined under Rule 15c3-3 as liabilities of a broker-dealer to customers, which are subject to immediate cash payment to customers on demand.<sup>87</sup> Rule 15c3-3 permits broker-dealers to use customer free credit balances only to finance customer-related debits (e.g., customers’ margin loans). Customers’ free credit balances not used to finance customer-related debits must be deposited in the broker-dealer’s customer reserve account to the extent the broker-dealer owes its customers more than the customers owe the firm, as described in Question 3 above.*

*Finally, paragraph (1) of Rule 15c3-3 states, with regard to the delivery of securities, that nothing stated in Rule 15c3-3 shall be construed as affecting the absolute right of a customer of a broker-dealer to receive in the course of normal business operations following demand made on the broker-dealer, the physical delivery of certificates for:*

- (1) Fully-paid securities to which he is entitled, and*
- (2) Margin securities upon full payment by such customer to the broker-dealer of his indebtedness to the broker-dealer; and, subject to the right of the broker-dealer under §220.7(b) of Regulation T [12 CFR 220.7(b)] to retain collateral for his own protection beyond the requirements of Regulation T, excess margin securities not reasonably required to collateralize such customer's indebtedness to the broker-dealer.*

*If a broker-dealer is in violation of Rule 15c3-3 or the hypothecation rules, it would not impact the customer’s right to demand the customer’s cash or securities from the broker-dealer.*

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<sup>86</sup>A Broker-dealer may decide which margin securities in a client’s margin account it wishes to pledge, loan, or sell under a repurchase agreement to finance customer debit balances.

<sup>87</sup> See definitions in paragraph (a) of Rule 15c3-3.

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*Exchange Act Rules 8c-1 and 15c2-1, commonly called the “hypothecation rules,” prohibit a broker-dealer from comingling customer securities with its own proprietary securities. Under Rules 8c-1 and 15c2-1 of the Exchange Act, broker-dealers are required to obtain a customer’s written consent in order to hypothecate securities under circumstances that would permit the commingling of customers’ securities and to give written notice to a pledgee that, among other things, a security pledged is carried for the account of a customer.*

*Under Exchange Act Rule 17a-3,<sup>88</sup> broker-dealers are required to make and keep current records identifying accounts for which the broker-dealer has extended credit. In the case of a margin account, broker-dealers are required to obtain and preserve customer signatures. Written consent, for the purposes of Rules 8c-1, 15c2-1 and 17a-3, is generally obtained by broker-dealers when a customer executes a margin agreement. Broker-dealers are not required to obtain additional client consents after receiving a signed margin agreement containing authorization to hypothecate securities under certain circumstances.<sup>89</sup>*

- 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 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. The broker-dealer must notify the clearinghouse regarding what securities relate to customer positions as opposed to firm positions.*

4. Are Investment Firms in your jurisdiction permitted to transfer to, or hold Client Assets belonging to clients in your jurisdiction 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?

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<sup>88</sup> 17 CFR 240.17a-3.

<sup>89</sup> Certain disclosures (required by Exchange Act Rule 10b-16) are also normally included within the margin agreement, which is designed to ensure that the customer, before the account is opened, understands the terms and conditions under which credit charges will be made.

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- 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 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.<sup>90</sup> The foreign entity must agree to hold the securities for the benefit of the broker-dealer’s customers and free of all charges, liens, or claims. Cash cannot, however, be held at a foreign location.*

5. Are Investment Firms in your jurisdiction permitted, under the Regime in your jurisdiction, to hold Client Assets (belonging to foreign clients) deposited by Investment Firms regulated/supervised by other jurisdictions ("Foreign Investment Firms") in an Omnibus Account (that includes Client Assets from domestic clients)? If so,
  - a. What protections are applicable to the Foreign Investment Firm’s Client Assets?
  - b. What steps, if any, must the Foreign Investment Firm take to secure such protections for its Client Assets?
  - c. What steps may the Foreign Investment Firm take that will reduce such protections (i.e. waiver of rights)? What is the impact if the Foreign Investment Firm takes such steps?

*See answer to 3 and 4, above, and 6 below. Exchange Act Rule 15c3-3(a)(1), defines the term “customer,” to generally include any person from whom or on whose behalf a broker-dealer has received or acquired or holds funds or securities for the account of that person. The rule generally does not distinguish between foreign and domestic customers.*

*Non-proprietary accounts of a foreign broker-dealer or a foreign bank would generally be considered “customers” under Rule 15c3-3.<sup>91</sup> The proprietary account of a foreign broker-dealer would be treated as a non-customer under Rule 15c3-3.*

*A Foreign Investment Firm depositing Client Assets belonging to its foreign clients in an Omnibus Account at U.S. broker-dealer should ensure that it maintains books and records for its individual foreign clients to ensure these clients receive maximum protection under SIPA in the event of a liquidation of the U.S. broker-dealer.*

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<sup>90</sup> See 17 CFR 240.15c3-3(c)(4) and (c)(7) and Exchange Act Release No. 10428 (Oct. 10, 1973).

<sup>91</sup> See Interpretation 15c3-3(a)(1)/01 available at <http://www.finra.org/web/groups/industry/@ip/@reg/@rules/documents/interpretationsfor/p037772.pdf>

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1. *The requirements of Rule 15c3-3 are mandatory for the broker-dealer. Consequently, customers, including foreign customers, generally may not “opt out” of the protection requirements.*
6. 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.*

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- *Securities held at any location, which the SEC has designated as adequate for the protection of customer securities.*

7. 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 quarterly account statements showing their security positions, as required by applicable SRO rules of which the broker-dealer is member. The account statements must include a description of any securities positions, money balances and account activity since the firm issued the prior account statement. In addition, each account statement is required to include a statement that advises the customer to report promptly any inaccuracy or discrepancy in that person's account to his or her brokerage firm. Such statement also must advise the customer that any oral communications should be re-confirmed in writing to further protect the customer's rights, including rights under SIPA.<sup>92</sup>*

*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.<sup>93</sup>*

*In addition, SRO rules also require that broker-dealers provide non-institutional customers with a margin disclosure statement describing the risks of trading in a margin account, as well as advise new customers when they open a new account about how to obtain information about SIPC. Broker-dealers whose customers trade in security futures are also required to provide a customer with disclosure regarding the protections afforded by a securities account or a futures account where the security futures may be held.<sup>94</sup>*

*In addition, customers are allowed to enter into certain transactions that are not protected under SIPA. Prior to entering into such a transaction, customers must be given notice that the transaction is not protected under SIPA.*

8. Under what conditions, if any, may clients choose to waive or otherwise reduce or vary any of the Client Asset protection requirements applicable in your jurisdiction? If so, how is this done and, based on your knowledge, is this routine in your jurisdiction?

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<sup>92</sup> For example, see FINRA Rule 2340. FINRA rules are available at [www.finra.org](http://www.finra.org).

<sup>93</sup> 17 CFR 240.10b-10.

<sup>94</sup> 17 CFR 240.15c3-3(o).

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*The segregation requirements discussed above are mandatory for the broker-dealer. Consequently, customers generally may not “opt out” of the protection requirements. Further, customers are not treated differently based on permissions they have granted pre-bankruptcy. However, as stated above, a customer may enter into a transaction that is not protected under SIPA, if given appropriate notice.*

### **Security-based swap dealers and major security-based swap participants – non-cleared security-based swaps**

*The Dodd-Frank Act establishes segregation requirements for cleared and non-cleared security-based swaps and provides the SEC with authority to adopt rules with respect to segregation for security-based swap dealers and major security-based swap participants. In particular, section 763 of the Dodd-Frank Act amends the Exchange Act to add new section 3E.<sup>95</sup> Section 3E sets forth requirements applicable to security-based swap dealers and major security-based swap participants with respect to the segregation of cleared and non-cleared security-based swaps collateral and provides the SEC with rulemaking authority in this area.<sup>96</sup>*

*In particular, Exchange Act Section 3E(f)(1)(B) provides that, if requested by the counterparty, a security-based swap dealer or major security-based swap participant shall segregate the funds or other property for the benefit of the counterparty and, in accordance with such rules and regulations as the SEC may promulgate, maintain the funds or other property in a segregated account separate from the assets and other interests of the security-based swap dealer or major security-based swap participant.<sup>97</sup> Section 3E(f)(3) provides that the segregated account shall be carried by an independent third-party custodian and be designated as a segregated account for and on behalf of the counterparty (“individual segregation”).<sup>98</sup> In the case of non-cleared security-based swaps, therefore, each counterparty has the right to require its collateral to be isolated in an account at an independent custodian that identifies the counterparty by name, rather than commingled with collateral of other counterparties. The objective of individual segregation is for the funds and other property of the counterparty to be carried in a manner that will keep these assets separate from the bankruptcy estate of the security-based swap dealer or major security-based swap participant if it fails financially and becomes subject to a liquidation proceeding.*

9. Are Investment Firms in your jurisdiction required to report to regulators or Self-Regulatory Organizations concerning Client Assets? Specifically:
  - a. Does the Investment Firm report where client assets are held?
  - b. Does the Investment Firm or depository report the protections applicable to such client assets?

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<sup>95</sup> See Pub. L. 111-203 § 763 and 15 U.S.C. 78c-5.

<sup>96</sup> See 15 U.S.C. 78c-5.

<sup>97</sup> See 15 U.S.C. 78c-5(f)(1)(B).

<sup>98</sup> See 15 U.S.C. 78c-5(f)(3).

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c. Does the Investment Firm or depository report the amount of assets that are held?

In each case, are such reports provided on request or periodically? If periodically, with what frequency?

*A broker-dealer is also subject to important reporting requirements (to the SEC) that are relevant to the protection of customer assets. In particular:*

- To assist the SEC in monitoring broker-dealer compliance with the SEC's financial responsibility rules, the SEC requires broker-dealers to file monthly, quarterly, and annual financial reports (commonly referred to as "FOCUS reports"). The FOCUS report contains, among other things, a statement of financial condition, a statement of income, a statement of changes in ownership equity, a net capital computation and a reserve computation under Exchange act Rule 15c3-3. Broker-dealers that carry customer accounts generally file FOCUS reports monthly.*
- A broker-dealer also must file an annual audit with the SEC and its designated examining authority under Exchange Act 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.*
- Pursuant to Exchange Act Rule 15c3-3, a broker-dealer must immediately notify the SEC and its designated examining authority if the broker-dealer fails to make a required deposit in its reserve bank account (see discussion of reserve accounts in response to question 3(a)). The broker-dealer must promptly thereafter confirm such notification to the SEC in writing.<sup>99</sup> In addition, 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 certain specified levels.<sup>100</sup> The equity capital of a broker-dealer may not be withdrawn if it falls below the early warning levels.*

10. What steps do regulators or Self-Regulatory Organizations take, whether through examinations, inspections, audits, or otherwise, to verify

a. Where Client Assets are held?

b. The amount of Client Assets held at a depository?

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<sup>99</sup> 17 CFR 240.15c3-3(i).

<sup>100</sup> 17 CFR 240.17a-11.

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### c. The safeguards applicable to Client Assets held at a depository?

*Exchange Act Section 17(b) currently subjects broker-dealers to routine inspections and examinations by staff of the SEC and the relevant SRO. In addition, Section 17 of the Exchange Act, together with Exchange Act Rule 17a-5, require a broker-dealer to, among other things, file an annual report with the SEC and the broker-dealer's designated examining authority. The report must contain audited financial statements and certain supporting schedules and supplemental reports, as applicable. An independent public accountant registered with the Public Company Accounting Oversight Board (PCAOB) must conduct the audit.*

*In June 2011,<sup>101</sup> the SEC proposed amendments would enhance these broker-dealer examinations in two ways. First, the proposed amendments would require a broker-dealer that maintains custody of customer securities and cash or clears transactions to allow Commission and SRO examiners to:*

- Access the work papers of the registered public accounting firm that audits the broker-dealer; and*
- Discuss any findings with the personnel of the registered public accounting firm.*

*The examiners could use this information to better focus their examinations.*

*Second, the proposed amendments would require a broker-dealer to file a report on a quarterly basis that contains information about whether and, if so how, it maintains custody of its customers' securities and cash. The report would establish a custody profile for the broker-dealer that examiners could use as a starting point to focus their custody examinations.*

*A number of FINRA rules are also relevant to this question. For example, under FINRA Rule 4110, FINRA may impose greater capital requirements on clearing or carrying broker-dealers for the protection of investors or when in the public interest. In addition, FINRA Rule 4311 sets forth a number of requirements for the establishment of a relationship between an introducing firm and carrying firm, including the allocation of responsibilities related to such things as receipt and delivery of funds and securities, maintenance of books and records and monitoring of accounts. Furthermore, FINRA Rule 4160 (verification of assets) states that a FINRA member firm, when notified by FINRA, may not continue to custody or retain record ownership of assets, whether such assets are proprietary or customer assets, at a financial institution that is not a member of FINRA, which, upon FINRA staff's request, fails promptly to provide FINRA with written verification of assets maintained by the member at such financial institution.*

*Rule 4160 does not apply to:*

- (1) Proprietary assets of members that are treated as non-allowable assets under SEC Rule 15c3-1; or*
- (2) Instances where FINRA determines that there is no independent custody or record ownership of the assets.*

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<sup>101</sup> See <http://www.sec.gov/rules/proposed/2011/34-64676.pdf>.

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*Finally, FINRA has made arrangements with the DTCC that provides FINRA with routine and direct access to position reports and similar information that DTCC (and its subsidiaries and affiliates) provides to its participants.*

11. Where an Investment Firm based in a foreign jurisdiction (a “Foreign Investment Firm”) deposits Client Assets (*i.e.*, of the clients of the Foreign Investment Firm) in an Omnibus Account at an Investment Firm or depository in your jurisdiction, what steps may a foreign regulator with jurisdiction over that Foreign Investment Firm take to verify
  - a. The amount and/or value of such Client Assets?

*A foreign regulator could obtain confirmation directly from the U.S. investment firm. Moreover, where there is an applicable MOU, the foreign regulator could obtain information through the MOU.*

- b. The protections actually applicable to such Client Assets, in light of the steps taken by the Foreign Investment Firm to secure or to reduce such protections?

*Such client assets are generally entitled to the same protections as the client assets of U.S. customers as set forth under SIPA.*

12. 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 noted above in response to question 9, 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 certain specified levels.<sup>102</sup> The equity capital of a broker-dealer may not be withdrawn if it falls below the early warning levels.*

13. 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 does not have sufficient net capital.<sup>103</sup> Further, a broker-dealer is restricted from withdrawing capital if certain parameters have been broken.<sup>104</sup> The Self Regulatory Organizations (“SROs”), *i.e.* FINRA, also have rules that*

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<sup>102</sup> 17 CFR 240.17a-11.

<sup>103</sup> 15 U.S.C. 78o(c)(3) and 17 CFR 240.15c3-1.

<sup>104</sup> 17 CFR 240.15c3-1(e)(2).

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*restrict the activities of a broker-dealer in financial difficulty.<sup>105</sup> The SROs have rules that allow the SRO to direct the intermediary to take specific corrective or prophylactic actions, such as reducing their business.<sup>106</sup> The SEC may also petition the court to place a freeze on the broker-dealer's assets. 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.<sup>107</sup> 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 liquidation under SIPA.*

### **Post-Insolvency**

14. 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. 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.<sup>108</sup>*

*Generally, when a broker-dealer goes out of business, it self-liquidates by transferring customer accounts to a new firm. The goal is to have these accounts transferred to a solvent broker-dealer in an orderly self-liquidation, i.e., prior to any liquidation under SIPA.*

*When a self-liquidation is not possible, a court supervised proceeding is conducted under the provisions of SIPA. Specifically, SIPC may, upon notice to a failing member, file an application for a protective decree with any court of competent jurisdiction<sup>109</sup> if SIPC determines that the member has failed or is in danger of failing to meet its obligations to customers, and is (1) insolvent or is unable to meet its obligations as they mature; or (2) the subject of a proceeding in which a receiver, trustee, or liquidator for such debtor has been appointed; or (3) not in*

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<sup>105</sup> See e.g., FINRA Rule 4120.

<sup>106</sup> Id.

<sup>107</sup> 15 U.S.C. 78eee(a)(1).

<sup>108</sup> 15 U.S.C. 78eee(a)(1).

<sup>109</sup> 15 U.S.C. 78eee(a)(3).

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*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 (4) unable to make such computation as may be necessary to establish compliance with such financial responsibility or hypothecation rules.*

*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.<sup>110</sup> SIPC thus acts either as trustee or works with an independent court-appointed trustee in a brokerage insolvency case to recover funds.*

*The trustee in a liquidation under SIPA is responsible for distributing customer property and liquidating the failed broker-dealer; all securities (such as stocks and bonds) are returned to the customers of the failed brokerage firm, where those securities are registered in their names or are in the process of being registered (i.e., securities certificates in the name of the customer held by the broker-dealer). 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<sup>111</sup> and customer accounts are properly margined, the trustee likely can transfer the accounts to another broker-dealer in a process known as a bulk transfer. After the transfer, customers may choose to maintain their accounts at the new firm or transfer them to a firm of their choice. (Client consent is not required to do a bulk transfer).*

*If a bulk transfer is not possible, the trustee returns customer securities and cash directly to customers through a claims process. The firm's remaining customer assets are distributed on a pro rata basis with securities and cash shared in proportion to the size of claims. 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.*

*Clients are not required to have secondary or "back-up accounts" with other broker-dealers. It is not common practice for them to do so. Large institutional clients, however, may have customer relationships with more than one broker-dealer.*

15. 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*

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<sup>110</sup> 15 U.S.C. 78eee(b)(3).

<sup>111</sup> When the records of the brokerage firm are accurate, deliveries of some securities and cash to customers may begin shortly after the trustee receives the completed claim forms from customers, or even earlier if the trustee can transfer customer accounts to another broker-dealer. Delays of several months usually arise when the failed brokerage firm's records are not accurate. It also is not uncommon for delays to take place when the troubled brokerage firm or its principals were involved in fraud.

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*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.<sup>112</sup> In certain small liquidations, SIPC itself may be appointed as the trustee.*

### 16. What are the duties of the Administrative Officer?

*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.<sup>113</sup>*

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

*The Trustee must be guided by his/hers duties as set forth in SIPA.*

- 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 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.*

### 17. 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.<sup>114</sup> In addition, the SEC may apply to any Federal District Court of the United States for an order requiring SIPC to initiate a proceeding and commit its funds to protect customers.<sup>115</sup>*

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<sup>112</sup> 15 U.S.C. 78eee(b)(3).

<sup>113</sup> 15 U.S.C. 78fff(a).

<sup>114</sup> 15 U.S.C. 78eee(c).

<sup>115</sup> 15 U.S.C. 78ggg(b).

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18. What are the requirements, if any, governing the segregation and treatment of Client Assets *during* the insolvency of an Investment Firm?

*The Trustee is required to treat all Client Assets in accordance with the provisions as set forth under SIPA. SIPA defines the terms “customer,” “customer property,” “net equity” and other terms. These definitions provide important guidance for implementation of the requirements of SIPA and, in particular, how client assets are to be treated during the liquidation process.*

19. 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?
- What steps, if any, are prerequisite to accomplishing such a transfer? In general, how long does it take to accomplish those steps?
  - What factors, if any, affect the time period required to accomplish such a transfer?

*As explained in response to question 14, 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 transfer the accounts to another broker-dealer in about a week 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.*

20. 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 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).*

21. 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

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

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.*

22. 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 segregation requirements discussed above are mandatory for the broker-dealer. Consequently, customers generally may not "opt out" of the protection requirements. Further, customers are not treated differently based on permissions they have granted pre-bankruptcy (re-hypothecation is irrelevant). However, as stated above, a customer may enter into a transaction that is not protected under SIPA, if given appropriate notice.*

23. 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 do not make this decision. Customer assets can only be held at a "control" location approved by the SEC. See answer to question 6(b) above, for an explanation of what might constitute a "good control location." In short, however, a broker-dealer is deemed to have control over securities if they are in the custody of a foreign depository, foreign clearing agency or foreign custodian bank, which the Commission has deemed a "satisfactory control location" for securities. However, cash cannot be held in a foreign location.*

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

*They would be prosecuted to the full extent of the law. Under the current regime, all customers, as defined under Rule 15c3-3, generally are treated the same way.*

25. 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?

## 2013 IOSCO Collated Responses to the Client Asset Protection Survey

*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 SIPC reserve funds are used to supplement the distribution, up to a ceiling of \$500,000 per customer, including a maximum of \$250,000 for cash claims.*

26. 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?

*Claims of customers are ahead of other creditors. The U.S. Bankruptcy Code and the regulations promulgated thereunder do not differentiate between foreign and domestic customers. See CFTC answer for further details.*

### **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 in our responses. However, the list is not complete. Links to other rules and statutory provisions can be provided upon request.*

*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>*

*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>*

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*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>*

# **Banking Act\***

## ***(Gesetz über das Kreditwesen)***

Revised read-only version  
Unofficial text

**July 2009**

\* Translated by the Deutsche Bundesbank. This translation is not official; the only authentic text is the German one as published in the Federal Law Gazette (*Bundesgesetzblatt*).

# Banking Act

## ***(Gesetz über das Kreditwesen)***

Revised read-only version

Unofficial text

In the wording of the announcement of 9 September 1998 (Federal Law Gazette I, page 2776)

- as last amended by Article 2 of the Act of 25 June 2009 (Act to Implement the Prudential Supervisory Provisions of the Payment Services Directive (*Gesetz zur Umsetzung der aufsichtsrechtlichen Vorschriften der Zahlungsdiensterichtlinie*), also known as the Payment Services Implementation Act (*Zahlungsdiensteumsetzungsgesetz*)), Federal Law Gazette I, page 1522.

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# Part I

## General provisions

### Division 1 CREDIT INSTITUTIONS, FINANCIAL SERVICES INSTITUTIONS, FINANCIAL HOLDING COMPANIES, MIXED FINANCIAL HOLDING COMPANIES, FINANCIAL CONGLOMERATES, MIXED-ACTIVITY HOLDING COMPANIES AND FINANCIAL ENTERPRISES

#### Section 1 Definition of terms

(1) <sup>1</sup>Credit institutions are enterprises which conduct banking business commercially or on a scale which requires a commercially organised business undertaking. <sup>2</sup>Banking business comprises

- 1 the acceptance of funds from others as deposits or of other unconditionally repayable funds from the public, unless the claim to repayment is securitised in the form of bearer or order bonds, irrespective of whether or not interest is paid (deposit business),
- 1a the business specified in section 1 (1) sentence 2 of the Pfandbrief Act (*Pfandbriefgesetz*) (Pfandbrief business),
- 2 the granting of money loans and acceptance credits (lending business),
- 3 the purchase of bills of exchange and cheques (discount business),
- 4 the purchase and sale of financial instruments in the credit institution's own name for the account of others (principal broking services),
- 5 the safe custody and administration of securities for the account of others (safe custody business),
- 6 (Repealed)
- 7 the incurrance of the obligation to repurchase previously sold claims in respect of loans prior to their maturity,
- 8 the assumption of sureties, guarantees and other warranties on behalf of others (guarantee business),
- 9 the execution of cashless payment and clearing operations (giro business),
- 10 the purchase of financial instruments at the credit institution's own risk for placing in the market or the assumption of equivalent guarantees (underwriting business),
- 11 the issuance and administration of electronic money (e-money business),
- 12 acting in the capacity of a central counterparty within the meaning of subsection (31).

(1a) <sup>1</sup>Financial services institutions are enterprises which provide financial services to others commercially or on a scale which requires a commercially organised business undertaking, and which are not credit institutions. <sup>2</sup>Financial services comprise

- 1 the brokering of business involving the purchase and sale of financial instruments (investment broking),
  - 1a providing customers or their representatives with personal recommendations relating to transactions in certain financial instruments insofar as the recommendation is based on an evaluation of the investor's personal circumstances or is presented as being suitable for the investor and is not provided exclusively via information distribution channels or for the general public (investment advice),
  - 1b operating a multilateral system, which brings together a large number of persons' interests in the purchase and sale of financial instruments within the system according to set rules in a way that leads to a purchase agreement for these financial instruments (operation of a multilateral trading system),
  - 1c the placing of financial instruments without a firm underwriting commitment (placement business),
- 2 the purchase and sale of financial instruments in the name of and for the account of others (contract broking),
- 3 the management of individual portfolios of financial instruments for others on a discretionary basis (portfolio management),
- 4 the purchase and sale of financial instruments on an own-account basis as a service for others (proprietary trading),
- 5 the brokering of deposit business with enterprises domiciled in a state outside the European Economic Area (non-EEA state) (non-EEA deposit broking),
- 6 the execution of payment orders (money transmission services),
- 7 dealing in foreign notes and coins (foreign currency dealing),
- 8 the issuance or administration of credit cards and travellers' cheques (credit card business) unless the card issuer also provides the service underlying the payment transaction,
- 9 the ongoing purchase of receivables on the basis of standard agreements, with or without recourse (factoring),
- 10 the conclusion of finance lease agreements in the capacity of the lessor and the management of asset-leasing vehicles within the meaning of section 2 (6) sentence 1 number 17 (finance leasing),
- 11 the purchase and sale of financial instruments for a community of investors, who are natural persons, with discretionary leeway regarding the choice of financial instruments, insofar as this is a core element of the product offered and serves the purpose of ensuring that these investors have a share in the performance of the financial instruments acquired (asset management).

<sup>3</sup>The purchase or sale of financial instruments on an own-account basis which does not constitute a service for others within the meaning of sentence 2 number 4 is also deemed to be a financial service (proprietary business).

(1b) Institutions within the meaning of this Act are credit institutions and financial services institutions.

(2) <sup>1</sup>Senior managers within the meaning of this Act are those natural persons who are appointed according to law, articles of association, articles of incorporation or a partnership agreement to manage the business of and represent an institution organised in the form of a legal person or a commercial partnership. <sup>2</sup>In exceptional cases, the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, hereinafter referred to as BaFin) may also revocably designate as senior manager another person entrusted with the management of an institution's business and empowered to represent it if that person is trustworthy and has the necessary professional qualifications; section 33 (2) applies. <sup>3</sup>If the institution is operated by a sole proprietor, a person whom the proprietor has entrusted with the management of the institution's business and empowered to represent it may be revocably designated as senior manager in exceptional cases under the conditions set out in sentence 2. <sup>4</sup>If a person is designated as senior manager at the institution's request, the designation shall be revoked at the request of the institution or the senior manager.

(3) <sup>1</sup>Financial enterprises are enterprises which are not institutions, German asset management companies or investment stock corporations, and whose principal activities involve

- 1 acquiring and holding participating interests,
- 2 acquiring monetary claims against payment,
- 3 being an asset-leasing vehicle within the meaning of section 2 (6) sentence 1 number 17,
- 4 (Repealed)
- 5 trading in financial instruments on an own-account basis,
- 6 advising others on investing in financial instruments,
- 7 advising enterprises on their capital structure, their industrial strategy and associated issues and, in the event of corporate mergers and acquisitions, advising the enterprises and tendering services, or
- 8 arranging loans between credit institutions (money-broking business).

<sup>2</sup>The Federal Ministry of Finance (*Bundesministerium der Finanzen*), after consulting the Deutsche Bundesbank, can, by way of a statutory order (*Rechtsverordnung*), designate as financial enterprises other enterprises which principally engage in an activity which is added to the list in Annex I to Directive 2006/48/EC of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (OJ EU L 177/1) (Banking Directive).

(3a) <sup>1</sup>Financial holding companies are financial enterprises which are not mixed financial holding companies and whose subsidiaries are exclusively or mainly institutions or financial enterprises, at least one of which is a deposit-taking credit institution, an e-money institution or a securities trading firm. <sup>2</sup>Mixed financial holding companies are parent undertakings

which are not regulated financial conglomerate enterprises and which form a financial conglomerate together with their subsidiaries – at least one of which is a regulated financial conglomerate enterprise domiciled in Germany or another EEA state – and other enterprises.<sup>3</sup> Regulated financial conglomerate enterprises are deposit-taking credit institutions, e-money institutions, securities trading firms or primary insurance companies within the meaning of section 104k number 2 letter (a) of the Insurance Supervision Act (*Versicherungsaufsichtsgesetz*) as well as German asset management companies or other asset management companies within the meaning of Article 2 (5) and Article 30 of Directive 2002/87/EC which form part of a conglomerate.

(3b) <sup>1</sup>Mixed-activity holding companies are enterprises which are not financial holding companies, mixed financial holding companies or institutions and whose subsidiaries include at least one deposit-taking credit institution, e-money institution or securities trading firm.<sup>2</sup> A mixed-activity group consists of a mixed-activity holding company and its subsidiaries.

(3c) Ancillary service providers are enterprises which are neither institutions nor financial enterprises and whose principal activity comprises managing property, operating computer centres or performing similar activities which are ancillary activities relative to the principal activity of one or more institutions.

(3d) <sup>1</sup>Deposit-taking credit institutions are credit institutions which receive deposits or other unconditionally repayable funds from the public and conduct lending business. <sup>2</sup>Securities trading firms are institutions which are not deposit-taking credit institutions and which conduct banking business within the meaning of subsection (1) sentence 2 number 4 or 10 or provide financial services within the meaning of subsection (1a) sentence 2 numbers 1 to 4, unless the banking business or financial services are confined to foreign exchange or units of account. <sup>3</sup>Securities trading banks are credit institutions which are not deposit-taking credit institutions and which conduct banking business within the meaning of subsection (1) sentence 2 number 4 or 10 or provide financial services within the meaning of subsection (1a) sentence 2 numbers 1 to 4. <sup>4</sup>E-money institutions are credit institutions which only conduct e-money business.

(3e) Stock exchanges or futures exchanges within the meaning of this Act are stock markets or futures markets which are regulated and supervised by competent public agencies, are held regularly and are accessible to the general public either directly or indirectly, including

- 1 their operators if the said operators' principal activity involves the operation of stock markets or futures markets, and
- 2 their systems for safeguarding the settlement of the trades in these markets (clearing houses) that are regulated and supervised by competent public agencies.

(4) The home state is the state in which the head office of an institution is authorised to operate.

(5) The host state is the state in which an institution maintains a branch or provides cross-border services outside its home state.

(5a) <sup>1</sup>The European Economic Area (EEA) within the meaning of this Act comprises the member states of the European Union as well as the other signatories to the Agreement on the European Economic Area. <sup>2</sup>Non-EEA states within the meaning of this Act are all other states.

(5b) (Repealed)

(6) Parent enterprises are enterprises which are deemed to be parent enterprises within the meaning of section 290 of the German Commercial Code (*Handelsgesetzbuch*) or which can exercise a controlling influence irrespective of their legal form and domicile.

(7) <sup>1</sup>Subsidiaries are enterprises which are deemed to be subsidiaries within the meaning of section 290 of the Commercial Code or in which a controlling influence can be exercised irrespective of their legal form and domicile. <sup>2</sup>Affiliated enterprises are enterprises which have a common parent enterprise.

(7a) Parent institutions in a member state are institutions domiciled in an EEA state to which an institution within the meaning of section 10a (1) sentence 2 or (4) is subordinated and which themselves are not subordinated to either an institution or a financial holding company domiciled in the same EEA state.

(7b) Parent financial holding companies in a member state are financial holding companies which themselves are not subsidiaries of either an institution or a financial holding company domiciled in the same EEA state.

(7c) EU parent institutions are parent institutions in a member state which themselves are not subordinated to either an institution or a financial holding company domiciled in an EEA state within the meaning of section 10a (1) sentence 2 or (4).

(7d) EU parent financial holding companies are parent financial holding companies in a member state which themselves are not subsidiaries of either an institution or a financial holding company domiciled in an EEA state.

(8) Control shall exist if an enterprise is deemed to be a parent enterprise in relation to another enterprise, or if a similar relationship exists between a natural or a legal person and an enterprise.

(9) <sup>1</sup>A major participating interest shall exist if at least 10 per cent of the capital of, or the voting rights in, a third-party enterprise is held directly or indirectly through one or more subsidiaries or a similar relationship or through collaboration with other persons or enterprises, in the holder's own interests or in the interests of a third party, or if a significant influence can be exercised on the management of another enterprise. <sup>2</sup>For calculating the share of the voting rights, section 21 (1) in conjunction with a statutory order pursuant to subsection (3), section 22 (1) to (3a) in conjunction with a statutory order pursuant to subsection (5) and section 23 of the Securities Trading Act (*Wertpapierhandelsgesetz*) as well as section 32 (2) and (3) in conjunction with a statutory order pursuant to subsection (5)

number 1 of the Investment Act (*Investmentgesetz*) shall apply *mutatis mutandis*.<sup>3</sup>This shall not include the voting rights or capital shares which institutions hold in connection with underwriting business pursuant to subsection (1) sentence 2 number 10, provided that these rights are not exercised or used in any other way to interfere with the issuer's management and they are sold within one year of being acquired.<sup>4</sup>Participating interests which are held indirectly are to be attributed in full to the persons and enterprises holding the indirect participating interests.

(10) A close link shall exist if an institution and another natural person or another enterprise are linked

- 1 through the direct or indirect holding by one or more subsidiaries or trustees of at least 20 per cent of the capital or the voting rights, or
- 2 as a parent enterprise and its subsidiary, through a similar relationship or as affiliated enterprises.

(11) <sup>1</sup>Financial instruments within the meaning of subsections (1) to (3) and (17) as well as within the meaning of section 2 (1) and (6), notwithstanding section 1a (3), are securities, money market instruments, foreign exchange or units of account and derivatives. <sup>2</sup>Securities – even if they are not evidenced by certificates – are all types of transferable securities, with the exception of payment instruments, which by their nature are tradable in the capital markets, in particular:

- 1 shares and other stakes in German or foreign legal persons, commercial partnerships and any other enterprises if these stakes are comparable to shares, as well as certificates representing shares;
- 2 debt instruments, in particular, participation certificates, bearer bonds, order bonds and certificates representing these debt instruments;
- 3 any other securities which provide a right to purchase or sell securities in accordance with numbers 1 and 2 or lead to a cash payment that is determined in connection with securities, with currencies, interest rates or other income streams, or with commodities, indices or benchmarks;
- 4 units in collective investment schemes issued by a German asset management company or a foreign asset management company.

<sup>3</sup>Money market instruments are all types of receivables that are not covered by sentence 1 and which are normally traded on the money market, with the exception of payment instruments. <sup>4</sup>Derivatives are

- 1 futures or options contracts in the form of a purchase, exchange or similar transaction, which are to be settled with a time lag and whose value is derived directly or indirectly from the price or measure of an underlying (forward transactions) in relation to the following underlyings:
  - (a) securities or money market instruments,

- (b) foreign exchange or units of account,
  - (c) interest rates or other income streams,
  - (d) indices of the underlyings for letters (a), (b) or (c), other financial indices or financial benchmarks, or
  - (e) derivatives;
- 2 forward transactions in relation to commodities, freight rates, emission allowances, climatic or other physical variables, inflation rates or other macroeconomic variables or any other assets, indices or measures as underlyings if they
- (a) must either be settled by means of cash settlement or give a contracting party the right to demand cash settlement without this right arising as a result of default or another termination event,
  - (b) are conducted on an organised market or in a multilateral trading system, or
  - (c) have the characteristics of other derivative financial instruments and are not for commercial purposes pursuant to Article 38 (1) of Commission Regulation (EC) No 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive (OJ EU L 241/1), and the conditions under Article 38 (4) of this Regulation are not met,
- and provided that they are not spot contracts within the meaning of Article 38 (2) of Commission Regulation (EC) No 1287/2006;
- 3 financial contracts for differences;
- 4 futures or options contracts in the form of a purchase, exchange or similar transaction, which are to be settled with a time lag and serve to transfer credit risk (credit derivatives);
- 5 forward transactions in relation to the underlyings listed in Article 39 of Commission Regulation (EC) No 1287/2006 if they meet the conditions laid down in number 2.

(12) (Repealed)

(13) <sup>1</sup>Risk models within the meaning of this Act are time-related stochastic representations of changes in market rates, prices, values or interest rates and their effects on the market value of individual financial instruments or groups of financial instruments (value-at-risk measures) based on the sensitivity of these financial instruments or groups of financial instruments to changes in their relevant risk-determining factors. <sup>2</sup>They comprise mathematical-statistical structures and distributions that are used for determining risk-capturing ratios, notably the extent of and correspondence between fluctuations in rates, prices and interest rates (volatility and correlation) as well as the sensitivity of financial instruments and groups of financial instruments, which are determined by means of appropriate computer-assisted procedures, notably time series analyses.

(14) Electronic money consists of units of value in the form of a claim on the issuing agency which are

- 1 stored on electronic data media,
- 2 issued against receipt of a sum of money, and
- 3 are accepted by third parties as a means of payment without being legal tender.

(15) <sup>1</sup>A qualifying participating interest within the meaning of this Act shall exist if a person or an enterprise holds at least 10 per cent of the capital of, or voting rights in, another enterprise directly or indirectly through one or more subsidiaries or a similar relationship, or can exercise a significant influence on the management of the other enterprise; subsection (9) sentences 2 and 3 shall apply *mutatis mutandis*. <sup>2</sup>Capital shares which are not intended to serve the holder's own business operations by establishing permanent links shall not be included in the computation of the level of the participating interest.

(16) <sup>1</sup>A system within the meaning of section 24b is a written arrangement pursuant to Article 2 letter (a) of Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (OJ EC L 166/45), including the arrangement between a participant and an indirectly participating credit institution which has been reported to the Commission of the European Communities by the Deutsche Bundesbank or the competent authority of either another member state or a contracting state of the EEA. <sup>2</sup>The systems of non-EEA states are equivalent to the systems mentioned in sentence 1 provided that they essentially fulfil the requirements set out in Article 2 letter (a) of Directive 98/26/EC.

(17) <sup>1</sup>Financial collateral arrangements within the meaning of this Act are cash balances, monetary amounts, securities, money market instruments and any other loans against borrowers' notes, including any rights or claims in connection therewith, which are provided as collateral under security interest, transfer or title transfer structures on the basis of an agreement between a collateral taker and a collateral provider belonging to one of the categories listed in Article 1 (2) letters (a) to (e) of Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (OJ EC L 168/43). <sup>2</sup>If a collateral provider is a person or corporate entity mentioned in Article 1 (2) letter (e) of Directive 2002/47/EC, then a financial collateral arrangement is deemed to exist only if the collateral serves as backing for liabilities arising from contracts or from the brokerage of contracts concerning

- (a) the purchase and sale of financial instruments,
- (b) repurchase transactions, lending transactions and comparable transactions relating to financial instruments, or
- (c) loans to finance the purchase of financial instruments.

<sup>3</sup>If a collateral provider is a person or corporate entity mentioned in Article 1 (2) letter (e) of Directive 2002/47/EC, then the collateral provider's own capital shares or capital shares in affiliated enterprises within the meaning of section 290 (2) of the Commercial Code are not

financial collateral arrangements; the point in time at which the collateral is provided is decisive. <sup>4</sup>Collateral providers from non-EEA states are equivalent to the collateral providers mentioned in sentence 1 provided that they essentially correspond to the authorities, financial institutions and entities listed in Article 1 (2) letters (a) to (e) of Directive 2002/47/EC.

(18) Sectoral legislation within the meaning of this Act is the legislation of the European Communities in the area of financial supervision, in particular Directives 73/239/EEC, 85/611/EEC, 98/78/EC, 2004/39/EC, 2006/48/EC and 2006/49/EC as well as Annex V Part A of Directive 2002/83/EC, the national legislation based thereon, in particular this Act, the Insurance Supervision Act, the Securities Trading Act, the Investment Act, the Pfandbrief Act, the Act on Building and Loan Associations (*Gesetz über Bausparkassen*) and the Money Laundering Act (*Geldwäschegesetz*) including the statutory orders enacted in connection therewith as well as any other laws, regulations and administrative provisions enacted in the area of financial supervision.

(19) Financial sector within the meaning of this Act consists of the following sectors:

- 1 the banking and investment services sector: covers credit institutions within the meaning of subsection (1), financial services institutions within the meaning of subsection (1a), German asset management companies within the meaning of section 2 (6) of the Investment Act, investment stock corporations within the meaning of section 2 (5) of the Investment Act, financial enterprises within the meaning of subsection (3), ancillary service providers within the meaning of subsection (3c) and corresponding enterprises domiciled outside Germany; for the purposes of sections 51a und 51c, German asset management companies and investment stock corporations are not deemed to belong to this sector;
- 2 the insurance sector: covers primary insurance companies within the meaning of section 104k number 2 letter (a) of the Insurance Supervision Act, reinsurance companies within the meaning of section 104a (2) number 3 of the Insurance Supervision Act, insurance holding companies within the meaning of section 104a (2) number 4 of the Insurance Supervision Act and corresponding enterprises domiciled outside Germany;
- 3 a further sector consisting of mixed financial holding companies.

(20) <sup>1</sup>A financial conglomerate within the meaning of this Act, subject to section 51a (2) to (6), is a group of enterprises

- 1 which consists either of a parent enterprise, its subsidiaries and enterprises in which the parent enterprise or a subsidiary holds a participating interest, or of enterprises which are consolidated into a horizontal group;
- 2 which is headed by a regulated financial conglomerate enterprise which is the parent enterprise of a financial sector enterprise, is an enterprise which holds a participating interest in a financial sector enterprise or is an enterprise which is consolidated with another banking and investment services sector or insurance sector enterprise into a

horizontal group; if the group is not headed by a regulated financial conglomerate enterprise but has at least one of these enterprises as a subsidiary, then the group shall be deemed to be a financial conglomerate if it is predominantly active in the financial sector;

- 3 which includes at least one insurance sector enterprise as well as at least one enterprise from the banking and investment services sector, and
- 4 which has significant consolidated or aggregated activities within both the insurance sector and the banking and investment services sector, and/or whose enterprises have significant consolidated or aggregated activities within both the insurance sector and the banking and investment services sector.

<sup>2</sup>A subgroup of a group within the meaning of sentence 1 number 1 shall also be deemed to be a financial conglomerate provided that this subgroup itself fulfils the conditions laid down in sentence 1 numbers 1 to 4.

(21) A horizontal group within the meaning of this Act is a group in which an enterprise is linked to one or more other enterprises in such a way that

- 1 they are jointly under single management owing to a provision in their articles of association, articles of incorporation or a contract, or
- 2 their management or supervisory bodies, for the most part, are made up of the same persons, who remain in office during the financial year and up to the end of the period laid down in section 290 (1) of the Commercial Code, when they must or ought to prepare consolidated financial statements.

(22) Intra-group transactions in a financial conglomerate within the meaning of this Act are transactions in which regulated financial conglomerate enterprises, to fulfil an obligation, directly or indirectly draw on the support of other enterprises within the same financial conglomerate or on that of natural or legal persons which are closely linked to the group enterprises, whereby it is immaterial whether this occurs on a contractual or non-contractual or on a gratuitous or non-gratuitous basis.

(23) Risk concentrations within the meaning of this Act are all exposures of the enterprises within a financial conglomerate that are subject to default risk and are large enough to jeopardise the solvency or the general financial position of the regulated financial conglomerate enterprises, whereby the risk of default is based on, or can be based on, counterparty risk, credit risk, investment risk, insurance risk, market risk, any other type of risk, a combination of the above risks or an interplay between these types of risk.

(24) Refinancing enterprises are enterprises which, for self-refinancing or transferee refinancing purposes, sell assets or claims thereto from their business operations to special purpose vehicles, refinancing intermediaries, a credit institution domiciled in an EEA state or one of the entities mentioned in section 2 (1) number 1 or 3a; if economic risks are also passed on without being accompanied by a devolution of title, this does not have any detrimental effect.

(25) Refinancing intermediaries are credit institutions which purchase assets or claims thereto from a refinancing enterprise's business operations from refinancing enterprises or other refinancing intermediaries in order to sell them to special purpose vehicles or refinancing intermediaries; if economic risks are also passed on without being accompanied by a devolution of title, this does not have any detrimental effect.

(26) Special purpose vehicles are enterprises whose essential purpose is to raise funds or gain other pecuniary advantages by issuing financial instruments or in some other way in order to purchase assets or claims thereto from a refinancing enterprise's business operations from refinancing enterprises or refinancing intermediaries; if economic risks are also taken over without being accompanied by a devolution of title, this does not have any detrimental effect.

(27) Multilateral development banks within the meaning of this Act are:

- 1 the International Bank for Reconstruction and Development,
- 2 the International Finance Corporation,
- 3 the Multilateral Investment Guarantee Agency,
- 4 the Inter-American Development Bank,
- 5 the African Development Bank,
- 6 the Asian Development Bank,
- 7 the Caribbean Development Bank,
- 8 the Nordic Investment Bank,
- 9 the Council of Europe Development Bank,
- 10 the European Bank for Reconstruction and Development,
- 11 the European Investment Bank,
- 12 the European Investment Fund,
- 13 the Inter-American Investment Corporation,
- 14 the Black Sea Trade and Development Bank,
- 15 the Central American Bank for Economic Integration,
- 16 the Islamic Development Bank, and
- 17 the International Finance Facility for Immunisation.

(28) International organisations within the meaning of this Act are:

- 1 the European Community,
- 2 the International Monetary Fund, and
- 3 the Bank for International Settlements.

(29) <sup>1</sup>Recognised securities trading firms from non-EEA states within the meaning of this Act are securities trading firms that are authorised to operate in a non-EEA state and are subject to a prudential supervisory regime which is equivalent to the prudential supervisory regime for trading book institutions pursuant to the provisions of this Act. <sup>2</sup>Sentence 1 does not apply to investment advisers and brokers who, in providing financial services, are not authorised to obtain ownership or possession of funds or securities of customers and who do not trade in financial instruments for their own account.

(30) <sup>1</sup>Public-sector entities within the meaning of this Act are non-commercial administrative bodies which are responsible solely to central or regional governments or local authorities and perform the tasks of central or regional governments or local authorities. <sup>2</sup>Public-sector entities also include legally independent development institutions operating non-competitively within the jurisdictional reach of this Act which are also supported by a domestic central or regional government or local authority and for whose payment obligations at least one domestic central or regional government or local authority has assumed liability.

(31) A central counterparty is an enterprise which legally interposes itself between the buyer and the seller for contracts of sale traded within one or more financial markets in order to serve as a contracting party for each of them, and whose claims arising from counterparty risk vis-à-vis all participants in its systems are adequately collateralised on an intraday basis.

## **Section 1a Trading book and banking book**

(1) <sup>1</sup>For the purposes of determining trading book risk positions and calculating the relevant capital charges, the following positions shall be deemed to be part of an institution's trading book within the meaning of this Act:

- 1 financial instruments within the meaning of subsection (3) and commodities which the institution holds as proprietary positions with a view to reselling them in the short term or which are acquired by the institution with the intention of profiting for its own account in the short term from existing or expected differences between buying and selling prices or fluctuations in market rates, prices, values or interest rates (trading intent),
- 2 financial instruments within the meaning of subsection (3) as well as commodities for hedging market risk in the trading book and any refinancing operations in connection therewith,
- 3 repurchase and lending transactions relating to trading book positions as well as transactions which are comparable to repurchase and lending transactions relating to trading book positions,
- 4 name-to-follow transactions, and
- 5 receivables in the form of fees, commissions, interest, dividends and margin payments that are directly linked to the trading book positions.

<sup>2</sup>Financial instruments and commodities that are deemed to be part of the trading book pursuant to sentence 1 number 1 or sentence 1 number 2 may not be subject to any restrictive provisions with regard to their tradability or must themselves be hedgeable.

(2) The banking book comprises all of an institution's transactions that are not deemed to be part of the trading book.

(3) Financial instruments within the meaning of this Act, subject to section 1 (11), are all contracts which create a financial asset for one of the parties involved and a financial liability or a capital? instrument for the other.

(4) <sup>1</sup>Positions are to be assigned to the trading book according to internally defined, verifiable criteria of which BaFin and the Deutsche Bundesbank must be informed; any changes to these criteria must be reported to BaFin and the Deutsche Bundesbank promptly, stating the reasons therefor. <sup>2</sup>The institutions must regularly monitor, as well as fully and comprehensibly document, compliance with these criteria in their records. <sup>3</sup>Trading book positions must be reclassified as banking book positions and banking book positions must be reclassified as trading book positions if the requirements for deeming the relevant positions to be part of the trading book or the banking book are no longer applicable. <sup>4</sup>Otherwise, trading book positions may be reclassified as banking book positions and banking book positions may be reclassified as trading book positions only if there is a compelling reason for doing so. <sup>5</sup>The reclassification of positions must be fully documented, as well as comprehensibly and adequately substantiated, in the institution's records.

(5) <sup>1</sup>The institutions must have clearly defined policies and procedures for the operation and management of their trading book that also expressly outline the institutions' assessment of the tradability and hedgeability of the various kinds of trading book positions which they hold. <sup>2</sup>In particular, the institutions must set up and permanently maintain suitable control mechanisms by means of which they can reliably identify actual and legal restrictions on the tradability and hedgeability of their trading book positions and can adequately assess how reliable the valuation of their trading book positions is.

(6) <sup>1</sup>In the case of trading book positions held with trading intent, this trading intent must be evidenced on the basis of a trading strategy approved by senior management as well as clearly defined guidelines on both the active management of the positions and the monitoring of the institution's trading book positions against the institution's trading strategy. <sup>2</sup>The structure and documentation of the trading strategy as well as an institution's own guidelines on the management and monitoring of the trading book positions against the trading strategy must comply with the requirements laid down in Annex VII, Part A of Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (OJ EU L 177/201) (Capital Adequacy Directive). <sup>3</sup>The trading strategy may thereby be a part of the strategies required in section 25a (1) sentence 3 number 1.

(7) <sup>1</sup>Internal hedges are transactions which serve to hedge, materially or completely, one or more banking book positions. <sup>2</sup>They may be deemed to be part of the trading book only if

they are conducted at market conditions and are used consistently to hedge the institution's banking book positions and if the institution includes them in the management and monitoring of its trading book positions in the same way as comparable trading book positions which are not internal hedges. <sup>3</sup>Subsections (4), (5) and (8) shall apply *mutatis mutandis*. <sup>4</sup>Moreover, for such hedges to be deemed part of the trading book, they must be effected and permanently monitored through specially created internal control mechanisms in accordance with the provisions on conducting such hedges approved by the institution's senior management. <sup>5</sup>The inclusion of internal hedges in the trading book must be comprehensibly documented in the institution's records. <sup>6</sup>The assignment of internal hedges to the trading book shall be without prejudice to the assignment of the banking book positions secured by these hedges to the banking book as well as to the capital requirements applicable to these banking book positions as a result. <sup>7</sup>By contrast, subject to the conditions and in the manner laid down by the statutory order pursuant to section 10 (1) sentence 9, an institution can recognise a credit derivative, which it has acquired from a third party and uses to hedge a banking book position, when determining the capital requirements in relation to this banking book position even if this credit derivative is deemed to be part of the trading book. <sup>8</sup>In doing so, however, the institution may recognise this credit derivative only to the extent that it books this credit derivative to the banking book through an internal hedge.

(8) <sup>1</sup>Institutions must value trading book positions at market prices obtained from independent sources on a daily basis. <sup>2</sup>Where such direct marking to market is not possible, the institution may estimate the market value of the trading book positions using valuation models based on reference prices observed in the market. <sup>3</sup>Institutions must set up and permanently maintain suitable systems and control mechanisms for valuing trading book positions. <sup>4</sup>These systems and control mechanisms must have written guidelines and procedures for the trading book position valuation process and must ensure that trading book positions are valued prudently and reliably. <sup>5</sup>When valuing their trading book positions, institutions must, in particular, take due account of the risk that, in the event that these trading book positions are sold or hedged at short notice, the value received will be lower than their most recently observed market price or estimated value.

(9) <sup>1</sup>The Federal Ministry of Finance shall be authorised to issue by way of a statutory order, in consultation with the Deutsche Bundesbank, more detailed provisions on the composition, operation and management of institutions' trading book as well as on the application of provisions regarding the trading book in groups of institutions and financial holding groups within the meaning of section 10a (1) to (5), in particular in respect of

- 1 the assignment of further tradable positions to the trading book,
- 2 the exclusion of positions from assignment to the trading book,
- 3 the distinction between trading book institutions and non-trading book institutions,
- 4 the requirements for the trading book and the positions included therein,
- 5 the management of trading book positions and the risks inherent in the trading book,  
and

- 6 the valuation of trading book positions and the requirements for the internal systems and control mechanisms which must be in place for this purpose.

<sup>2</sup>The Federal Ministry of Finance may delegate this authority to BaFin by way of a statutory order, subject to the proviso that the statutory order is issued in agreement with the Deutsche Bundesbank. <sup>3</sup>The central associations of the institutions shall be consulted before the statutory order is issued.

## **Section 2 Exceptions**

(1) Subject to subsections (2) and (3), the following are not deemed to be credit institutions:

- 1 the Deutsche Bundesbank;
- 2 the KfW banking group (*Kreditanstalt für Wiederaufbau*);
- 3 the statutory social security funds and the Federal Employment Agency (*Bundesagentur für Arbeit*);
- 3a the public debt administration of the Federal Government, of one of its special funds, of a regional government or of another EEA state and EEA central bank, provided that it does not accept funds from others as deposits or other repayable funds from the public or conduct lending business;
- 3b German asset management companies, even if they undertake the management and safekeeping of units in collective investment schemes for others pursuant to section 7 (2) number 4 of the Investment Act, and investment stock corporations;
- 4 private and public insurance companies;
- 5 enterprises engaged in pawnbroking, insofar as they conduct this business by granting loans against pledges;
- 6 enterprises recognised under the Act Concerning Risk Capital Investment Companies (*Gesetz über Unternehmensbeteiligungsgesellschaften*) as risk capital investment companies;
- 6a enterprises recognised under the Act to Promote Venture Capital Investment (*Gesetz zur Förderung von Wagniskapitalbeteiligungen*) as venture capital companies;
- 7 enterprises which conduct banking business solely with their parent enterprise or with their subsidiaries or affiliated enterprises;
- 8 enterprises which, without being involved in cross-border activities, conduct banking business solely in the form of principal broking services on domestic stock exchanges or in domestic multilateral trading systems within the meaning of section 1 (1a) sentence 2 number 1c on or in which derivatives are traded (derivatives markets) for other members of these markets or trading systems, provided that clearing members of these markets or trading systems are liable for the fulfilment of the contracts which the aforementioned enterprises conclude on the said markets or in the said trading systems;

9 enterprises which engage in principal broking services only in relation to derivatives within the meaning of section 1 (11) sentence 4 numbers 2 and 5, provided that

(a) they are not part of a corporate group whose principal activity comprises providing financial services within the meaning of section 1 (1a) sentence 2 numbers 1 to 4 or conducting banking business within the meaning of section 1 (1) sentence 2 numbers 1, 2, 8 or 11,

(b) the principal broking services, financial services within the meaning of section 1 (1a) sentence 2 numbers 1 to 4 in relation to derivatives within the meaning of section 1 (11) sentence 4 numbers 2 and 5 and proprietary business in financial instruments at a group level are of secondary significance to the principal activity, and

(c) the principal broking services are provided only for principal activity customers in objective connection with principal activity operations.

(2) Section 14, sections 22a to 22o and any arrangements made by virtue of section 47 (1) number 2 and section 48 shall apply to the KfW banking group; section 14 shall apply to the statutory social security funds, the Federal Employment Agency, insurance companies and risk capital investment companies.

(3) Enterprises of the types specified in subsection (1) numbers 4 to 6 shall be subject to the provisions of this Act insofar as they conduct banking business which is not part of their characteristic business.

(4) <sup>1</sup>In individual cases, BaFin can decide that sections 2c, 10 to 18, 24, 24a, 25, 25a, 26 to 38, 45, 46 to 46c and 51 (1) of this Act shall not apply as a whole to an institution if the enterprise does not require supervision in this respect given the nature of the business which it conducts. <sup>2</sup>A decision of this kind shall be published in the electronic Federal Gazette.

(5) <sup>1</sup>In individual cases, BaFin, in consultation with the Deutsche Bundesbank, can decide that sections 2c, 10 to 18, 24, 32 to 38, 45 and 46a to 46c of this Act shall not apply as a whole to an enterprise which conducts only e-money business if the enterprise does not require supervision in this respect given the nature or the volume of the business which it conducts. <sup>2</sup>A decision of this kind shall be published in the electronic Federal Gazette. <sup>3</sup>The Federal Ministry of Finance may, by way of a statutory order to be issued in consultation with the Deutsche Bundesbank, issue more detailed provisions on the exemption pursuant to sentence 1. <sup>4</sup>The Federal Ministry of Finance may delegate this authority to BaFin by way of a statutory order, subject to the proviso that the statutory order is issued in agreement with the Deutsche Bundesbank.

(6) <sup>1</sup>The following are not deemed to be financial services institutions:

1 the Deutsche Bundesbank;

2 the KfW banking group;

- 3 the public debt administration of the Federal Government, of one of its special funds, of a regional government or of another EEA state and EEA central bank;
- 4 private and public insurance companies;
- 5 enterprises which provide financial services within the meaning of section 1 (1a) sentence 2 solely within a corporate group;
- 5a German asset management companies, even if they provide individual asset management services pursuant to section 7 (2) number 1, investment advice pursuant to section 7 (2) number 3 or other services and ancillary services pursuant to section 7 (2) number 7 of the Investment Act, and investment stock corporations;
- 5b foreign asset management companies, insofar as they issue units in foreign collective investment schemes within the meaning of section 2 (9) of the Investment Act;
- 6 enterprises whose financial service for others solely comprises the administration of a system of employee participations in themselves or their affiliated enterprises;
- 7 enterprises which solely provide financial services within the meaning of both number 5 and number 6;
- 8 enterprises which provide financial services for others that solely comprise investment advice, investment broking and contract broking between customers and
  - (a) domestic institutions,
  - (b) institutions or financial enterprises domiciled in another EEA state which fulfil the conditions of section 53b (1) sentence 1 or (7),
  - (c) enterprises that are treated as enterprises domiciled in the EEA or granted exemption from the provisions by way of a statutory order pursuant to section 53c, or
  - (d) German asset management companies, investment stock corporations and foreign asset management companiesinsofar as these financial services are confined to units in collective investment schemes which are issued by a German asset management company or investment stock corporation within the meaning of sections 96 to 111a of the Investment Act or to units in foreign collective investment schemes which may be sold publicly pursuant to the Investment Act, and the enterprises are not authorised to obtain ownership or possession of funds or shares of customers in providing such financial services, unless the enterprise applies for and is granted appropriate authorisation pursuant to section 32 (1); units in common funds with additional risks (hedge funds) pursuant to section 112 of the Investment Act shall not be deemed to be units in collective investment schemes within the meaning of this provision;
- 9 enterprises which, without being involved in cross-border activities, conduct proprietary business on derivatives markets within the meaning of subsection (1) number 8 and trade on spot markets only for the purpose of hedging these positions, which engage in proprietary trading or contract broking only for other members of

these derivatives markets or which determine prices for other members of these derivatives markets through proprietary trading as a market maker within the meaning of section 23 (4) of the Securities Trading Act, provided that clearing members of these markets or trading systems are liable for the fulfilment of the contracts which the aforementioned enterprises conclude;

- 10 members of independent professions who provide financial services within the meaning of section 1 (1a) sentence 2 numbers 1 to 4 only occasionally within their client relationships as self-employed professionals and who belong to a professional chamber having the legal form of a public-law corporation whose professional rules do not exclude the provision of financial services;
- 11 enterprises which conduct proprietary business in financial instruments or provide financial services within the meaning of section 1 (1a) sentence 2 numbers 1 to 4 only in relation to derivatives within the meaning of section 1 (11) sentence 4 numbers 2 and 5, provided that
  - (a) they are not part of a corporate group whose principal activity comprises providing financial services within the meaning of section 1 (1a) sentence 2 numbers 1 to 4 or conducting banking business within the meaning of section 1 (1) sentence 2 numbers 1, 2, 8 or 11,
  - (b) the provision of financial services is of secondary significance to the principal activity at a group level, and
  - (c) the financial services relating to derivatives within the meaning of section 1 (11) sentence 4 numbers 2 and 5 are provided only for principal activity customers in objective connection with principal activity operations;
- 12 enterprises whose sole financial service within the meaning of section 1 (1a) sentence 2 is dealing in foreign notes and coins, unless their principal activity is foreign currency dealing;
- 13 enterprises whose principal activity involves conducting proprietary business and proprietary trading in commodities or derivatives within the meaning of section 1 (11) sentence 4 number 2 relating to commodities, provided that these enterprises do not belong to a corporate group whose principal activity comprises providing financial services within the meaning of section 1 (1a) sentence 2 numbers 1 to 4 or conducting banking business pursuant to section 1 (1) sentence 2 numbers 1, 2, 8 or 11;
- 14 enterprises whose sole financial service comprises conducting proprietary business or proprietary trading, unless they
  - (a) continuously offer to buy or sell financial instruments at prices which they themselves have determined on an organised market or in a multilateral trading system, or
  - (b) undertake trading, often for their own account, in an organised and systematic manner outside an organised market or a multilateral trading system by providing

a system accessible to third parties in order to transact business with these third parties;

- 15 enterprises whose sole financial service within the meaning of section 1 (1a) sentence 2 comprises providing investment advice as part of another occupational activity and which are not remunerated separately for providing this investment advice;
- 16 operators of organised markets which, apart from operating a multilateral trading system, do not provide any other financial services within the meaning of section 1 (1a) sentence 2;
- 17 enterprises whose sole financial service within the meaning of section 1 (1a) sentence 2 comprises carrying out finance leasing activities, if they act only as an asset-leasing vehicle for a single leased asset, do not make their own business policy decisions and are managed by an institution domiciled in an EEA state which is authorised to conduct finance leasing operations under the laws of the home state;
- 18 enterprises whose only financial service comprises carrying out asset management activities and whose parent enterprise is the KfW banking group or an institution within the meaning of sentence 2. An institution within the meaning of sentence 1 is a financial services institution which has authorisation to engage in asset management activities, or a deposit-taking credit institution or securities trading firm domiciled in another EEA state within the meaning of section 53b (1) sentence 1 which, in its home state, is authorised to conduct business comparable with that described in section 1 (1a) sentence 2 number 11, or an institution domiciled in a non-EEA state which, pursuant to subsection (4), is exempt from the authorisation requirement pursuant to section 32 with regard to the business specified in section 1 (1a) sentence 2 number 11.

<sup>2</sup>The provisions of this Act shall apply to entities and enterprises within the meaning of sentence 1 numbers 3 and 4 insofar as they provide financial services which are not part of their characteristic business.

(7) <sup>1</sup>The provisions of section 2b (2), sections 10, 11 to 18 and 24 (1) number 9, sections 24a and 33 (1) sentence 1 number 1, section 35 (2) number 5 and sections 45 and 46a to 46c shall not apply to financial services institutions which provide no financial services within the meaning of section 1 (1a) sentence 2 apart from credit card business, non-EEA deposit broking, money transmission services and foreign currency dealing. <sup>2</sup>The provisions of section 2b (2), sections 10, 11 to 13d, sections 15 to 18 and 24 (1) numbers 6, 9, 11 and 13, sections 25 and 33 (1) sentence 1 number 1, section 35 (2) number 5 and sections 45 and 46a to 46c shall not apply to enterprises which solely provide financial services pursuant to section 1 (1a) sentence 2 number 9 or 10. <sup>3</sup>BaFin can, in individual cases, exempt a financial services institution whose sole financial service within the meaning of section 1 (1a) sentence 2 comprises credit card business or money transmission services from the provisions of this Act as long as the manner of performing the business conducted does not require supervision.

(8) The provisions of section 2b (2), sections 10, 11 and 12 (1), sections 13, 13a, 14 to 18 and 35 (2) number 5 and section 45 shall not apply to investment advisers, investment brokers, contract brokers, operators of multilateral trading systems and enterprises engaging in placement business who, in providing financial services, are not authorised to obtain ownership or possession of funds or securities of customers and who do not trade in financial instruments for their own account, or to enterprises which are to be classified as institutions by virtue of subsection (1) number 8 or subsection (6) number 9 owing to the counter-exception for performing cross-border transactions.

(8a) Subject to section 64h (7), the requirements of section 10 shall not apply to institutions whose principal activity solely comprises conducting banking business or providing financial services in connection with derivatives pursuant to section 1 (11) sentence 4 numbers 2, 3 and 5.

(9) (Repealed)

(10) <sup>1</sup>An enterprise which does not conduct any banking business within the meaning of section 1 (1) sentence 2 and provides financial services that only comprise investment broking or contract broking, placement business or investment advice solely for the account and under the liability of a deposit-taking credit institution or securities trading firm domiciled in Germany or operating in Germany in accordance with section 53b (1) sentence 1 or (7) (tied agent) shall not be deemed to be a financial services institution, but rather a financial enterprise if this is reported to BaFin by the deposit-taking credit institution or securities trading firm as the liable enterprise. <sup>2</sup>The activities of the tied agent shall be attributed to the liable enterprise. <sup>3</sup>If there is any change in the circumstances reported by the liable enterprise, the new circumstances shall be reported to BaFin promptly. <sup>4</sup>More detailed provisions on the contents of the reports pursuant to sentences 1 and 3 as well as the accompanying documentation and evidence can be issued by means of a statutory order pursuant to section 24 (4). <sup>5</sup>BaFin shall forward the reports pursuant to sentences 1 and 3 to the Deutsche Bundesbank. <sup>6</sup>BaFin shall keep a public register of the tied agents reported to it pursuant to this subsection on its website; the names of the liable enterprise and the tied agents as well as the date on which the activity pursuant to sentence 1 starts and ends shall be entered in this register. <sup>7</sup>More detailed provisions on the prerequisites for entry in the register, the contents and the keeping of the register can be issued by means of a statutory order pursuant to section 24 (4), in particular the liable enterprise can be granted write access for the register page to be set up for this enterprise as well as given responsibility for ensuring the accuracy of and updating this page. <sup>8</sup>BaFin can prohibit a liable enterprise, which has not duly selected or monitored its tied agents or has breached the duties entrusted to it in connection with the keeping of the register, from integrating tied agents within the meaning of sentences 1 and 2 into the enterprise.

(11) <sup>1</sup>An institution shall not be required to apply the provisions of this Act concerning the trading book if

- 1 the share of the institution's trading book activities does not normally exceed 5 per cent of its total on- and off-balance-sheet business,
- 2 its total individual trading book positions do not normally exceed the equivalent of 15 million euro, and
- 3 the share of its trading book activities never exceeds 6 per cent of its total on- and off-balance-sheet business and its total trading book positions never exceed the equivalent of 20 million euro.

<sup>2</sup>For the purpose of determining the share of the trading book activities, derivatives shall be valued according to the nominal value or the market price of their underlying instruments, and the other financial instruments at their principal value or market price; long positions and short positions shall be summed regardless of their signs. <sup>3</sup>More detailed provisions shall be laid down by way of a statutory order pursuant to section 22. <sup>4</sup>The institution shall notify BaFin and the Deutsche Bundesbank promptly if it makes use of the option pursuant to sentence 1, if it has exceeded one of the limits laid down in sentence 1 number 3 or if it applies the provisions concerning the trading book even though the conditions specified in sentence 1 exist.

(12) <sup>1</sup>The requirements of sections 25a and 33 (1) numbers 1 to 4 as well as the notification requirements pursuant to section 2c (1) and (4) as well as section 24 (1) numbers 1, 2 and 11 and subsection (1a) number 2 shall apply *mutatis mutandis* to operators of organised markets domiciled outside Germany whose sole financial service comprises operating a multilateral trading system in Germany. <sup>2</sup>The requirements mentioned in sentence 1 shall also apply *mutatis mutandis* to entities responsible for a domestic stock exchange whose sole financial service, apart from over-the-counter trade, comprises operating a multilateral trading system in Germany. <sup>3</sup>It shall be assumed that the senior managers of a domestic stock exchange and persons who actually manage the business of a foreign organised market fulfil the requirements pursuant to section 33 (1) numbers 2 and 4. <sup>4</sup>BaFin's powers pursuant to sections 2c and 25a (1) sentence 7 as well as sections 44 to 48 shall apply *mutatis mutandis*. <sup>5</sup>BaFin can prohibit the persons mentioned in sentence 1 from operating a multilateral trading system in the cases described in section 35 (2) numbers 4, 5 and 6 as well as if they do not fulfil the requirements pursuant to section 33 (1) sentence 1 numbers 1 to 4. <sup>6</sup>The persons mentioned in sentence 1 shall notify BaFin promptly of the commencement of operations.

## **Section 2a Exceptions for institutions belonging to a group**

(1) An institution domiciled in Germany, which is a subordinated enterprise of a group of institutions pursuant to section 10a (1) or (2), need not apply the provisions of sections 10, 13 and 13a as well as 25a (1) sentence 3 number 1 on the establishment of an internal control procedure if

- 1 the superordinated institution holds more than 50 per cent of the voting rights attaching to shares in the capital of the subordinated institution or has the right to

appoint and/or remove a majority of the members of the subordinated institution's management body,

- 2 the prudential management of the subordinated institution by the superordinated institution fulfils BaFin's requirements,
- 3 the superordinated institution's processes for identifying, assessing, managing as well as monitoring and reporting risks cover the subordinated institution,
- 4 there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities by the superordinated institution, and
- 5 the superordinated institution, with BaFin's consent, has declared with binding force that it guarantees the current and future commitments entered into by the subordinated institution, or if the risks incurred by the subordinated institution are of secondary significance.

(2) <sup>1</sup>The institution shall notify BaFin and the Deutsche Bundesbank promptly that and to what extent it will make use of the exception set out in subsection (1). <sup>2</sup>The institution shall furnish BaFin and the Deutsche Bundesbank with suitable documentation to prove the existence of the conditions specified in subsection (1).

(3) <sup>1</sup>The institution shall examine on an *ad hoc* basis whether the conditions specified in subsection (1) still exist and shall document the outcome in writing. <sup>2</sup>This documentation shall be presented to BaFin and the Deutsche Bundesbank upon request.

(4) <sup>1</sup>If the existence of the conditions specified in subsection (1) is not proven, BaFin can ask the institution or the superordinated enterprise to present the required evidence or to take measures that are suitable and necessary to eliminate the prevailing deficiencies; BaFin may set an appropriate deadline for compliance. <sup>2</sup>If evidence is not presented or is not presented within the prescribed period, or if the deficiencies are not remedied or are not remedied within the prescribed period, BaFin can order that the institution shall again apply the provisions of sections 10, 13 and 13a as well as 25a (1) sentence 3 number 1 on the establishment of an internal control system.

(5) Subsections (1) to (4) shall apply *mutatis mutandis* to institutions domiciled in Germany which are subordinated enterprises of a financial holding group pursuant to section 10a (3) if the financial holding company is likewise domiciled in Germany.

(6) <sup>1</sup>A superordinated enterprise within the meaning of section 10a (1) to (3) domiciled in Germany need not apply the provisions of sections 10, 13 and 13a as well as 25a (1) sentence 3 number 1 on the establishment of an internal control procedure if

- 1 there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities to the superordinated institution, and
- 2 the superordinated enterprise is included in the processes for identifying, assessing, managing as well as monitoring and reporting risks used for supervision on a consolidated basis.

<sup>2</sup>Subsections (2) to (4) shall apply *mutatis mutandis*. <sup>3</sup>If a superordinated enterprise makes use of the exception pursuant to sentence 1, BaFin shall inform the competent authorities of the other EEA states accordingly.

## **Section 2b Legal form**

(1) Credit institutions which require authorisation pursuant to section 32 (1) may not be operated in the legal form of a sole proprietorship.

(2) <sup>1</sup>In the case of securities trading firms in the legal form of a sole proprietorship or commercial partnership, the risk assets of the proprietor or general partners shall be included in the assessment of the institution's solvency pursuant to section 10 (1); however, the personal assets of the proprietor or partners shall be excluded when calculating the institution's own funds. <sup>2</sup>If such an institution is operated in the legal form of a sole proprietorship, the proprietor shall take appropriate measures to protect his/her customers in the event that the institution discontinues its business operations owing to the proprietor's death or legal incapacity or for other reasons.

## **Section 2c Holders of major participating interests**

(1) <sup>1</sup>Anyone who intends to purchase a major participating interest in an institution, either alone or through collaboration with other persons or enterprises (prospective purchaser), shall report this intention in writing to BaFin and the Deutsche Bundesbank promptly pursuant to sentence 2. <sup>2</sup>In this report, the prospective purchaser shall give the key facts and documentation, which are to be specified in more detail by way of a statutory order pursuant to section 24 (4), germane to the amount of the participating interest and to the establishment of the significant influence, as well as to the assessment of his/her trustworthiness and examination of the further grounds for prohibition pursuant to subsection (1b) sentence 1, and name the individuals or enterprises from whom or which he/she intends to acquire the corresponding capital shares. <sup>3</sup>The statutory order may provide that, in particular also in case-by-case decisions or as a general rule, the prospective purchaser shall present the documentation specified in section 32 (1) sentence 2 number 6 letters (d) and (e). <sup>4</sup>If the prospective purchaser is a legal person or a commercial partnership, the report shall contain the key facts germane to assessing the trustworthiness of its legal representatives or representatives pursuant to the articles of association or articles of incorporation, or of its general partners. <sup>5</sup>The holder of a major participating interest shall promptly report every newly appointed legal representative or representative pursuant to the articles of association or articles of incorporation, or new general partner to BaFin and the Deutsche Bundesbank in writing, together with the key facts germane to assessing his/her trustworthiness. <sup>6</sup>The holder of a major participating interest shall, moreover, promptly notify BaFin and the Deutsche Bundesbank in writing if he/she intends, either alone or through collaboration with other persons or enterprises, to increase the amount of the major participating interest in such a way that the thresholds of 20 per cent, 30 per cent or 50 per cent of the voting rights or capital are reached or exceeded, or that the institution comes under his/her control. <sup>7</sup>BaFin shall provide the party required to submit the report with written

confirmation of receipt of a complete report pursuant to sentence 1 or sentence 6 promptly, but at the latest within two working days of receipt thereof.

(1a) <sup>1</sup>BaFin shall assess the report pursuant to subsection (1) within 60 working days of the date on its letter confirming receipt of a complete report (assessment period). <sup>2</sup>In the confirmation provided pursuant to subsection (1) sentence 7, BaFin shall inform the party required to submit the report of the date on which the assessment period will end. <sup>3</sup>BaFin can make a written request for further information which it requires to complete the assessment no later than the 50th working day of the assessment period. <sup>4</sup>The request shall be made in writing, specifying the additional information required. <sup>5</sup>BaFin shall provide the party required to submit the report with written confirmation of receipt of this additional information promptly, at the latest however within two working days of receipt thereof. <sup>6</sup>The assessment period shall be suspended from the time when the request for further information is made until BaFin receives this information. <sup>7</sup>In the event of a suspension pursuant to sentence 6, the assessment period shall last no more than 80 working days. <sup>8</sup>BaFin can ask for additional data or clarifications regarding this information; this shall not lead to a further suspension of the assessment period. <sup>9</sup>Notwithstanding sentence 7, the assessment period can be extended to no more than 90 working days in the event of a suspension if the party required to submit the report

- 1 is resident or supervised in a non-EEA state, or
- 2 is a natural person or enterprise not subject to supervision pursuant to Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance, Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance, Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments, Directive 2005/68/EC of the European Parliament and of the Council of 16 November 2005 on reinsurance, or the Banking Directive.

(1b) <sup>1</sup>BaFin can prohibit the intended purchase of or increase in the major participating interest within the assessment period if facts are known which warrant the assumption that

- 1 the party required to submit the report or, if it is a legal person, a legal representative or representative pursuant to the articles of association or articles of incorporation, or, if it is a commercial partnership, a partner, is not trustworthy or for any other reason does not satisfy the requirements to be set in the interests of the sound and prudent management of the institution; in case of doubt, this shall also apply if facts are known which warrant the assumption that the funds raised in order to purchase the major participating interest have been acquired by an action which objectively constitutes a criminal offence;
- 2 the institution will not be or remain in a position to meet the supervisory requirements, in particular those pursuant to the Banking Directive, Directive 2000/46/EC of the

European Parliament and of the Council of 18 September 2000 on the taking up, pursuit of and prudential supervision of the business of electronic money institutions, Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions, or the institution, through purchasing or increasing the major participating interest, would be integrated into a corporate network with the holder of the major participating interest which, owing to the structure of cross-shareholdings or because of inadequate economic transparency, would hamper the effective supervision of the institution or the effective exchange of information between the competent agencies or the allocation of responsibilities between the said agencies;

- 3 the purchase of or increase in the major participating interest would make the institution a subsidiary of an institution domiciled in a non-EEA state that is not effectively supervised in the state where it is domiciled or has its head office or whose competent supervisory body is not prepared to cooperate satisfactorily with BaFin;
- 4 the future senior manager is not trustworthy or does not have the necessary professional qualifications;
- 5 the intended purchase of or increase in the participating interest is being used or has been used for money laundering or terrorist financing within the meaning of Article 1 of Directive 2005/60/EC, these criminal offences have been attempted, or the purchase of or increase in the participating interest could aggravate the risk of such occurring, or
- 6 the party required to submit the report does not have the requisite financial soundness; this is especially the case if, owing to its capital adequacy or asset situation, the party required to submit the report is unable to fulfil the special requirements laid down by law with regard to an institution's own funds and liquidity.

<sup>2</sup>BaFin can also prohibit the purchase of or increase in the participating interest if the data pursuant to subsection (1) sentence 2 or sentence 6 or the additional information required pursuant to subsection (1a) sentence 3 are incomplete or incorrect or do not meet the requirements laid down in the statutory order pursuant to section 24 (4). <sup>3</sup>BaFin may neither impose preconditions on the size of the participating interest to be purchased or the intended increase in the participating interest nor be guided by the economic needs of the market in its assessment. <sup>4</sup>If, after completing its assessment, BaFin decides to prohibit the purchase of or increase in the participating interest, it shall inform the party required to submit the report of its decision in writing within two working days and in observance of the assessment period, stating the reasons therefor. <sup>5</sup>Any comments and reservations on the part of the agencies competent for the party required to submit the report shall be cited in the decision; prohibition is permissible only for the reasons given in sentences 1 and 2. <sup>6</sup>If the purchase of or increase in the participating interest is not prohibited in writing within the assessment period, then the purchase or increase may be executed; this is without prejudice to BaFin's

rights pursuant to subsection (2). <sup>7</sup>BaFin can set a deadline after the expiry of which the party required to submit the report shall notify it whether or not the intended purchase of or increase in the participating interest has been executed. <sup>8</sup>After the expiry of this deadline, the party required to submit the report shall submit the report to BaFin promptly.

(2) <sup>1</sup>BaFin may prohibit the holder of a major participating interest as well as the enterprises that it controls from exercising the voting rights and order that the capital shares may be used only with BaFin's consent if

- 1 the prerequisites for a prohibition order pursuant to subsection (1b) sentence 1 or sentence 2 exist,
- 2 the holder of the major participating interest has not fulfilled its duty pursuant to subsection (1) to give BaFin and the Deutsche Bundesbank prior notification of its intention and has not made such notification subsequently by a deadline set by BaFin, or
- 3 the participating interest has been purchased or increased contrary to an enforceable prohibition pursuant to subsection (1b) sentence 1 or sentence 2.

<sup>2</sup>In the event of a prohibition pursuant to sentence 1, the court having jurisdiction at the institution's domicile – at the request of BaFin, the institution or a holder of a participating interest in the institution – shall appoint a trustee to whom it shall transfer the exercise of voting rights. <sup>3</sup>In exercising the voting rights, the trustee shall take due account of the interests of a sound and prudent management of the institution. <sup>4</sup>Over and above the measures pursuant to sentence 1, BaFin may commission the trustee to sell the capital shares insofar as they establish a major participating interest if the holder of the major participating interest does not provide BaFin with proof of a trustworthy buyer by an appropriate deadline set by BaFin; the holders of the capital shares shall cooperate in the sale to the extent necessary. <sup>5</sup>If the prerequisites specified in sentence 1 no longer exist, BaFin shall apply for the appointment of the trustee to be revoked. <sup>6</sup>The trustee shall be entitled to the reimbursement of reasonable expenses and remuneration for his/her activities. <sup>7</sup>The court shall determine such expenses and remuneration at the trustee's request; an appeal on a point of law against the fixing of remuneration by the court shall not be permissible. <sup>8</sup>The institution and the relevant holder of the major participating interest shall be jointly and severally liable for the costs arising from the appointment of the trustee, the expenses that he/she is to be granted and his/her remuneration. <sup>9</sup>BaFin shall advance such expenses and remuneration.

(3) <sup>1</sup>Anyone who intends to relinquish a major participating interest in an institution or to reduce the amount of his/her major participating interest below the thresholds of 20 per cent, 30 per cent or 50 per cent of the voting rights or the capital, or to change the participating interest in such a way that the institution is no longer a controlled enterprise, shall report this promptly in writing to BaFin and the Deutsche Bundesbank. <sup>2</sup>The intended residual level of the participating interest shall be indicated in the report. <sup>3</sup>BaFin can set a deadline after the expiry of which the person or commercial partnership who has submitted the report pursuant to sentence 1 shall provide notification of whether or not the intended reduction or change in

the participating interest has been executed. <sup>4</sup>After the expiry of this deadline, the person or commercial partnership who has submitted the report pursuant to sentence 1 shall submit the notification to BaFin promptly.

(4) <sup>1</sup>BaFin shall temporarily prohibit or limit the purchase of a direct or indirect participating interest in an institution, through which the institution would become a subsidiary of an enterprise domiciled in a non-EEA state, if a decision to this effect has been taken by the European Commission pursuant to Article 151 (2) of the Banking Directive or Article 15 (3) sentence 2 of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (OJ EU L 145/1, 2005 OJ EU L 45/18 (Markets in Financial Instruments Directive)). <sup>2</sup>The temporary prohibition or limitation may not last for more than three months from the date of the decision. <sup>3</sup>If the Council of the European Union decides to prolong the period pursuant to sentence 2, BaFin shall take due account of this prolongation and prolong the temporary prohibition or limitation accordingly.

## **Section 2d Management bodies of financial holding companies and mixed financial holding companies**

(1) Any persons who actually manage the business of a financial holding company or a mixed financial holding company shall be trustworthy and have the professional qualifications necessary to manage the company.

(2) In the case of financial holding companies and mixed financial holding companies which have been classified as the superordinated enterprise pursuant to section 10a (3) sentence 6 or sentence 7 or section 10b (3) sentence 8, BaFin can demand that the persons within the meaning of subsection (1) are dismissed and prohibit them from carrying out their activities if

- 1 they do not fulfil the conditions of subsection (1), or
- 2 they have intentionally or recklessly contravened the provisions of this Act, the regulations issued to implement this Act or orders issued by BaFin, and if they persist in such behaviour despite having been duly cautioned by BaFin.

## **Section 3 Prohibited business**

The following activities are prohibited:

- 1 the conduct of deposit business if the majority of the depositors are persons employed by the enterprise (company savings banks), unless other banking business is conducted which exceeds the scale of such deposit business;
- 2 the acceptance of monetary amounts if the majority of the financiers have a legal right to the granting of loans or the procurement of items on credit out of these monetary amounts (special-purpose savings enterprises); this shall not apply to building and loan associations (*Bausparkassen*);

- 3 the conduct of lending business or deposit business if, by agreement or in line with standard business practice, it is not permissible or extremely difficult to withdraw the amount of the loan or the deposits in cash.

#### **Section 4 BaFin's decision**

<sup>1</sup>In cases of doubt, BaFin shall decide whether an enterprise is subject to the provisions of this Act. <sup>2</sup>Its decisions shall be binding upon the administrative authorities.

## **Division 2 FEDERAL FINANCIAL SUPERVISORY AUTHORITY (BAFIN)**

### **Section 5 (Repealed)**

### **Section 6 Functions**

(1) BaFin shall exercise supervision over institutions pursuant to the provisions of this Act.

(2) BaFin shall counteract undesirable developments in the banking and financial services sector which may endanger the safety of the assets entrusted to institutions, impair the proper conduct of banking business or provision of financial services or lead to serious disadvantages for the economy as a whole.

(3) <sup>1</sup>BaFin may, as part of its statutory mandate, issue orders to institutions and their senior managers that are appropriate and necessary to stop or prevent violations of regulatory provisions or to prevent or overcome undesirable developments at an institution which could endanger the safety of the assets entrusted to the institution or impair the proper conduct of its banking business or provision of financial services. <sup>2</sup>The power to issue orders pursuant to sentence 1 shall also apply vis-à-vis financial holding companies or mixed financial holding companies as well as vis-à-vis the persons who actually manage the business of these companies.

(4) (Repealed)

### **Section 6a Special functions**

(1) If there are grounds for inferring that the deposits accepted by an institution, any other assets entrusted to an institution or a financial transaction serve or – if a financial transaction were to be executed – would serve the purpose of financing a terrorist organisation pursuant to section 129a also in conjunction with section 129b of the German Criminal Code (*Strafgesetzbuch*), then BaFin may

- 1 issue instructions to the management of the institution;
- 2 prohibit an institution from allowing funds to be withdrawn or transferred from an account or safe custody account held with it;
- 3 prohibit an institution from executing any other financial transactions.

(2) Such grounds within the meaning of subsection (1) are, as a rule, particularly deemed to exist if the holder of an account or a safe custody account, any party authorised to draw on the said accounts, or a customer of the institution is a natural or legal person or a group of persons without legal personality whose name is included on the applicable list of the European Council approved in connection with combating terrorism as part of the Council Common Position 2001/931/CFSC of 27 December 2001 on the application of specific measures to combat terrorism (OJ EC L 344/93).

(3) BaFin can release assets subject to an order issued pursuant to subsection (1) in individual cases at the request of the natural or legal person or group of persons without legal personality concerned if these assets cover the minimum subsistence outlays of the person or his/her family or are required for pension payments, maintenance payments or similar purposes.

(4) An order issued pursuant to subsection (1) shall be rescinded as soon and insofar as the reason for issuing it no longer exists.

(5) The institution or any other aggrieved party can raise an objection to an order issued pursuant to subsection (1).

(6) This is without prejudice to the possibility of imposing restrictions on capital transfers and payment transactions pursuant to section 2 (2) in conjunction with section 7 (1) of the Foreign Trade and Payments Act (*Aussenwirtschaftsgesetz*).

## **Section 7 Cooperation with the Deutsche Bundesbank**

(1) <sup>1</sup>BaFin and the Deutsche Bundesbank shall cooperate as stipulated in this Act. <sup>2</sup>Notwithstanding further legal provisions, such cooperation shall encompass the ongoing monitoring of institutions by the Deutsche Bundesbank. <sup>3</sup>Ongoing monitoring shall specifically include evaluating the documentation submitted by institutions, audit reports pursuant to section 26 and annual financial statements as well as performing and evaluating audits of banking operations with a view to assessing institutions' capital adequacy and risk management procedures, as well as appraising audit findings. <sup>4</sup>As a rule, the Deutsche Bundesbank's ongoing monitoring activities shall be performed by its Regional Offices (*Hauptverwaltungen*).

(2) <sup>1</sup>In this context, the Deutsche Bundesbank shall observe the guidelines issued by BaFin. <sup>2</sup>BaFin's guidelines on ongoing supervision shall be issued in agreement with the Deutsche Bundesbank. <sup>3</sup>If agreement cannot be reached within an appropriate period, the Federal Ministry of Finance shall issue such guidelines in consultation with the Deutsche Bundesbank. <sup>4</sup>BaFin shall be responsible for any supervisory action taken against institutions, especially general dispositions and administrative acts, including audit orders pursuant to section 44 (1) sentence 2 and section 44b (2) sentence 1. <sup>5</sup>As a rule, BaFin shall base its supervisory action on the Deutsche Bundesbank's audit findings and appraisals.

(3) <sup>1</sup>BaFin and the Deutsche Bundesbank shall exchange any observations and findings which are necessary for the performance of their functions. <sup>2</sup>In this respect, the Deutsche Bundesbank shall also provide BaFin with the data that it obtains by virtue of collecting statistics pursuant to section 18 of the Bundesbank Act (*Gesetz über die Deutsche Bundesbank*). <sup>3</sup>It shall consult BaFin prior to ordering such collection of statistics; section 18 sentence 5 of the Bundesbank Act shall apply *mutatis mutandis*.

(4) <sup>1</sup>The cooperation pursuant to subsection (1) and the information pursuant to subsection (3) include the transmission of personal data which are needed by the recipient for the

performance of its functions. <sup>2</sup>In order to perform their functions under this Act, BaFin and the Deutsche Bundesbank may access the data stored in each other's databases by means of an automated procedure. <sup>3</sup>Every tenth time that BaFin retrieves personal data from the Deutsche Bundesbank's database, the Deutsche Bundesbank shall log the time, the details which enable the retrieved data sets to be ascertained as well as the identity of the retriever. <sup>4</sup>The log data may be used solely for the purpose of monitoring compliance with data protection rules, for data backups or for ensuring the proper functioning of the data processing system. <sup>5</sup>They must be deleted at the end of the calendar year following that in which the data are logged, unless they are needed for an ongoing control procedure. <sup>6</sup>Sentences 3 to 5 shall apply *mutatis mutandis* to data retrievals by the Deutsche Bundesbank from BaFin's database. <sup>7</sup>This is without prejudice to the provisions of the Federal Data Protection Act (*Bundesdatenschutzgesetz*).

(5) <sup>1</sup>BaFin and the Deutsche Bundesbank can set up joint data files. <sup>2</sup>Each party may alter, block or delete only the data which it itself has entered and is deemed to be the competent authority within the meaning of the Federal Data Protection Act with regard only to the data which it itself has entered. <sup>3</sup>If either party has grounds to suspect that the data entered by the other party are incorrect, it shall notify the other party thereof promptly. <sup>4</sup>The other party shall promptly check the accuracy of the data and, if necessary, promptly correct, block or delete the data. <sup>5</sup>When a joint data file is set up, it shall be determined which party shall take the technical and organisational measures pursuant to section 9 of the Federal Data Protection Act. <sup>6</sup>The party designated pursuant to sentence 5 shall ensure that employees are granted access to personal data only to the extent necessary for performing their functions. <sup>7</sup>Retrievals of personal data by the party which did not enter the data shall be logged in accordance with subsection (4) sentences 3 to 5.

## **Section 8 Cooperation with other authorities**

(1) (Repealed)

(2) If criminal proceedings for tax offences are initiated against proprietors or senior managers of institutions as well as against holders of major participating interests in institutions or their legal representatives or representatives pursuant to the articles of association or articles of incorporation or general partners or against persons who actually manage the business of a financial holding company or a mixed financial holding company, or if such proceedings are not initiated owing to voluntary disclosure pursuant to section 371 of the Fiscal Code (*Abgabenordnung*), then section 30 of the Fiscal Code shall not preclude notifying BaFin of the proceedings and the underlying facts; the same shall apply if the proceedings are directed at persons who committed the offence whilst they were an employee of an institution or of a holder of a major participating interest in an institution.

(3) <sup>1</sup>BaFin and the Deutsche Bundesbank – insofar as it takes action under this Act – shall work together with the competent EEA authorities in the supervision of institutions which conduct banking business or provide financial services in another EEA state as well as in the supervision of groups of institutions or financial holding groups within the meaning of section

10a (1) to (5). <sup>2</sup>For the assessment pursuant to section 2c (1a) and (1b), BaFin shall work together with the competent EEA authorities if the party required to submit the report is

- 1 a deposit-taking credit institution, an e-money institution or a securities trading firm, a primary insurance company, a reinsurance company or a management company within the meaning of Article 1a number 2 of Council Directive 85/611/EEC (UCITS management company) which is authorised to operate in a member state or sector other than the one in which a major participating interest is to be purchased;
- 2 a parent enterprise of a deposit-taking credit institution, an e-money institution or a securities trading firm, a primary insurance company, a reinsurance company or a UCITS management company which is authorised to operate in a member state or sector other than the one in which a major participating interest is to be purchased, or
- 3 a natural or legal person who controls a deposit-taking credit institution, an e-money institution or a securities trading firm, a primary insurance company, a reinsurance company or a UCITS management company which is authorised to operate in a member state or sector other than the one in which a major participating interest is to be purchased.

<sup>3</sup>Subject to section 4b (1) in conjunction with section 15 (1) of the Federal Data Protection Act, they shall exchange with them all relevant and essential information required for the performance of supervision. <sup>4</sup>Essential information can be passed on even without an appropriate request from the competent authority. <sup>5</sup>All information which may affect the assessment of an institution's financial situation in the EEA state in question shall be deemed to be essential information in this respect. <sup>6</sup>This includes, in particular:

- 1 identification of the group structure, including of all major institutions in the group, as well as of the competent authorities of the institutions in the group,
- 2 procedures for the collection of information from the institutions in a group, and the verification of that information,
- 3 adverse developments in institutions or in other entities of a group which could seriously affect the institutions, and
- 4 major sanctions or exceptional supervisory measures which BaFin has taken pursuant to this Act or the statutory orders issued with regard to this Act's enforcement.

<sup>7</sup>BaFin shall provide the competent authority in the host state with all the information necessary for assessing the trustworthiness and the professional qualifications of the persons mentioned in section 1 (2) sentence 1 as well as for assessing the trustworthiness of the holders of a major participating interest in enterprises of the same group domiciled in Germany which is required for granting authorisation to and the ongoing supervision of an enterprise within the meaning of section 33b sentence 1 that intends to conduct banking business in accordance with section 1 (1) sentence 2 numbers 1, 2, 4 and 10 or provide financial services in accordance with section 1 (1a) sentence 2 numbers 1 to 4 in the host state.

(3a) <sup>1</sup>The competent authority within the meaning of subsection (3) sentence 1 can ask for BaFin's cooperation in a monitoring operation or an examination or inquiry. <sup>2</sup>In the case of requests within the meaning of sentence 1, BaFin – for the purposes of monitoring compliance with this Act and the relevant provisions of these states – shall make use of all the powers vested in it according to law, insofar as this is appropriate and necessary to fulfil the requests. <sup>3</sup>BaFin can refuse to perform an examination, provide information or allow employees of these foreign authorities to participate in such examinations if

- 1 the sovereignty, security or public order of the Federal Republic of Germany could thereby be undermined, or
- 2 judicial proceedings have already been instituted or an unappealable decision has already been rendered with regard to the persons in question on the basis of the same matters.

<sup>4</sup>In the event that BaFin does not fulfil a pertinent request or if it avails itself of its right pursuant to sentence 1, it shall inform the authority making the request of this promptly, explaining the reasons therefor; in the case of a refusal pursuant to sentence 3 number 2, it shall provide precise information about the judicial proceedings or unappealable decision.

(4) <sup>1</sup>In cases where BaFin is responsible for the supervision of EU parent institutions or institutions which are controlled by an EU parent financial holding company, it shall, upon request, provide all relevant information to the competent authorities of the other EEA states which are responsible for the supervision of subsidiaries of these institutions. <sup>2</sup>All information which may materially influence the assessment of the financial soundness of an institution in another EEA state shall be deemed to be relevant information in this respect. <sup>3</sup>The extent of the duty to provide information shall depend, in particular, on the subsidiary's importance within the financial system of the state concerned.

(5) Information from the competent authorities of another state may be used only for the following purposes:

- 1 to verify an institution's approval for business operations,
- 2 to monitor the institutions' activities on a stand-alone or consolidated basis,
- 3 for orders issued by BaFin as well as BaFin's prosecution and punishment of breaches of administrative regulations,
- 4 in the context of administrative proceedings regarding legal remedies against a decision by BaFin, or
- 5 in the context of proceedings before administrative courts, insolvency courts, public prosecutor's offices or courts having jurisdiction in criminal cases or administrative fine cases.

(6) <sup>1</sup>Before a decision is rendered on the following matters, BaFin shall regularly consult the competent EEA authorities if the decision is of importance for their supervisory tasks:

- 1 changes in the shareholder, organisational or management structure of institutions in a group which require BaFin's approval or authorisation,
- 2 major sanctions or exceptional supervisory measures. In these cases, at least the competent authority responsible for supervision on a consolidated basis shall always be consulted, unless this supervision falls within BaFin's area of responsibility.

<sup>2</sup>In the event of imminent risk, BaFin may waive prior consultation of the competent authorities. <sup>3</sup>The same shall apply if prior consultation could compromise the effectiveness of the measure; in these cases, BaFin shall promptly inform the competent authorities after it has ordered or implemented the measure.

(7) <sup>1</sup>If BaFin is responsible for the supervision of a group of institutions or a financial holding group on a consolidated basis and an emergency situation arises within the group which potentially jeopardises the stability of the financial system in any EEA state in which one of the enterprises belonging to the group is domiciled, then BaFin shall promptly inform the Federal Ministry of Finance and the Deutsche Bundesbank. <sup>2</sup>This is without prejudice to section 9.

(8) BaFin shall notify the competent authorities of the host state of any measures which it will take to end an institution's infringements of the host state's legal provisions of which BaFin has been informed by the competent authorities of the host state.

(9) <sup>1</sup>If BaFin has sufficient evidence to indicate an infringement of the provisions of this Act or the corresponding provisions of the EEA states, it shall inform the authority responsible for cooperation in the supervision of institutions within whose jurisdiction the improper action has occurred. <sup>2</sup>If BaFin receives corresponding notification from the competent authorities of other states, it shall inform these authorities of the outcome of any inquiries which it institutes in this regard.

## **Section 8a Special tasks relating to supervision on a consolidated basis**

(1) If BaFin is responsible for the consolidated supervision of a group of institutions or a financial holding group within the meaning of section 10a (1) to (5) headed by an EU parent institution or an EU parent financial holding company, it shall be responsible not only for the tasks ensuing from this Act, but also for carrying out the following tasks:

- 1 coordination of the gathering and dissemination of relevant and essential information pursuant to section 8 (3) as part of ongoing supervision as well as in emergency situations, and
- 2 planning and coordination of supervisory activities as part of ongoing supervision as well as in emergency situations. BaFin and the Deutsche Bundesbank – insofar as it takes action under this Act – shall hereby work together with the competent authorities of the other EEA states insofar as this is necessary. This shall particularly be the case for the ongoing monitoring of institutions' risk management frameworks as well as for cross-border examinations.

(2) <sup>1</sup>BaFin and the competent EEA authorities can lay down detailed provisions for the supervision of groups of institutions or financial holding groups within the meaning of section 10a (1) to (5) in cooperation agreements. <sup>2</sup>These arrangements may entrust additional tasks to the competent authority responsible for supervision on a consolidated basis and specify procedures for the decision-making process and for cooperation with other competent authorities.

## **Section 8b Cooperation in the supervision of financial conglomerates**

(1) <sup>1</sup>BaFin and the Deutsche Bundesbank – insofar as it takes action under this Act – shall work together with the competent authorities of the other EEA states in determining the existence of and supervising financial conglomerates pursuant to Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council (OJ EU 2003 L 35/1); section 8 (5) shall apply *mutatis mutandis*. <sup>2</sup>Where a deposit-taking credit institution, an e-money institution, a securities trading firm or a German asset management company belongs to a cross-border corporate group which could be a financial conglomerate but has not yet been classified as such pursuant to Directive 2002/87/EC, BaFin shall inform the competent authorities of the other EEA states concerned accordingly.

(2) <sup>1</sup>BaFin together with the competent authorities of the other EEA states concerned shall designate pursuant to Article 10 of Directive 2002/87/EC a single coordinator responsible for the supplementary supervision of the financial conglomerate pursuant to this Act. <sup>2</sup>If BaFin is the coordinator, it shall be responsible for the following tasks, in particular, pursuant to Article 11 of Directive 2002/87/EC:

- 1 coordination of the gathering and dissemination of relevant and essential information as part of ongoing supervision as well as in emergency situations;
- 2 supervisory overview and assessment of the financial situation of a financial conglomerate;
- 3 assessment of compliance with the provisions on capital adequacy as well as on risk concentration and intra-group transactions pursuant to Articles 6 to 8 of Directive 2002/87/EC;
- 4 assessment of the financial conglomerate's structure, organisation and internal control system pursuant to Article 9 of Directive 2002/87/EC;
- 5 planning and coordination of supervisory activities as part of ongoing supervision as well as in emergency situations in cooperation with the competent authorities of the other EEA states concerned, and
- 6 any other tasks, measures and decisions assigned to BaFin by Directive 2002/87/EC or deriving from its application.

<sup>3</sup>As the coordinator, BaFin shall

- 1 inform the competent authorities of the other EEA states concerned that notification has been provided of the finding that a group of enterprises is a financial conglomerate pursuant to section 51b (1);
- 2 consult the competent authorities of the other EEA states concerned prior to
  - (a) decisions pursuant to section 10b (3) sentence 8, also in conjunction with section 13d (1), and section 53d;
  - (b) exemptions pursuant to section 31 (5) sentence 3; in urgent cases, BaFin can waive prior consultation;
  - (c) measures pursuant to section 10b (5), section 13d (4) sentence 5, section 45 (3) and section 45a (1) sentence 2 if these are of importance for the authorities' supervisory activities; in urgent cases or in the event of imminent risk, BaFin may waive prior consultation of the competent authorities. It shall promptly inform the competent authorities of the EEA states concerned thereof;
- 3 present the competent authorities of the other EEA states concerned with proposals for decisions on
  - (a) disregarding conglomerate enterprises when calculating thresholds pursuant to section 51a (4);
  - (b) revoking the finding that a group of enterprises is a financial conglomerate and that an enterprise is a superordinated financial conglomerate enterprise pursuant to section 51b (3);
  - (c) exemptions pursuant to section 51c number 2.

(3) <sup>1</sup>In the cases specified in section 8d (2), section 10b (4), section 51a (4) and (6) sentence 4, section 51b (3) and section 51c, BaFin shall render a decision in agreement with the competent authorities of the other EEA states concerned. <sup>2</sup>Only relevant competent authorities shall be deemed to be competent authorities within the meaning of sentence 1 as well as subsection (2) sentence 3 number 2 letters (a) and (b) and number 3. <sup>3</sup>Relevant competent authorities shall mean the coordinator pursuant to subsection (2) sentence 1 and the other authorities defined as relevant competent authorities in Article 2 number 17 of Directive 2002/87/EC or identified as such in the procedure described therein.

(4) BaFin shall lay down detailed provisions on cooperation in the supervision of financial conglomerates in cooperation agreements concluded with the competent authorities of the other EEA states concerned.

### **Section 8c Delegation of responsibility for the supervision of groups of institutions, financial holding groups and institutions belonging to a group**

(1) <sup>1</sup>BaFin may waive supervision of a group of institutions or a financial holding group within the meaning of section 10a (1) to (5) and revocably delegate responsibility for supervision on

a consolidated basis to another competent authority within the EEA if supervision by BaFin would be inappropriate in view of the institutions concerned and the importance of their business activities in the other state, and if

- 1 in the case of groups of institutions, the group's superordinated enterprise is a subsidiary of a deposit-taking credit institution or a securities trading firm domiciled in the other EEA state and is included in supervision on a consolidated basis in accordance with the Banking Directive in that other state, or
- 2 in the case of financial holding groups, these groups are supervised on a consolidated basis in accordance with the Banking Directive by the competent authorities of the other EEA state.

<sup>2</sup>In these cases, BaFin shall revocably exempt the superordinated enterprise from the provisions of this Act relating to supervision on a consolidated basis. <sup>3</sup>The superordinated enterprise shall be consulted before exemption and delegation of responsibility to another authority. <sup>4</sup>The Commission of the European Communities shall be notified of the existence and contents of any such agreements.

(2) <sup>1</sup>If BaFin assumes responsibility for supervision on a consolidated basis of a group of institutions or a financial holding group by virtue of an agreement with a competent authority within the EEA, it can designate a group institution domiciled in Germany as the superordinated enterprise. <sup>2</sup>Section 10a shall apply *mutatis mutandis*.

(3) <sup>1</sup>BaFin can revocably delegate responsibility for the supervision of an institution which it is responsible for authorising to another competent authority within the EEA if the institution is a subsidiary of an institution which this competent authority is responsible for authorising and supervising pursuant to the Banking Directive. <sup>2</sup>This institution shall be consulted before delegation of responsibility to another authority. <sup>3</sup>The Commission of the European Communities shall be informed of the existence and contents of any such agreements.

#### **Section 8d Responsibility for supplementary supervision at conglomerate level**

(1) BaFin may waive supervision of a financial conglomerate and revocably exempt the superordinated financial conglomerate enterprise from the provisions of this Act relating to supervision at conglomerate level if

- 1 the financial conglomerate is subordinated to another financial conglomerate, whose superordinated financial conglomerate enterprise is domiciled in another EEA state and is included in supplementary supervision at conglomerate level there pursuant to Directive 2002/87/EC, or
- 2 this is appropriate, taking into account the financial conglomerate's structure and the relative importance of its activities in different EEA states; the superordinated financial conglomerate enterprise shall be given the opportunity to comment.

(2) <sup>1</sup>Over and above the cases specified in section 1 (20) and section 10b (3) sentences 6 to 8 or (4), BaFin can designate a cross-sector corporate group as a financial conglomerate and

an institution as a superordinated financial conglomerate enterprise pursuant to Article 2 number 14 as well as Articles 3 and 5 of Directive 2002/87/EC. <sup>2</sup>The provisions of this Act relating to the supplementary supervision of financial conglomerates shall apply *mutatis mutandis* in this case.

## **Section 9 Confidentiality requirement**

(1) <sup>1</sup>Persons employed by BaFin and persons commissioned under section 4 (3) of the Act Concerning the Federal Financial Supervisory Authority (*Gesetz über die Bundesanstalt für Finanzdienstleistungsaufsicht*), supervisors appointed under section 46 (1) sentence 2 number 4, the liquidators appointed under section 37 sentence 2 and section 38 (2) sentences 2 and 4 and persons employed by the Deutsche Bundesbank, insofar as they are acting to implement this Act, may not disclose or use without authorisation facts which have come to their notice in the course of their activities and which should be kept secret in the interests of the institution or a third party (especially business and trade secrets), not even after they have left such employment or their activities have ended. <sup>2</sup>This is without prejudice to the provisions of the Federal Data Protection Act which must be complied with by the institutions and enterprises under supervision. <sup>3</sup>This shall also apply to other persons who, by way of official reporting, obtain knowledge of the facts referred to in sentence 1. <sup>4</sup>In particular, it shall not be deemed to be such disclosure or use without authorisation within the meaning of sentence 1 if facts are passed on to

- 1 criminal prosecution authorities or courts having jurisdiction in criminal cases or administrative fine cases,
- 2 authorities which are entrusted by law or public mandate with the supervision of institutions, asset management companies, financial enterprises, insurance companies, financial markets or payment systems or operations, and to persons commissioned by such authorities,
- 3 authorities dealing with an institution's liquidation or insolvency proceedings over its assets,
- 4 persons entrusted with the statutory auditing of the accounts of institutions or financial enterprises and to authorities which supervise such persons,
- 5 a deposit guarantee scheme or an investor compensation scheme,
- 6 stock exchanges or futures exchanges,
- 7 central banks, or
- 8 providers of systems pursuant to section 1 (16),

insofar as these authorities require the information for the performance of their functions. <sup>5</sup>The confidentiality requirement specified in sentence 1 shall apply *mutatis mutandis* to persons employed by these authorities. <sup>6</sup>If the authority is located in another state, the facts may be passed on only if that authority and the persons commissioned by it are subject to a confidentiality requirement corresponding to that specified in sentence 1. <sup>7</sup>The foreign authority is to be informed that it may use information solely for the purpose for which it has

been passed on to it. <sup>8</sup>Information from another state may be passed on only with the express permission of the competent authorities providing this information and only for such purposes as have been agreed by these authorities.

(2) <sup>1</sup>Sections 93, 97 and 105 (1), section 111 (5) in conjunction with section 105 (1), and section 116 (1) of the Fiscal Code shall not apply to the persons specified in subsection (1) insofar as they are acting to implement this Act. <sup>2</sup>This shall not apply if the fiscal authorities require the information for instituting tax offence proceedings and the associated tax assessment proceedings in the prosecution of which there is a pressing public interest, or if the person required to provide information or the persons acting on his/her behalf have intentionally supplied incorrect information. <sup>3</sup>Sentence 2 shall not apply if the facts involved were communicated to the persons specified in subsection (1) sentence 1 or 3 by the competent supervisory authority of another state or by persons commissioned by that authority.

## Part II

# Provisions for institutions, groups of institutions, financial holding groups, financial conglomerates, mixed financial holding companies and mixed-activity holding companies

## Division 1 OWN FUNDS AND LIQUIDITY

### Section 10 Own funds requirements for institutions, groups of institutions and financial holding groups

(1) <sup>1</sup>In order to meet their obligations to their creditors, and in particular to safeguard the assets entrusted to them, institutions as well as groups of institutions and financial holding groups pursuant to section 10a (1) to (5) must have adequate own funds. <sup>2</sup>To assess the adequacy of their own funds, institutions as well as groups of institutions and financial holding groups within the meaning of section 10a (1) to (5) may, subject to BaFin's prior approval, use internal risk measurement procedures, in particular internal rating systems for estimating risk parameters relating to counterparty credit risk, internal market risk models and internal estimation procedures for determining operational risk. <sup>3</sup>Institutions may collect and use personal data on their customers, on persons with whom they conduct contractual negotiations on transactions that give rise to counterparty credit risk and on persons responsible for the performance of a counterparty credit risk, provided that these data are

- 1 verifiably material to determining and recognising counterparty credit risks using a scientifically recognised mathematical-statistical method, and
- 2 necessary for the setting up and operation, including the development and improvement, of internal rating systems for estimating risk parameters relating to the institution's counterparty credit risk

and do not pertain to information about nationality or data pursuant to section 3 (9) of the Federal Data Protection Act. <sup>4</sup>Business and trade secrets shall be deemed to be equivalent to personal data. <sup>5</sup>Notwithstanding sentence 3 number 1, institutions may, for the purpose of developing and improving rating systems, also collect and use data that may be material to determining and recognising counterparty credit risk based on plausible economic rationale. <sup>6</sup>In particular, data that belong to the following categories or have been obtained from data in the following categories may be material to determining and recognising counterparty credit risk:

- 1 income, financial and employment circumstances as well as other economic circumstances, in particular type, scope and profitability of the business activity of the person concerned,
- 2 the past payment behaviour and contract fulfilment of the person concerned,
- 3 enforceable claims and judicial enforcement proceedings and measures against the person concerned,

- 4 insolvency proceedings relating to the assets of the person concerned where these have been opened or an application has been made to open such proceedings.

<sup>7</sup>These data may be collected from

- 1 the person concerned,
- 2 institutions that belong to the same group of institutions,
- 3 external credit assessment institutions (ECAIs) and credit information agencies, and
- 4 publicly accessible sources.

<sup>8</sup>Institutions may transmit personal data collected pursuant to sentence 3 to other institutions within the same group and, in a pseudo-anonymised form, also to service providers tasked with the setting up and operation, including the development and improvement, of rating systems, provided that this is necessary for the setting up and operation, including the development and improvement, of internal rating systems for estimating risk parameters relating to counterparty credit risk. <sup>9</sup>The Federal Ministry of Finance shall be authorised to issue by way of a statutory order, in consultation with the Deutsche Bundesbank, more detailed provisions on determining the own funds adequacy (solvency) of institutions as well as groups of institutions and financial holding groups, in particular concerning

- 1 the determination of the transactions that are subject to capital charges for counterparty credit risk, including equity and dilution risk, as well as market risk (in particular foreign currency risk, commodities risk and position risk in the trading book) and their risk parameters;
- 2 the subject and procedures relating to determining capital requirements for operational risk;
- 3 the methods for calculating capital requirements and the requisite technical principles;
- 4 details concerning the collection and use of personal data for determining and recognising counterparty credit risk; the statutory order shall include deadlines for deleting or anonymising the data;
- 5 the approval criteria for using internal risk measurement procedures, in particular internal rating systems for estimating risk parameters relating to counterparty credit risk, internal market risk models as well as internal estimation procedures for determining operational risk, the approval procedure and the execution of examinations pursuant to section 44 (1) sentence 2 concerning the approval of internal risk measurement procedures;
- 6 the substance, type, scope and form of the information required to demonstrate adequate own funds pursuant to subsection (1e) and the data storage media, transmission channels and data formats permissible for data transmission;
- 7 institutions' obligation to disclose information used as the basis for demonstrating adequate own funds pursuant to section 26a (1) and (2), including the subject of the disclosure requirement and the medium and frequency of disclosure;

- 8 the calculation methods used to determine the positions pursuant to subsection (2b) sentence 1 number 9 and subsection (6a), and
- 9 the requirements that an external credit assessment institution has to fulfil for its ratings to be recognised for risk weighting purposes and the requirements in terms of the rating.

<sup>10</sup>The Federal Ministry of Finance may delegate this authority to BaFin by way of a statutory order, subject to the proviso that the statutory order is issued in agreement with the Deutsche Bundesbank. <sup>11</sup>The central associations of the institutions shall be consulted before the statutory order is issued.

(1a) <sup>1</sup>When institutions belonging to a cross-border group of institutions or a financial holding group subject to consolidated supervision by BaFin in accordance with section 10a (1) to (5) intend for the first time to use an internal risk measurement procedure to calculate their own funds requirements for counterparty credit risk or operational risk or an internal market risk model on a consolidated basis pursuant to subsection (1) sentence 2, the superordinated enterprise shall submit the application for approval to BaFin. <sup>2</sup>A cross-border group of institutions or financial holding group within the meaning of this provision shall be deemed to exist if the enterprises belonging to the group are domiciled in at least two different EEA countries. <sup>3</sup>After receiving the complete application, BaFin shall promptly forward it to the competent EEA authorities responsible for supervising the enterprises covered by the application in accordance with the Banking Directive. <sup>4</sup>The competent authorities shall, within six months of receipt of the complete application by BaFin, take a joint decision on the application. <sup>5</sup>If a joint decision is not reached within this time, BaFin shall decide on its own. <sup>6</sup>As soon as a decision pursuant to sentence 4 or 5 has been reached, BaFin shall inform the group's superordinated enterprise of its substance in writing, giving the principal reasons and referring to the legal foundations on which the decision was based. <sup>7</sup>Where a decision is taken pursuant to sentence 5, BaFin shall additionally inform the other competent authorities involved; in this case, any reservations expressed by these agencies shall also be referred to when giving the principal reasons. <sup>8</sup>BaFin will issue the notice of approval to use the internal risk measurement procedure on a consolidated and a stand-alone basis if it is responsible for supervising the enterprises covered by the application on a stand-alone basis. <sup>9</sup>Sentence 8 shall apply *mutatis mutandis* to notices of approval to institutions that belong to a cross-border group within the meaning of sentence 2 but are subject to supervision by BaFin only on a stand-alone basis.

(1b) When assessing the adequacy of the own funds, BaFin may, in particular cases,

- (a) stipulate own funds requirements exceeding the solvency principles for institutions which, by virtue of their asset or business profile, have a risk structure which compares unfavourably with that of most other institutions engaged in similar business, in line with the institution's extraordinary risk structure (extraordinary circumstances), and
- (b) permit, upon application from the institution, a different method of calculating the own funds requirements in order to avoid risks being reflected inappropriately in

particular cases. Such permission must be compatible with the framework laid down by European Community legislation as stipulated in subsection (1).

(1c) (Repealed)

(1d) <sup>1</sup>The calculation of the adequacy of the own funds in accordance with the statutory order pursuant to subsection (1) sentence 9 shall be based on modified available capital. <sup>2</sup>To determine the modified available capital, the amounts required to back positions with liable capital pursuant to the provisions of this Act and the positions pursuant to subsection (6a) shall be deducted from liable capital pursuant to subsection (2) sentence 2, and the eligible part of the position in subsection (2b) sentence 1 number 9 shall be added to it. <sup>3</sup>When calculating liable capital pursuant to subsection (2) sentence 2 for the purposes of sections 12, 13, 13a and 15, the positions of subsection (6a) and the eligible part of the position in subsection (2b) sentence 1 number 9 shall be disregarded. <sup>4</sup>The same applies to the amounts required to back positions with liable capital pursuant to the provisions of this Act.

(1e) <sup>1</sup>Institutions and the superordinated enterprises of a group of institutions or a financial holding group pursuant to section 10a (1) to (3) shall submit the information necessary for monitoring capital adequacy to BaFin and the Deutsche Bundesbank once a quarter. <sup>2</sup>The statutory order pursuant to subsection (1) sentence 9 number 6 may prescribe a longer reporting period in particular cases.

(2) <sup>1</sup>The own funds consist of liable capital and tier 3 capital. <sup>2</sup>The liable capital is the sum of tier 1 capital pursuant to subsection (2a) sentence 1, less the deductible positions pursuant to subsection (2a) sentence 2 numbers 1 to 5, and tier 2 capital pursuant to subsection (2b) sentence 1 numbers 1 to 8, less the positions of subsection (6) sentence 1. <sup>3</sup>For the purpose of calculating the liable capital, tier 2 capital pursuant to sentence 2 may only be included up to the level of the tier 1 capital pursuant to sentence 2. <sup>4</sup>Moreover, the amount of tier 2 capital included in the calculation consisting of longer-term subordinated liabilities and the add-on for the extended liability of members of cooperatives may not exceed 50 per cent of the tier 1 capital. <sup>5</sup>Own funds made available by third parties may be included only if they have actually been transferred to the institution. <sup>6</sup>The acquisition of own funds of the institution by a third party acting for the institution's account, by a subsidiary of the institution or by a third party acting for the account of the institution's subsidiary shall be deemed, for the purpose of inclusion, to be equivalent to an acquisition by the institution, unless the institution can prove that the own funds were actually transferred to it. <sup>7</sup>Such acquisition shall be equivalent to collateral pledged as security.

(2a) <sup>1</sup>Tier 1 capital consists of the following after deducting the positions listed in sentence 2:

- 1 in the case of sole proprietorships, general partnerships and limited partnerships: the paid-up capital and the reserves, less withdrawals by the proprietor or the general partners and loans granted to them, and less any net debt in the proprietor's unencumbered personal assets;
- 2 in the case of public limited companies, limited partnership companies and private limited companies: the paid-up capital, less shares entitling the holder to preferential

payment of dividends (preferential shares), and the reserves; in the case of limited partnership companies, also capital contributions of the general partners not paid into the capital, less withdrawals by the general partners and loans granted to them;

- 3 in the case of registered cooperative societies: the amounts paid up on members' shares and the reserves; amounts paid up on the shares of members who are retiring at the end of the financial year and their rights to the disbursement of a share in the cooperative society's revenue reserves, as shown separately in the balance sheet by registered cooperative societies pursuant to section 73 (3) of the Cooperative Societies Act (*Genossenschaftsgesetz*), shall be deducted;
- 4 in the case of public savings banks and private savings banks recognised as public savings banks: the reserves;
- 5 in the case of public credit institutions that do not come under the provisions of number 4: the paid-up endowment capital and the reserves;
- 6 in the case of credit institutions organised in any other form: the paid-up capital and the reserves;
- 7 the special items for general banking risks pursuant to section 340g of the Commercial Code;
- 8 the contributions to capital by silent partners within the meaning of subsection (4);
- 9 the net profit for the financial year, insofar as its appropriation to the capital, to the reserves, or to the amounts paid up on members' shares has been agreed.

<sup>2</sup>The deductible positions pursuant to sentence 1 are

- 1 the net loss for the financial year,
- 2 the intangible assets,
- 3 the adjustment item pursuant to subsection (3b),
- 4 loans to limited partners, to shareholders in a private or public limited company or in a limited partnership company, or to shareholders in a public institution who own more than 25 per cent of the capital (nominal capital, total amount of capital shares) of the institution, or who hold more than 25 per cent of the voting rights, if they have not been granted on market terms or if they are not adequately secured in line with banking practice,
- 5 loans to silent partners within the meaning of subsection (4) whose contribution to the capital amounts to more than 25 per cent of the tier 1 capital, excluding the capital contributions of silent partners, if they have not been granted on market terms or if they are not adequately secured in line with banking practice,
- 6 at least half of the respective amounts of the positions pursuant to subsection (6) sentence 1, subsection (6a) and of the amounts to be backed by liable capital pursuant to section 12 (1) sentence 4, section 13, section 13a and section 15, and

7 the negative tier 2 capital balance that results if the sum of the at most half of the respective amounts of the positions pursuant to subsection (6) sentence 1 and subsection (6a) and of the positions to be backed by liable capital pursuant to section 12 (1) sentence 4, section 13, section 13a and section 15 exceeds the eligible tier 2 capital pursuant to subsection (2) sentence 3.

<sup>3</sup>Section 16 (2) to (4) of the Companies Act (*Aktiengesetz*) shall apply *mutatis mutandis* to the calculation of the percentages pursuant to sentence 2 numbers 4 and 5.

(2b) <sup>1</sup>Tier 2 capital consists of the following after deducting the adjustment items pursuant to subsection (3b):

- 1 non-committed contingency reserves pursuant to section 340f of the Commercial Code,
- 2 preferential shares,
- 3 reserves pursuant to section 6b of the Income Tax Act (*Einkommensteuergesetz*) up to the amount of 45 per cent, insofar as these reserves were formed by the transfer of the profits from the sale of land, land rights and buildings,
- 4 liabilities represented by participation rights within the meaning of subsection (5),
- 5 longer-term subordinated liabilities within the meaning of subsection (5a),
- 6 the unrealised reserves shown in the notes to the last set of approved annual accounts pursuant to subsections (4a) and (4b) in the case of land, land rights and buildings up to the amount of 45 per cent of the difference between the book value and the mortgage lending value,
- 7 the unrealised reserves shown in the notes to the last set of approved annual accounts pursuant to subsections (4a) and (4c) in the case of banking book positions up to the amount of 45 per cent of the difference between the book value, including contingency reserves, and
  - (a) the market price of securities which are tradable on a stock exchange,
  - (b) the value, to be ascertained pursuant to section 11 (2) sentences 2 to 5 of the Valuation Act (*Bewertungsgesetz*), of unlisted securities evidencing shares in incorporated enterprises belonging to the networks of credit cooperatives or savings banks with a balance sheet total of at least 10 million euro, or
  - (c) the published repurchase price of units in a common fund within the meaning of the Investment Act or of units in a collective investment scheme launched by an asset management company domiciled in another EEA state in accordance with the provisions of the UCITS Directive,
- 8 in the case of registered cooperative societies, the capital add-on which takes into account the members' extended liability, to be set by way of a statutory order by the Federal Ministry of Finance after having consulted the Deutsche Bundesbank; the Federal Ministry of Finance may delegate this authority by way of a statutory order to BaFin,

9 the recognisable value adjustment excess that arises at an institution (IRBA institution) which may, when determining whether its own funds are adequate pursuant to subsection (1), recognise credit risk exposures according to the Internal Ratings-based Approach (IRBA) from calculating the difference between the value adjustments and provisions created for all IRBA exposures in the exposure classes Central governments, Institutions, Corporates and Retail claims and the expected loss amounts for these IRBA exposures; the value adjustment excess shall be recognised up to 0.6 per cent of the sum of the risk-weighted IRBA exposure amounts for all IRBA exposures that are not IRBA securitisation positions with a risk weight of 1,250 per cent.

<sup>2</sup>The deductible positions also include the at most half of the respective amounts of the positions pursuant to subsection (6) sentence 1, subsection (6a) and of the amounts to be backed by liable capital pursuant to section 12 (1) sentence 4, section 13, section 13a and section 15.

(2c) <sup>1</sup>Tier 3 capital consists of the following:

- 1 the proportional profit that would arise from the notional closing of all trading book positions, less all foreseeable charges and dividends and less the likely loss that would ensue from banking book business in the event of the enterprise's liquidation, unless this is already included in the adjustment items pursuant to subsection (3b) (net profit),
- 2 short-term subordinated liabilities within the meaning of subsection (7), and
- 3 positions that may not be recognised as tier 2 capital owing solely to capping pursuant to subsection (2) sentences 3 and 4.

<sup>2</sup>The aforementioned positions may be recognised as tier 3 capital (eligible tier 3 capital) only up to an amount which, together with that part of the tier 2 capital pursuant to subsection (2b) which is not needed to back counterparty credit risk and operational risk under the provisions of this Act (free tier 2 capital), does not exceed 250 per cent of the tier 1 capital pursuant to subsection (2a) not needed to back counterparty credit risk and operational risk under the provisions of this Act (free tier 1 capital). <sup>3</sup>For securities trading firms, the limit stipulated in sentence 2 shall be 200 per cent of the free tier 1 capital, unless the illiquid assets within the meaning of sentence 4, where these have not been deducted from the liable capital pursuant to subsection (6) sentence 1 number 1, and the losses of its subsidiaries are deducted from the tier 3 capital. <sup>4</sup>Illiquid assets are

- 1 tangible assets,
- 2 shares and claims arising from capital contributions of silent partners, participation rights or subordinated liabilities which are not evidenced by securities that are tradable on a stock exchange and do not form part of the trading book,
- 3 loans and non-marketable debt securities with a remaining maturity of more than 90 days, and

4 physical stocks, unless they have to be backed by own funds in accordance with the statutory order pursuant to subsection (1) sentence 9.

<sup>5</sup>Margin payments on forward or futures transactions concluded on a stock exchange or financial futures exchange shall not be deemed to be illiquid assets.

(2d) <sup>1</sup>When calculating the adequacy of the own funds in accordance with the statutory order pursuant to subsection (1) sentence 9, institutions shall calculate their tier 3 capital pursuant to subsection (2c), in the case of trading book institutions less the large exposure excess amounts from borrower-related trading book and overall business positions pursuant to section 13a (4) and (5) where these excess amounts are backed by tier 3 capital (available tier 3 capital). <sup>2</sup>Available tier 3 capital may be used only to back the capital charges for market risk.

(2e) (Repealed)

(3) <sup>1</sup>Where an institution draws up interim accounts, these shall be audited by an external auditor; in these cases, the interim accounts shall be deemed comparable to the annual accounts for the purposes of this provision, with interim profits assignable to tier 1 capital insofar as they are not earmarked for anticipated dividends or tax payments. <sup>2</sup>Losses arising from interim accounts shall be deducted from tier 1 capital. <sup>3</sup>The institution shall submit the interim accounts to both BaFin and the Deutsche Bundesbank promptly. <sup>4</sup>The external auditor shall submit a certificate on the audit of the interim accounts to BaFin and the Deutsche Bundesbank promptly after completion of the audit. <sup>5</sup>A truncated set of annual accounts covering a period of less than twelve months drawn up in the wake of a merger shall not constitute a set of interim accounts within the meaning of this subsection.

(3a) <sup>1</sup>Reserves within the meaning of subsection (2a) sentence 1 shall comprise only the amounts designated as such in the balance sheet in the last approved annual accounts for the end of a financial year, with the exception of liability-side items that will not be liable to tax until after they have been released. <sup>2</sup>Amounts designated as reserves that have been formed from income which will not become liable to tax until after a future event occurs may only be recognised up to 45 per cent. <sup>3</sup>Reserves which are formed as a result of premium income obtained through a share issue or through some other inflow of external funds may be included from the time of their inflow. <sup>4</sup>Where an institution is the originator of a securitisation transaction, net gains arising from the capitalisation of future income from the securitised assets and providing credit enhancement to positions in the securitisation shall not be deemed to constitute reserves within the meaning of subsection (2a) sentence 1.

(3b) <sup>1</sup>BaFin may impose an adjustment item on the liable capital. <sup>2</sup>If the adjustment item is imposed so as to take account of capital changes which have not yet affected the balance sheet, the adjustment shall become null and void with the next approved annual accounts drawn up for the end of a financial year. <sup>3</sup>At the institution's request, BaFin shall rescind its adjustment insofar as the reasons for its imposition no longer apply.

(4) <sup>1</sup>Capital contributions of silent partners shall be recognised towards tier 1 capital if

- 1 they share fully in any loss and the institution is entitled to defer interest payments in the event of a loss,
- 2 it has been agreed that, in the event of the opening of insolvency proceedings over the institution's assets or of the institution's liquidation, they will not be repaid until all creditors have been satisfied,
- 3 they have been made available to the institution for a period of at least five years,
- 4 the claim to repayment does not, or, under the terms of the partnership agreement, cannot, fall due within less than two years,
- 5 the partnership agreement contains no debtor warrant clauses by which the reduction in the repayment claim caused by losses during the period to maturity of the capital contribution can be offset by profits which arise more than four years after the repayment claim has matured, and
- 6 the institution, when establishing the silent partnership, referred explicitly and in writing to the legal consequences specified in sentences 2 and 3.

<sup>2</sup>Subsequently, participation in any loss cannot be changed to the detriment of the institution, the subordination of claims cannot be limited, and neither the period to maturity nor the period of notice can be shortened. <sup>3</sup>Any early repayment shall be returned to the institution, notwithstanding any arrangements to the contrary, unless the capital has been replaced by the payment of other liable capital of at least equivalent value or BaFin has consented to the early repayment. <sup>4</sup>Sections 723 to 725, 727 and 728 of the German Civil Code (*Bürgerliches Gesetzbuch*) shall not apply if the company's purpose is to supply liable capital.

(4a) <sup>1</sup>Unrealised reserves may be recognised as liable capital only if the tier 1 capital pursuant to subsection (2a) sentence 1, after taking account of the deductible positions pursuant to subsection (2a) sentence 2 numbers 1 to 5, is at least 4.4 per cent of 12.5 times the total capital charge for credit risk; the unrealised reserves may be recognised as liable capital only up to 1.4 per cent of this amount. <sup>2</sup>For the purpose of these calculations, trading book positions may be treated as banking book positions. <sup>3</sup>Unrealised reserves may be recognised only if all assets pursuant to subsection (2b) sentence 1 number 6 or 7 are included in the calculation of the difference. <sup>4</sup>The calculation of the unrealised reserves shall be disclosed to BaFin and the Deutsche Bundesbank at the former's request, indicating the relevant valuations.

(4b) <sup>1</sup>Section 16 (1) and (2) of the Pfandbrief Act shall apply *mutatis mutandis* to the calculation of the mortgage lending value of land, land rights and buildings. <sup>2</sup>These values shall be determined by means of expert valuations at least every three years. <sup>3</sup>The institution shall appoint a committee of experts consisting of at least three members to calculate the mortgage lending value. <sup>4</sup>Section 77 (2) and (3) of the Investment Act shall apply *mutatis mutandis*. <sup>5</sup>If the mortgage lending value is lower than the book value, this negative difference shall be deducted from the unrealised reserves.

(4c) <sup>1</sup>The market value of securities listed in subsection (2b) sentence 1 number 7 (a) shall be determined by the market price on the reporting date. <sup>2</sup>If no market price is available on a

reporting date, the last market price ascertained before the reporting date shall apply. <sup>3</sup>If securities are treated in accordance with the principles for fixed assets, the difference between the applicable market value and the higher book value shall be deducted from the unrealised reserves. <sup>4</sup>The procedure described in sentences 1 to 3 shall be used *mutatis mutandis* to determine the value of securities listed in subsection (2b) sentence 1 number 7 (b) pursuant to section 11 (2) of the Valuation Act, and to determine the repurchase price of units in a common fund.

(5) <sup>1</sup>Capital paid up against the granting of participation rights (liabilities represented by participation rights) shall be recognised towards tier 2 capital only if

- 1 it shares fully in any loss, and if the institution is entitled to defer interest payments in the event of a loss,
- 2 it has been agreed that in the event of the opening of insolvency proceedings over the institution's assets or of the institution's liquidation, it will not be repaid until all non-subordinated creditors have been satisfied,
- 3 it has been made available to the institution for a period of at least five years,
- 4 the claim to repayment does not, or, under the terms of the agreement, cannot, fall due within less than two years,
- 5 the agreement governing the contribution of capital in the form of participation rights contains no debtor warrant clauses by which the reduction in the repayment claim caused by losses during the period to maturity of the contribution can be offset by profits which arise more than four years after the repayment claim has matured, and
- 6 the institution, when concluding the agreement, referred explicitly and in writing to the legal consequences specified in sentences 3 and 4.

<sup>2</sup>The institution may reserve the right to terminate the liability without notice in the event that a change in taxation gives rise to additional payments to the party acquiring the participation rights. <sup>3</sup>Subsequently, participation in any loss cannot be changed to the detriment of the institution, the subordination of claims cannot be limited, and neither the period to maturity nor the period of notice can be shortened. <sup>4</sup>Except in the cases described in sentence 6, any early repurchase of the claim or other repayment shall be returned to the institution, notwithstanding any arrangements to the contrary, unless the capital has been replaced by the payment of other liable capital of at least equivalent value or BaFin has consented to the early repayment; the institution may reserve such a right contractually. <sup>5</sup>If securities are issued in respect of the participation rights, the legal consequences specified in sentences 3 and 4 shall be specified only in the subscription and issuance terms. <sup>6</sup>An institution may purchase its own participation rights evidenced by securities up to 3 per cent of the total nominal amount of an issue for market-smoothing purposes or if it is thereby carrying out instructions to buy on a commission basis. <sup>7</sup>BaFin and the Deutsche Bundesbank shall be notified promptly of an institution's intention to make use of the market-smoothing option pursuant to sentence 6.

(5a) <sup>1</sup>Capital which has been paid up by virtue of the incurrence of subordinated liabilities shall be recognised as liable capital in the form of longer-term subordinated liabilities if

- 1 it has been agreed that in the event of the institution's bankruptcy or liquidation it will not be repaid until all non-subordinated creditors have been satisfied,
- 2 it has been made available to the institution for a period of at least five years, and
- 3 the repayment claim cannot be offset against claims of the institution and the terms of the contract do not stipulate the provision of collateral for the liabilities by the institution or third parties.

<sup>2</sup>If the claim to repayment falls due or, under the terms of the agreement, can fall due within less than two years, only two-fifths of the liabilities shall be recognised as liable capital. <sup>3</sup>The institution may reserve the right to terminate the liability without notice in the event that a change in taxation gives rise to additional payments to the party acquiring the subordinated claims. <sup>4</sup>Subsequently, the subordination of claims cannot be limited, and neither the period to maturity nor the period of notice can be shortened. <sup>5</sup>Except in the cases described in sentence 6, any early repurchase of the claim or other repayment shall be returned to the institution, notwithstanding any arrangements to the contrary, unless the capital has been replaced by the payment of other liable capital of at least equivalent value or BaFin has consented to the early repayment; the institution may reserve such a right contractually. <sup>6</sup>An institution may purchase its own subordinated liabilities evidenced by securities up to 3 per cent of the total nominal amount of an issue for market-smoothing purposes or if it is thereby carrying out instructions to buy on a commission basis. <sup>7</sup>BaFin and the Deutsche Bundesbank shall be notified promptly of an institution's intention to make use of the market-smoothing option pursuant to sentence 6. <sup>8</sup>The institution, when concluding the agreement, shall refer explicitly and in writing to the legal consequences specified in sentences 4 and 5; if securities are issued in respect of the subordinated liabilities, the aforementioned legal consequences shall be specified only in the subscription and issuance terms. <sup>9</sup>Section 309 number 3 of the Civil Code concerning the ban on netting shall not apply to claims arising from the institution's subordinated liabilities. <sup>10</sup>No designation may be used for subordinated liabilities, or for advertising for subordinated liabilities, which contains the word "saving" (*Spar*), or which is otherwise liable to deceive as to the subordinated status in the event of the opening of insolvency proceedings or liquidation; this shall not apply, however, insofar as a credit institution uses its firm-name as protected under section 40. <sup>11</sup>Notwithstanding sentence 1 number 3, an institution may provide subordinated collateral for subordinated liabilities incurred by a subsidiary of the institution set up exclusively for the purpose of raising capital.

(6) <sup>1</sup>Half of the following shall, in each case, be deducted from tier 1 and tier 2 capital:

- 1 direct participating interests in institutions and financial enterprises amounting to more than 10 per cent of these enterprises' capital;

- 2 claims arising from subordinated liabilities within the meaning of subsection (5a) and claims arising from participation rights in institutions and financial enterprises in which the institution directly holds a capital share of more than 10 per cent;
- 3 capital contributions of silent partners in institutions and financial enterprises in which the institution directly holds a capital share of more than 10 per cent;
- 4 the total amount of the following positions insofar as it exceeds 10 per cent of the institution's liable capital before deducting the amounts pursuant to numbers 1 to 3, 5 and 6 and pursuant to this number:
  - (a) direct participating interests in institutions and financial enterprises amounting to not more than 10 per cent of these enterprises' capital;
  - (b) claims arising from subordinated liabilities within the meaning of subsection (5a) and claims arising from participation rights in institutions and financial enterprises in which the institution has no direct participating interest or in which such participating interest amounts to not more than 10 per cent of these enterprises' capital;
  - (c) capital contributions of silent partners in institutions and financial enterprises in which the institution has no direct participating interest or in which such participating interest amounts to not more than 10 per cent of these enterprises' capital;
- 5 participating interests within the meaning of section 271 (1) sentence 1 of the Commercial Code or a direct or indirect participating interest of at least 20 per cent of the capital or of the voting rights in primary insurance companies, reinsurance companies and insurance holding companies, and
- 6 claims arising from participation rights within the meaning of section 53c (3) sentence 1 number 3a in conjunction with subsection (3a) of the Insurance Supervision Act and claims arising from subordinated liabilities within the meaning of section 53c (3) sentence 1 number 3b in conjunction with section (3b) of the Insurance Supervision Act on primary insurance companies, reinsurance companies and insurance holding companies in which the institution holds a participating interest within the meaning of number 5.

<sup>2</sup>At the institution's request, BaFin may allow exemptions in terms of the deductible positions pursuant to sentence 1 numbers 1 to 6 if the institution holds shares in another institution, financial enterprise, primary insurance company or reinsurance company or in an insurance holding company temporarily for the purposes of financially assisting the enterprise in question with a view to reorganising or saving it. <sup>3</sup>Shares in another institution, financial enterprise, primary insurance company or reinsurance company or in an insurance holding company that an institution holds only temporarily to trade for its own account, on a continuous basis, on the financial markets using its own capital by buying and selling these shares at the prices it sets shall not be deducted from tier 1 and tier 2 capital, provided that the institution has reported this activity to BaFin and the Deutsche Bundesbank and has in place appropriate systems and controls for trading with these shares. <sup>4</sup>Positions pursuant to

sentence 1 numbers 1 to 4 which an institution or its superordinated enterprise mandatorily or voluntarily includes in the consolidation pursuant to sections 10a, 13b (3) sentence 1 and section 12 (2) sentences 1 and 2 need not be deducted from the institution's liable capital. <sup>5</sup>Where an institution belongs to a cross-sector corporate group that is not a financial conglomerate, it does not need to deduct positions pursuant to sentence 1 numbers 5 and 6 from its liable capital if this corporate group, subject to BaFin's approval, additionally conducts a capital adequacy calculation using one of the methods described in more detail in the statutory order pursuant to section 10b (1) sentence 2 and the institution and the enterprises in question are included in this calculation as subordinated enterprises or the superordinated enterprise in accordance with the criteria pursuant to section 10b (3) sentences 5 to 8 or (4); calculation method 1 may only be applied if and to the extent that the scope and level of the integrated management and the internal controls are appropriate in terms of the enterprises included in the consolidated group. <sup>6</sup>The option pursuant to sentence 5 shall be applied for by the enterprise which is the group's superordinated enterprise in accordance with the criteria pursuant to section 10b (3) sentences 6 to 8 or (4); the chosen calculation method shall be applied on a consistent and permanent basis. <sup>7</sup>An institution that belongs to a financial conglomerate need not deduct the positions pursuant to sentence 1 numbers 1 to 6 from its liable capital if it itself and the enterprises concerned are included in the calculation of this financial conglomerate's own funds at conglomerate level pursuant to section 10b.

(6a) When determining the modified available capital within the meaning of subsection (1d) sentence 2, half of the following shall, in each case, be deducted from tier 1 and tier 2 capital:

- 1 value adjustment shortfalls which arise at an IRBA institution when calculating the difference between the sum of the expected loss amounts for all IRBA exposures in the exposure classes Central governments, Institutions, Corporates and Retail claims and the value adjustments and provisions created for these IRBA exposures;
- 2 expected loss amounts for IRBA equity exposures subject to the PD/LGD approach and IRBA equity exposures valued at the simple IRBA risk weight for equity exposures;
- 3 securitisation positions which are assigned a risk weight of 1,250 per cent in application of the statutory order pursuant to subsection (1) sentence 9 and which are not included in the institution's calculation of the risk-weighted exposure amounts for securitisations, and
- 4 the amount of the transferred value plus any replacement costs in the case of free deliveries made in the context of trading book securities transactions where performance has not been effectively executed five business days after it becomes due; free deliveries arising from system-wide failures of a clearing and settlement system may, subject to BaFin's approval, be disregarded until the system's functionality has been restored.

(7) <sup>1</sup>Capital which has been paid up by virtue of incurring subordinated liabilities shall be recognised as tier 3 capital in the form of short-term subordinated liabilities if

- 1 it has been agreed that, in the event of the opening of insolvency proceedings over the institution's assets or of the institution's liquidation, it will not be repaid until all non-subordinated creditors have been satisfied,
- 2 it has been made available to the institution for a period of at least two years,
- 3 it is expressly stipulated that the repayment claim cannot be offset against the institution's claims and the terms of the contract expressly stipulate that no collateral for the liabilities is provided by the institution or third parties, and
- 4 the terms of the contract expressly stipulate that
  - (a) neither repayments of principal nor payments of interest in respect of the liability need to be made if this would mean that the institution's own funds would no longer meet the statutory requirements, and
  - (b) any early repayments of principal or payments of interest made by the institution shall be returned to it, notwithstanding any arrangements to the contrary.

<sup>2</sup>Subsequently, the subordination of claims cannot be limited, and neither the period to maturity nor the period of notice can be shortened. <sup>3</sup>Except in the cases described in sentence 5, any early repurchase of the claim or other repayment shall be returned to the institution, notwithstanding any arrangements to the contrary, unless the capital has been replaced by the payment of other own funds of at least equivalent value or BaFin has consented to the early repayment; the institution may reserve such a right contractually. <sup>4</sup>The institution, when concluding the agreement, shall refer explicitly and in writing to the legal consequences specified in sentences 2 and 3; if securities are issued in respect of the subordinated liabilities, the aforementioned legal consequences shall be specified only in the subscription and issuance terms. <sup>5</sup>An institution may purchase its own subordinated liabilities evidenced by securities up to 3 per cent of the total nominal amount of an issue for market-smoothing purposes or if it is thereby carrying out instructions to buy on a commission basis. <sup>6</sup>BaFin and the Deutsche Bundesbank shall be notified promptly of an institution's intention to make use of the market-smoothing option pursuant to sentence 5. <sup>7</sup>An institution shall notify BaFin and the Deutsche Bundesbank promptly if its own funds fall below 120 per cent of the total adequate own funds pursuant to subsection (1) sentence 1 on account of repayments of principal or payments of interest in respect of the short-term subordinated liabilities. <sup>8</sup>Notwithstanding sentence 1 number 3, an institution may provide subordinated collateral for subordinated liabilities incurred by a subsidiary of the institution set up exclusively for the purpose of raising capital.

(8) <sup>1</sup>An institution shall promptly report to BaFin and the Deutsche Bundesbank any loan which is to be deducted pursuant to subsection (2a) sentence 2 numbers 4 and 5 in accordance with sentence 2. <sup>2</sup>It shall specify the collateral provided and the terms of the loan. <sup>3</sup>Such loans which it has reported pursuant to sentence 1 shall be promptly reported to BaFin and the Deutsche Bundesbank once again if the collateral provided or the terms of the

loan are contractually altered, together with the corresponding alterations. <sup>4</sup>BaFin may require institutions to submit to itself and the Deutsche Bundesbank every five years a summary report of the loans to be reported pursuant to sentence 1.

(9) <sup>1</sup>Portfolio managers not authorised to obtain the ownership or possession of money or securities of customers when providing financial services and which do not trade in financial instruments for their own account shall demonstrate that they have own funds amounting to at least 25 per cent of their costs shown in the profit and loss account in the last set of annual accounts under general administrative expenses, depreciation and value adjustments of tangible and intangible assets. <sup>2</sup>If a set of annual accounts has not yet been drawn up for the first full financial year, the corresponding estimates for these items contained in the business plan for the current year shall be indicated. <sup>3</sup>BaFin may raise the requirements pursuant to sentences 1 and 2 if this appears appropriate in view of an expansion of the institution's business activity. <sup>4</sup>Upon application by the institution, BaFin may reduce the costs for the current year used as the basis for calculating the ratio pursuant to sentences 1 and 2 if it deems this appropriate because of a verifiably significant reduction in the institution's business activity in the current year compared with the preceding year. <sup>5</sup>Portfolio managers not authorised to obtain the ownership or possession of money or securities of customers when providing financial services and which do not trade in financial instruments for their own account shall submit to BaFin and the Deutsche Bundesbank the details and evidence necessary to verify the ratio and compliance with the requirements pursuant to sentences 1 and 3. <sup>6</sup>The Federal Ministry of Finance shall be authorised to issue by way of a statutory order in consultation with the Deutsche Bundesbank more detailed provisions concerning the substance, type, scope, timing and form of the information as well as the permissible data storage media, transmission channels and data formats. <sup>7</sup>The Federal Ministry of Finance may delegate this authority by way of a statutory order to BaFin, provided that BaFin's statutory orders are issued in agreement with the Deutsche Bundesbank.

(10) <sup>1</sup>Subject to further-reaching requirements, the own funds of an e-money institution shall amount to at least 2 per cent of

- 1 the current amount, or
- 2 the average amount over the past six months

of its liabilities arising from electronic money that has not yet been drawn down. <sup>2</sup>The applicable amount shall be the higher of the two. <sup>3</sup>If an e-money institution has been operating for a period of less than six months since the day it commenced business, its own funds shall amount to at least 2 per cent of

- 1 the current amount, or
- 2 the six-month target amount

of its liabilities arising from electronic money that has not yet been drawn down; sentence 2 shall apply *mutatis mutandis*. <sup>4</sup>The six-month target amount for liabilities shall be stated in the institution's business plan, which, if necessary, shall be amended in accordance with BaFin's requirements. <sup>5</sup>Subsection (9) sentences 5 to 7 shall apply *mutatis mutandis*.

(11) <sup>1</sup>Upon request, BaFin may allow an institution pursuant to section 1 (7a) and (7c) to include the corresponding positions of subsidiaries when determining the adequacy of its own funds on a stand-alone basis if

- 1 the subsidiary is covered by the institution's risk evaluation, measurement and control procedures,
- 2 the institution holds more than 50 per cent of the voting rights attaching to shares in the capital of the subsidiary or has the right to appoint or remove a majority of the members of the subsidiary's management body,
- 3 the subsidiary's material exposures or liabilities are to the institution, and
- 4 there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of the subsidiary's liabilities by the institution at any time.

<sup>2</sup>In its application, the institution shall demonstrate fully to BaFin the circumstances and arrangements, including legal agreements, necessary for satisfying the condition pursuant to sentence 1 number 4. <sup>3</sup>BaFin shall inform the competent EEA authorities on a regular basis and not less than once a year of approvals granted pursuant to sentence 1 as well as of the circumstances and arrangements pursuant to sentence 1 number 4. <sup>4</sup>If the subsidiary is domiciled in a non-EEA state, BaFin shall inform the competent authority in the non-EEA state concerned accordingly.

### **Section 10a Determining the own funds adequacy of groups of institutions and financial holding groups**

(1) <sup>1</sup>A group of institutions within the meaning of this Act shall comprise an institution within the meaning of section 1 (7a) or (7c) domiciled in Germany (superordinated enterprise) and its subordinated enterprises (group enterprises). <sup>2</sup>Subordinated enterprises within the meaning of this provision are the subsidiaries of an institution which themselves are institutions, German asset management companies, financial enterprises or ancillary service providers. <sup>3</sup>If, in the case of cross-shareholdings, no institution within the group fulfils the conditions of section 1 (7a) or (7c), BaFin shall determine which is to be deemed the group's superordinated enterprise. <sup>4</sup>A group of institutions shall be deemed not to exist if solely ancillary service providers are subordinated to an institution.

(2) <sup>1</sup>A group of institutions within the meaning of this Act shall also be deemed to exist if an institution forms a horizontal corporate group with other enterprises in the banking and investment services sector or the investment sector. <sup>2</sup>In such a group of institutions, the deposit-taking credit institution, e-money institution or securities trading firm belonging to the group and domiciled in Germany with the highest balance sheet total shall be deemed to be the superordinated enterprise; where the balance sheet totals are equal, BaFin shall determine which is to be deemed the superordinated enterprise.

(3) <sup>1</sup>A financial holding group within the meaning of this Act shall be deemed to exist if enterprises within the meaning of subsection (1) sentence 2 are subordinated to a financial

holding company within the meaning of section 1 (7b) or (7d) domiciled in Germany; of these subordinated enterprises, at least one deposit-taking credit institution, e-money institution or securities trading firm domiciled in Germany must be subordinated to the financial holding company as a subsidiary. <sup>2</sup>Sentence 1 shall not apply to financial holding companies within the meaning of section 1 (7b) which are themselves subordinated as a subsidiary to a deposit-taking credit institution, an e-money institution or a securities trading firm domiciled in another EEA state. <sup>3</sup>If the financial holding company within the meaning of section 1 (7b) or (7d) is domiciled in another EEA state, a financial holding group shall be deemed to exist if

- 1 at least one deposit-taking credit institution, e-money institution or securities trading firm domiciled in Germany, and neither a deposit-taking credit institution nor an e-money institution nor a securities trading firm domiciled in the financial holding company's country of domicile, is subordinated as a subsidiary to the financial holding company, and
- 2 the deposit-taking credit institution, e-money institution or securities trading firm domiciled in Germany has a larger balance sheet total than any other deposit-taking credit institution, e-money institution or securities trading firm domiciled in another EEA state that is subordinated as a subsidiary to the financial holding company; where the balance sheet totals are equal, the earlier date on which approval to operate was granted shall be decisive.

<sup>4</sup>In the case of a financial holding group, the deposit-taking credit institution, e-money institution or securities trading firm belonging to the group and domiciled in Germany which itself is not subordinated to any other group institution domiciled in Germany shall be deemed to be the superordinated enterprise. <sup>5</sup>If several deposit-taking credit institutions, e-money institutions or securities trading firms domiciled in Germany or – in the case of cross-shareholdings – no institution domiciled in Germany fulfils these conditions, the deposit-taking credit institution or e-money institution with the largest balance sheet total shall normally be deemed to be the superordinated enterprise; upon request or where the balance sheet totals are equal, BaFin shall determine which deposit-taking credit institution, e-money institution or securities trading firm domiciled in Germany is deemed to be the superordinated enterprise. <sup>6</sup>Notwithstanding sentences 4 und 5, BaFin, at the request of a financial holding company that is domiciled in Germany and after consulting the regulated enterprise which pursuant to sentences 4 und 5 is deemed to be the superordinated enterprise or would be designated such by BaFin, may rule that the financial holding company is deemed to be the superordinated enterprise if it has demonstrated that it has the requisite structure and organisation for ensuring compliance with the group-related obligations. <sup>7</sup>Notwithstanding sentence 6, BaFin, after consulting the regulated enterprise which pursuant to sentences 4 and 5 is deemed to be the superordinated enterprise or would be designated such by BaFin, may also designate a financial holding company that is domiciled in Germany as the superordinated enterprise without having been requested to do so where this is necessary for prudential reasons, especially reasons pertaining to the organisation and structure of the financial holding group. <sup>8</sup>The financial holding company that is designated pursuant to sentence 6 or sentence 7 shall fulfil all the group-related obligations of a superordinated enterprise. <sup>9</sup>If the conditions for such designation pursuant to sentence 6 or sentence 7 no

longer exist, especially if the financial holding company transfers its domicile to another state or is no longer in a position to ensure compliance with the group-related obligations, BaFin, after consulting the financial holding company, shall rescind its designation; section 35 (3) shall apply *mutatis mutandis*. <sup>10</sup>BaFin shall grant a financial holding company that is designated as the superordinated enterprise pursuant to sentence 6 or sentence 7 and its governing bodies all the authorisations vis-à-vis itself to which an institution as a superordinated enterprise and its governing bodies are entitled.

(4) <sup>1</sup>Institutions, German asset management companies, financial enterprises or ancillary service providers domiciled in or outside Germany shall also be deemed to be subordinated enterprises if a group enterprise directly or indirectly holds at least 20 per cent of their capital shares, manages the institutions, German asset management companies or enterprises together with other enterprises and has liability for the obligations of these institutions, German asset management companies or enterprises limited to the amount of its capital shares (qualified minority participation). <sup>2</sup>Capital shares which are held directly or indirectly and capital shares which are held by a third party for the account of a group enterprise shall be aggregated. <sup>3</sup>Capital shares which are held indirectly shall not be included if they are brokered by an enterprise which is not a subsidiary of the superordinated institution or of the financial holding company. <sup>4</sup>This shall apply *mutatis mutandis* to capital shares which are held indirectly that are brokered by more than one enterprise. <sup>5</sup>Capital shares shall be deemed to be equivalent to voting rights. <sup>6</sup>Section 16 (2) and (3) of the Companies Act shall apply *mutatis mutandis*.

(5) Enterprises that, pursuant to section 10 (6) sentence 4, are voluntarily included in the consolidation pursuant to this provision as well as pursuant to section 13b (3) sentence 1 and section 12 (2) sentences 1 and 2 shall also be deemed to be subordinated enterprises.

(6) <sup>1</sup>The question of whether or not group enterprises in the aggregate have adequate own funds shall be determined by consolidating their own funds, including the shares held by other shareholders, and the relevant risk exposures under the statutory order pursuant to section 10 (1) sentence 9; in the case of group enterprises, own funds shall be deemed to comprise the components recognised under section 10. <sup>2</sup>For the purposes of consolidation, the superordinated enterprise shall aggregate its relevant positions with those of the other group enterprises. <sup>3</sup>The following shall be deducted from the own funds to be consolidated pursuant to sentence 2:

- 1 the book values relating to the group enterprises as shown by the superordinated enterprise and the other enterprises belonging to the group of institutions or the financial holding group, namely the book values of the
  - (a) capital shares,
  - (b) capital contributions of silent partners pursuant to section 10 (4) sentence 1,
  - (c) participation rights pursuant to section 10 (5) sentence 1,
  - (d) longer-term subordinated liabilities pursuant to section 10 (5a) sentence 1, and

(e) short-term subordinated liabilities pursuant to section 10 (7) sentence 1, as well as

- 2 the unrealised reserves pursuant to section 10 (2b) sentence 1 numbers 6 and 7 included by the superordinated enterprise or another enterprise belonging to the group of institutions or the financial holding group insofar as they relate to group enterprises.

<sup>4</sup>Capital shares, subject to the provision for the capitalised aggregation difference pursuant to sentences 9 and 10, and the capital contributions of silent partners shall be deducted from the tier 1 capital. <sup>5</sup>Longer-term subordinated liabilities shall be deducted from the tier 2 capital components pursuant to section 10 (2b) sentence 3. <sup>6</sup>Liabilities represented by participation rights and the unrealised reserves shall be deducted from total tier 2 capital, in each case before the capping specified in section 10 (2b) sentences 2 and 3. <sup>7</sup>Short-term subordinated liabilities shall be deducted from the tier 3 capital pursuant to section 10 (2c) sentence 1 before the capping specified in section 10 (2c) sentences 2 and 4. <sup>8</sup>In the case of participating interests brokered by enterprises not belonging to the group, such book values and unrealised reserves shall be deducted in proportion to the arithmetical share of the capital. <sup>9</sup>If the book value of a participating interest is greater than that part of the capital and reserves of the subordinated enterprise to be consolidated pursuant to sentence 2, the superordinated enterprise shall deduct the difference in equal parts from the tier 1 capital and tier 2 capital of the group of institutions or the financial holding group. <sup>10</sup>The capitalised aggregation difference may thereby be treated as a participating interest in an enterprise outside the group, with an amount that decreases by at least one-tenth each year. <sup>11</sup>The counterparty credit risk exposures resulting from the legal relationships between group enterprises shall be disregarded. <sup>12</sup>The market risk exposures of different group enterprises shall not be netted with one another unless the enterprises are included in the superordinated enterprise's central risk management system, the own funds are appropriately distributed across the group of institutions or the financial holding group and, in the case of subordinated enterprises domiciled in non-EEA states, it is guaranteed that the local laws, regulations and administrative provisions do not impede the free transfer of capital to other group enterprises.

(7) <sup>1</sup>If the superordinated enterprise of a group of institutions is obliged to prepare group accounts pursuant to the provisions of the Commercial Code or if, pursuant to Article 4 of Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (OJ EC L 243/1), as amended, or in accordance with section 315a (2) of the Commercial Code, it is obliged to apply the international accounting standards adopted pursuant to Articles 3 and 6 of the aforementioned Regulation when preparing the group accounts, it shall base the determination of the consolidated own funds and the consolidated risk exposures in accordance with the statutory order pursuant to section 10 (1) sentence 9 on the group accounts no later than five years after this obligation has come into being; own funds shall be deemed to comprise the components corresponding to the components recognised under section 10. <sup>2</sup>This is without prejudice to section 64h (3) and (4). <sup>3</sup>If the superordinated enterprise of a group of institutions applies the aforementioned international accounting

standards in accordance with section 315a (3) of the Commercial Code, sentences 1 and 2 shall apply *mutatis mutandis*; the coming into being of the obligation shall be replaced by the first-time application of the international accounting standards. <sup>4</sup>Subject to sentence 6, subsection (6) shall not apply to the cases in sentences 1 to 3. <sup>5</sup>The own funds and other relevant risk exposures of the enterprises included in the group accounts which are not group enterprises within the meaning of this provision shall be excluded. <sup>6</sup>The own funds and other relevant risk exposures of enterprises not included in the group accounts which are group enterprises within the meaning of this provision shall be included, whereby the procedure pursuant to subsection (6) may be applied. <sup>7</sup>Sentences 1 to 6 shall apply *mutatis mutandis* to the superordinated enterprise of a financial holding group if the financial holding company is obliged under the aforementioned provisions to prepare group accounts or prepares group accounts according to the aforementioned international accounting standards pursuant to section 315a (3) of the Commercial Code.

(8) <sup>1</sup>A group of institutions or a financial holding group that, pursuant to subsection (7), must base the calculation of the consolidated own funds and the consolidated risk exposures on the group accounts may, subject to BaFin's permission, use the procedure pursuant to subsection (6) for this purpose if the use of the group accounts is unsuitable in a particular case. <sup>2</sup>In this case, the superordinated enterprise of the group of institutions or the financial holding group shall apply the procedure pursuant to subsection (6) for at least three consecutive years.

(9) <sup>1</sup>The Federal Ministry of Finance shall be authorised to issue by way of a statutory order in consultation with the Deutsche Bundesbank more detailed provisions on determining the adequacy of the own funds of groups of institutions and financial holding groups, in particular with regard to

- 1 the use of data from the group accounts in determining the consolidated adequacy of the own funds when using the procedure pursuant to subsection (7),
- 2 the treatment of participating interests valued using the equity method when using the procedure pursuant to subsection (7).

<sup>2</sup>The Federal Ministry of Finance may delegate this authority to BaFin by way of a statutory order, subject to the proviso that the statutory order is issued in agreement with the Deutsche Bundesbank. <sup>3</sup>The central associations of the institutions shall be consulted before the statutory order is issued.

(10) <sup>1</sup>If a group of institutions or a financial holding group determines the adequacy of its own funds in accordance with subsection (7) and if the superordinated enterprise of a group of institutions or a financial holding group prepares interim accounts, these shall be examined by the external auditor. <sup>2</sup>The interim accounts pursuant to sentence 1, for the purposes of this provision, shall be deemed to be comparable with the group accounts, whereby the profits shown in the interim accounts shall be assigned to the tier 1 capital, provided that they are not earmarked for anticipated dividends or tax payments. <sup>3</sup>Losses arising from interim accounts shall be deducted from the tier 1 capital. <sup>4</sup>The superordinated enterprise shall

submit the interim accounts to both BaFin and the Deutsche Bundesbank promptly. <sup>5</sup>The external auditor shall submit a certificate on the audit of the interim accounts to BaFin and the Deutsche Bundesbank promptly after completion of the audit.

(11) <sup>1</sup>In the case of subordinated enterprises which are not subsidiaries, the superordinated enterprise shall consolidate its own funds and the relevant risk exposures under the statutory order pursuant to section 10 (1) sentence 9 with the own funds and the relevant risk exposures of the subordinated enterprises, in each case in proportion to its share of the capital in the subordinated enterprise. <sup>2</sup>Subsections (6) and (7) shall also apply, in each case also in conjunction with the statutory order pursuant to subsection (9).

(12) <sup>1</sup>The superordinated enterprise is responsible for ensuring that the group of institutions or the financial holding group has adequate own funds. <sup>2</sup>However, in fulfilling its obligations pursuant to sentence 1, it may exert influence on the group enterprises only insofar as this does not conflict with applicable company law.

(13) <sup>1</sup>The group enterprises shall set up a proper organisational structure and appropriate internal control mechanisms in order to ensure that the data required for consolidation pursuant to subsections (6), (7) and (11) are duly processed and forwarded. <sup>2</sup>They are obliged to transmit the data needed for consolidation to the superordinated enterprise. <sup>3</sup>If a superordinated enterprise is unable to obtain the requisite data for individual group enterprises, the book values mentioned in subsection (6) sentence 3 relating to the group enterprise shall be deducted from the own funds of the superordinated enterprise.

(14) <sup>1</sup>Subsections (6) to (13) of this provision as well as section 10 shall apply to an institution domiciled in Germany to which at least one institution, asset management company within the meaning of Article 2 (5) of Directive 2002/87/EC or financial enterprise domiciled in a non-EEA state is subordinated, irrespective of whether or not it is itself a subordinated enterprise of a group of institutions or a financial holding group pursuant to subsections (1) to (5). <sup>2</sup>If the financial holding company at the head of a financial holding group has at least one institution, asset management company within the meaning of Article 2 (5) of Directive 2002/87/EC or financial enterprise domiciled in a non-EEA state as a subsidiary, sentence 1 shall apply subject to the proviso that the superordinated enterprise of the financial holding group is obliged to carry out the additional consolidation.

## **Section 10b Adequacy of own funds of financial conglomerates**

(1) <sup>1</sup>A financial conglomerate must have adequate own funds in the aggregate. <sup>2</sup>The Federal Ministry of Finance shall be authorised to issue in consultation with the Deutsche Bundesbank more detailed provisions by way of a statutory order that does not require the consent of the upper house of parliament (Bundesrat) on determining the adequate own funds required for carrying out Article 6 and Annex I of Directive 2002/87/EC, in particular concerning

- 1 the permissible composition of own funds,

- 2 the extent and form of the supplementary capital adequacy requirements calculation as well as other technical principles,
- 3 the following permissible calculation methods for the supplementary capital adequacy requirements:
  - (a) method 1: Accounting consolidation method;
  - (b) method 2: Deduction and aggregation method;
  - (c) method 3: Book value/Requirement deduction method, or
  - (d) combination of methods 1 to 3,
- 4 risk models,
- 5 calculation intervals.

<sup>3</sup>The Federal Ministry of Finance may by way of a statutory order delegate this authority to BaFin, provided that the statutory order is issued in agreement with the Deutsche Bundesbank. <sup>4</sup>The central associations of the institutions and the Insurance Advisory Council pursuant to section 92 of the Insurance Supervision Act shall be consulted prior to issuing the statutory order.

(2) <sup>1</sup>BaFin shall review the adequacy of the own funds of financial conglomerates. <sup>2</sup>The superordinated financial conglomerate enterprise within the meaning of subsection (3) sentences 6 to 8 or subsection (4) shall submit to BaFin and the Deutsche Bundesbank the information necessary to review the adequacy of the own funds at the conglomerate level in accordance with subsection (1), unless a superordinated financial conglomerate enterprise within the meaning of section 104a (3) sentences 6 to 8 or (4) of the Insurance Supervision Act is required to submit a report pursuant to section 104q (2) of the Insurance Supervision Act. <sup>3</sup>More detailed provisions on the type, scope, timing and form of the information as well as the permissible data storage media and transmission channels shall be specified in the statutory order pursuant to subsection (1) sentence 2.

(3) <sup>1</sup>The superordinated financial conglomerate enterprise domiciled in Germany and the financial conglomerate enterprises subordinated to it shall be included in the calculation of own funds at the conglomerate level pursuant to subsection (1). <sup>2</sup>For the enterprises to be included in the calculation of own funds at conglomerate level, the own funds are deemed to comprise components that are recognised as such pursuant to the provisions of this Act and of the Insurance Supervision Act. <sup>3</sup>BaFin shall determine which of the calculation methods described in more detail in the statutory order pursuant to subsection (1) sentence 2 the financial conglomerate is to use to calculate the own funds at conglomerate level; the superordinated financial conglomerate enterprise shall be consulted beforehand. <sup>4</sup>If a financial conglomerate is headed by a mixed financial holding company and its regulated financial conglomerate enterprises are not all domiciled in Germany, any of the calculation methods described in more detail in the statutory order pursuant to subsection (1) sentence 2 may be applied; the superordinated financial conglomerate enterprise shall notify BaFin and the Bundesbank promptly of which calculation method it has chosen. <sup>5</sup>Subordinated financial conglomerate enterprises within the meaning of this Act are the mixed financial holding

companies, credit institutions, financial services institutions, German asset management companies, financial enterprises, ancillary service providers, primary insurance companies, reinsurance companies and insurance holding companies belonging to the conglomerate that are not a superordinated financial conglomerate enterprise. <sup>6</sup>The superordinated financial conglomerate enterprise within the meaning of this Act is the regulated financial conglomerate enterprise in the banking and investment services sector which

- 1 heads a financial conglomerate, unless a primary insurance company domiciled in Germany also heads the financial conglomerate and the insurance sector is more strongly represented than the banking and investment services sector;
- 2 is a subsidiary of a mixed financial holding company domiciled in Germany, unless
  - (a) a primary insurance company domiciled in Germany is the subsidiary of the same mixed financial holding company and the insurance sector is more strongly represented than the banking and investment services sector;
  - (b) a regulated financial conglomerate enterprise in the banking and investment services sector in the same group domiciled in another EEA country, which is the subsidiary of a mixed financial holding company in its country of domicile, has a higher balance sheet total than the deposit-taking credit institution, e-money institution or securities trading firm domiciled in Germany;
  - (c) a primary insurance company in the same group domiciled in another EEA country is the subsidiary of a mixed financial holding company in its country of domicile and the insurance sector is more strongly represented than the banking and investment services sector;

if two or more regulated financial conglomerate enterprises in the banking and investment services industry that are domiciled in Germany meet these conditions, the institution with the highest balance sheet total shall be deemed to be the superordinated financial conglomerate enterprise;

- 3 is a subsidiary of a mixed financial holding company domiciled in another EEA country which is not the parent company of a regulated financial conglomerate enterprise domiciled in its country of domicile, if
  - (a) the banking and investment services sector is more strongly represented than the insurance industry, and
  - (b) the regulated financial conglomerate enterprise in the banking and investment services sector that is domiciled in Germany has the highest balance sheet total.

<sup>7</sup>Subject to sentence 6 numbers 2 and 3, a regulated financial conglomerate enterprise in the banking and investment services sector domiciled in Germany shall be deemed to be the superordinated financial conglomerate enterprise if the banking and investment services sector is more strongly represented than the insurance sector and this institution domiciled in Germany has the highest balance sheet total. <sup>8</sup>Notwithstanding sentence 6 numbers 1 to 3 and sentence 7, BaFin can designate a different regulated financial conglomerate enterprise or a mixed financial holding company as the superordinated financial conglomerate

enterprise after taking into account the financial conglomerate's structure and after consulting the regulated financial conglomerate enterprise that would be designated as the superordinated financial conglomerate enterprise pursuant to sentences 6 and 7; the enterprise that is to be designated shall likewise be consulted beforehand. <sup>9</sup>The financial sector which accounts for the highest average share pursuant to section 51a (3) shall be deemed to be more strongly represented within the meaning of this subsection.

(4) Where participating interests in one or more regulated financial conglomerate enterprises or capital ties to such enterprises exist or where a controlling influence can be exercised over such enterprises without this constituting a case pursuant to subsection (3) sentences 6 to 8, BaFin can wholly or partially apply the provisions of this Act concerning supplementary supervision at the conglomerate level to these enterprises *mutatis mutandis* and designate one of these companies as the superordinated financial conglomerate enterprise, if

- 1 at least one of these enterprises operates in the banking and investment services sector and at least one in the insurance industry, and
- 2 the consolidated or aggregated activities and/or the consolidated and aggregated activities of these enterprises within both the banking and investment services sector and the insurance sector are significant within the meaning of section 51a (3).

(5) <sup>1</sup>BaFin can impose an adjustment item on the financial conglomerate's own funds, if

- 1 without prejudice to the requirements pursuant to subsection (1) sentence 1 in conjunction with the statutory order pursuant to subsection (1) sentence 2 or pursuant to section 13d or section 25a (1a) being met, the solvency of the financial conglomerate is jeopardised;
- 2 significant intra-group transactions within the financial conglomerate or significant risk concentrations at conglomerate level jeopardise the financial conglomerate's financial position

<sup>2</sup>At the request of the superordinated financial conglomerate enterprise, BaFin shall rescind the adjustment item insofar as the reasons for its imposition no longer apply. <sup>3</sup>BaFin may undertake such imposition specified in sentence 1 only after the financial conglomerate has failed to remedy the deficiency within a period to be set by BaFin.

(6) <sup>1</sup>The superordinated financial conglomerate enterprise is responsible for ensuring that the financial conglomerate has adequate own funds. <sup>2</sup>To fulfil its obligations pursuant to sentence 1, it may, however, exercise an influence over enterprises to be included in the calculation of own funds at conglomerate level pursuant to subsection (3) sentence 1 only insofar as this does not contravene general company law.

(7) <sup>1</sup>The enterprises to be included in the calculation of own funds at the conglomerate level pursuant to subsection (3) sentence 1 shall set up a proper organisation and appropriate internal control mechanisms to ensure that the data required for the supplementary supervision of a financial conglomerate are duly processed and passed on. <sup>2</sup>They are obliged to pass on the data required for the supplementary supervision to the reporting enterprise

pursuant to subsection (2). <sup>3</sup>If the reporting enterprise pursuant to subsection (2) cannot procure the requisite information for individual subordinated financial conglomerate enterprises, the book values attributable to the subordinated financial conglomerate enterprise in accordance with the statutory order pursuant to subsection (1) sentence 2 shall be deducted from the own funds of the superordinated financial conglomerate enterprise.

(8) Subsections (1), (6) to (7) shall not apply to a financial conglomerate which itself is subordinated to a financial conglomerate to which subsections (1), (6) and (7) apply.

### **Section 10c Zero weighting of intra-group exposures**

(1) <sup>1</sup>A CRSA risk weight of 0 per cent may be applied to a credit risk standardised approach exposure (CRSA exposure) of an institution which is an enterprise belonging to a group of institutions pursuant to section 10a (1) or (2) or a financial holding group pursuant to section 10a (3) which is not assigned to the own funds of the obligor of the CRSA exposure, provided that the following conditions are met:

- 1 the obligor of the CRSA position is the superordinated enterprise of the group of institutions or financial holding group, a subordinated enterprise in the same group of institutions or financial holding group or the financial holding company at the head of the financial holding group,
- 2 both the institution and the obligor are included in the full consolidation,
- 3 the institution and the obligor of the CRSA exposure are domiciled in Germany,
- 4 the obligor of the CRSA exposure is subject to the same procedures to identify, assess, control, monitor and communicate risks as the institution, and
- 5 there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities from the obligor of the CRSA exposure to the institution.

<sup>2</sup>The institution shall provide adequate documentation showing that the requirements are met. <sup>3</sup>The statutory order pursuant to section 10 (1) sentence 9 shall lay down more detailed provisions on determining the CRSA exposure.

(2) <sup>1</sup>A CRSA risk weight of 0 per cent may be applied to a CRSA exposure to an enterprise that is a member of the same institutional protection scheme as the institution as long as it is not assigned to the own funds of the obligor of the CRSA exposure, provided that the following conditions are met:

- 1 the obligor of the CRSA exposure is an institution, a financial holding company, a financial enterprise or an ancillary services provider and is either subject to supervision pursuant to this Act or BaFin has auditing rights and regulatory powers over it,
- 2 the institution and the obligor of the CRSA exposure are domiciled in Germany,

- 3 there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities from the obligor of the CRSA exposure to the institution,
- 4 the institution and the obligor of the CRSA exposure have entered into a contractual or statutory liability arrangement which protects them and in particular ensures their liquidity and solvency to avoid bankruptcy in case it becomes necessary,
- 5 the liability arrangements ensure that the institutional protection scheme will be able to grant support necessary under its commitment from funds readily available to it,
- 6 the institutional protection scheme disposes of suitable and uniformly stipulated systems for the monitoring and classification of risk which gives a complete overview of the risk situations of all the individual members and the institutional protection scheme as a whole, with corresponding possibilities to take influence; those systems shall suitably monitor defaulted exposures,
- 7 the institutional protection scheme conducts its own risk review which is communicated to the individual members,
- 8 the institutional protection scheme publishes at least once a year either a consolidated report comprising a balance sheet, a profit-and-loss account, a situation report and a risk report concerning the institutional protection scheme as a whole or a report comprising an aggregated balance sheet, an aggregated profit-and-loss account, a situation report and a risk report concerning the institutional protection scheme as a whole,
- 9 the members of the institutional protection scheme are obliged to give advance notice of at least 24 months if they wish to end the arrangements,
- 10 the multiple use of elements eligible for the calculation of own funds ('multiple gearing') as well as any inappropriate creation of own funds between the members of the institutional protection scheme shall be eliminated,
- 11 the institutional protection scheme shall be based on a broad membership of institutions of a predominantly homogeneous business profile, and
- 12 the adequacy of the systems pursuant to number 6 is approved and monitored at regular intervals by BaFin.

<sup>2</sup>The institution shall provide adequate documentation showing that the requirements have been met. <sup>3</sup>The statutory order pursuant to section 10 (1) sentence 9 shall lay down more detailed provisions on determining the CRSA exposure.

(3) An IRBA institution may permanently exclude counterparty credit risk exposures which would, as CRSA exposures, meet the criteria stipulated in

- 1 subsection (1) sentence 1 number 1, or
- 2 subsection (2) sentence 1 numbers 1 to 12

from application of the IRBA and treat them as CRSA exposures.

## **Section 11 Liquidity**

(1) <sup>1</sup>Institutions must invest their funds in such a way as to ensure that adequate liquidity for payment purposes is guaranteed at all times. <sup>2</sup>The Federal Ministry of Finance shall be authorised to lay down by way of a statutory order, in consultation with the Deutsche Bundesbank, more detailed adequate liquidity requirements, in particular in respect of

- 1 the methods for assessing adequate liquidity and the requisite technical principles,
- 2 the transactions to be recognised as payment instruments and payment obligations, including their assessment bases, as well as
- 3 the institutions' duty to provide BaFin and the Deutsche Bundesbank with the information required to demonstrate adequate liquidity, including provisions on the substance, type, scope and form of the information, on the frequency of provision and on the permissible data storage media, transmission channels and data formats.

<sup>3</sup>The statutory order shall tie in with the definition of savings deposits in section 21 (4) of the Regulation on the Accounting of Credit Institutions and Financial Services Institutions (*Kreditinstituts-Rechnungslegungsverordnung*). <sup>4</sup>The Federal Ministry of Finance may delegate this authority to BaFin by way of a statutory order, subject to the proviso that the statutory order is issued in agreement with the Deutsche Bundesbank. <sup>5</sup>The central associations representing the institutions shall be consulted before the statutory order is issued.

(2) Section 10 (1b) relating to the determination of extraordinary circumstances shall apply *mutatis mutandis*.

(3) (Repealed)

## **Section 12 Limitation of qualifying participating interests, and shareholding restrictions for e-money institutions**

(1) <sup>1</sup>A deposit-taking credit institution may not hold a qualifying participating interest in an enterprise which is neither an institution, a German asset management company, a financial enterprise, a primary insurance company or a reinsurance company nor an ancillary service provider if the participating interest in the nominal capital, in terms of amount, exceeds 15 per cent of the deposit-taking credit institution's liable capital. <sup>2</sup>A deposit-taking credit institution may not hold qualifying participating interests in enterprises within the meaning of sentence 1 if the sum of the participating interests in the nominal capital, in terms of amount, exceeds 60 per cent of the deposit-taking credit institution's liable capital. <sup>3</sup>The deposit-taking credit institution may exceed the limits laid down in sentence 1 or 2 with BaFin's permission. <sup>4</sup>BaFin may give permission only if the deposit-taking credit institution backs that part of the participating interests that exceeds the limit – and, if both limits are exceeded, the larger amount – with liable capital.

(2) <sup>1</sup>The superordinated enterprise of a group within the meaning of section 10a (1) to (3) which includes at least one deposit-taking credit institution shall ensure that the group does not hold qualifying participating interests in an enterprise within the meaning of subsection (1) sentence 1 if the participating interests in the nominal capital, in terms of amount, exceed 15 per cent of the group's liable capital. <sup>2</sup>Moreover, it shall ensure that the group does not in total hold qualifying participating interests in enterprises within the meaning of subsection (1) sentence 1 if the sum of the participating interests in the nominal capital, in terms of amount, exceeds 60 per cent of the group's liable capital. <sup>3</sup>Subject to BaFin's permission, the superordinated enterprise may allow the group to exceed the limits laid down in sentence 1 or 2. <sup>4</sup>BaFin may give permission only if the institution backs that part of the participating interests that exceeds the limit – and, if both limits are exceeded, the larger amount – with the group's liable capital. <sup>5</sup>Sentences 1 to 4 shall apply *mutatis mutandis* to institutions within the meaning of section 10a (14).

(3) An e-money institution may not hold a participating interest in another enterprise unless that enterprise fulfils operational or other functions in connection with the electronic money issued or passed on by the institution concerned.

## **Section 12a Establishment of corporate relationships**

(1) <sup>1</sup>An institution or a financial holding company, when purchasing a participating interest in an enterprise domiciled outside Germany or when establishing a corporate relationship with such an enterprise by virtue of which the enterprise becomes a subordinated enterprise within the meaning of section 10a (1) to (5) or section 13b (2), shall ensure that it or, in the case of a financial holding company, the superordinated enterprise responsible for consolidation receives the data required to fulfil the relevant duties pursuant to sections 10a, 13b and 25 (2). <sup>2</sup>Sentence 1 shall not apply to the data required to fulfil the duties pursuant to sections 10a and 13b if due account is taken of the risk arising from the establishment of the participating interest or the corporate relationship by the deduction of the book values to be effected pursuant to section 10a (13) sentence 3 in a manner comparable to the consolidation pursuant to section 10a (6) or (7) and section 13b (3), and if it is rendered possible for BaFin to monitor compliance with this condition. <sup>3</sup>The institution or financial holding company shall promptly notify BaFin and the Deutsche Bundesbank of the establishment, modification or discontinuation of a participating interest or corporate relationship mentioned in sentence 1.

(2) <sup>1</sup>BaFin may prohibit the continuation of the participating interest or corporate relationship if the superordinated enterprise or the institution within the meaning of section 10a (14) does not receive the data required to fulfil the duties pursuant to sections 10a, 13b or 25 (2). <sup>2</sup>The exception pursuant to subsection (1) sentence 2 shall apply *mutatis mutandis* to the power of prohibition pursuant to sentence 1.

(3) Subsections (1) and (2) sentence 1 shall apply *mutatis mutandis* to a mixed financial holding company and a regulated superordinated financial conglomerate enterprise in the

banking and investment services sector with regard to the duties pursuant to sections 10b and 13d.

## **Division 2 LENDING BUSINESS**

### **Section 13 Large exposures of non-trading book institutions**

(1) <sup>1</sup>An institution which is exempt from the provisions concerning the trading book pursuant to section 2 (11) (non-trading book institution) shall promptly notify the Deutsche Bundesbank if its total exposure to a single borrower is equal to or exceeds 10 per cent of its liable capital (large exposure). <sup>2</sup>The statutory order pursuant to section 22 may provide for regular summary reports rather than immediate notification as laid down in sentence 1. <sup>3</sup>The Deutsche Bundesbank shall forward the reports to BaFin along with its comments; BaFin may waive the forwarding of certain reports.

(2) A non-trading book institution organised in the form of a legal person or a commercial partnership may – without prejudice to the validity of the legal transactions – incur a large exposure only by virtue of a unanimous decision by all its senior managers. <sup>2</sup>The decision is to be taken before the exposure is incurred. <sup>3</sup>If this is not possible in individual cases owing to the urgency of the transaction, then the decision shall be taken promptly thereafter. <sup>4</sup>The decision shall be placed on record. <sup>5</sup>If a large exposure has been incurred without a prior unanimous decision by all the senior managers and if a decision is not taken retrospectively within one month of the exposure having been incurred, the non-trading book institution shall promptly notify BaFin and the Deutsche Bundesbank of this fact. <sup>6</sup>If an exposure which has already been incurred becomes a large exposure owing to a reduction in the liable capital, the non-trading book institution may maintain this exposure – without prejudice to the validity of the legal transaction – only by virtue of a unanimous decision by all its senior managers to be taken promptly thereafter. <sup>7</sup>The decision shall be placed on record. <sup>8</sup>If a decision is not taken retrospectively within one month starting from the date on which the exposure became a large exposure, the non-trading book institution shall promptly notify BaFin and the Deutsche Bundesbank of this fact.

(3) <sup>1</sup>Without prejudice to the validity of the legal transactions, a non-trading book institution may not, without BaFin's permission, incur an exposure to a single borrower which in total exceeds 25 per cent of the non-trading book institution's liable capital (individual large exposure limit). <sup>2</sup>Regardless of whether BaFin gives permission, the non-trading book institution shall promptly notify BaFin and the Deutsche Bundesbank if the individual large exposure limit is exceeded and shall back the amount by which the large exposure exceeds the individual large exposure limit with liable capital. <sup>3</sup>Exposure to an affiliated enterprise that neither belongs to a group within the meaning of section 13b (2) nor is consolidated into a group by the competent agencies of another EEA state pursuant to Council Directive 92/121/EEC of 21 December 1992 on the monitoring and control of large exposures of credit institutions (OJ EC 1993 L 29/1) (Large Exposures Directive) may not, without BaFin's permission, exceed 20 per cent of the non-trading book institution's liable capital. <sup>4</sup>Sentence 2 shall apply *mutatis mutandis*. <sup>5</sup>The non-trading book institution shall ensure that the sum of

its large exposures does not, without BaFin's permission, exceed 800 per cent of its liable capital (aggregate large exposure limit).<sup>6</sup> Regardless of whether BaFin gives permission, the non-trading book institution shall promptly notify BaFin and the Deutsche Bundesbank if the aggregate large exposure limit is exceeded and shall back the amount by which the sum of its large exposures exceeds the aggregate large exposure limit with liable capital.<sup>7</sup> A non-trading book institution which exceeds both the individual large exposure limit with respect to one or more borrowers and the aggregate large exposure limit shall back only the greater excess amount with liable capital.<sup>8</sup> BaFin may give permission pursuant to sentences 1, 3 and 5 at its own diligent discretion.<sup>9</sup> BaFin can, in exceptional circumstances, temporarily exempt a non-trading book institution from the requirement to back the excessive amount with liable capital pursuant to sentence 2, also in conjunction with sentence 4, if a limit was exceeded as a result of an amalgamation of borrowers or similar events and this could not have been foreseen by the non-trading book institution.

(4) Subsections (1) and (2) shall also apply to general credit line commitments subject to the proviso that the reports pursuant to subsection (1) are to be filed on dates specified by way of a statutory order pursuant to section 24 (4) sentence 1.

### **Section 13a Large exposures of trading book institutions**

(1) <sup>1</sup>An institution which is not exempt from the provisions concerning the trading book pursuant to section 2 (11) (trading book institution) shall promptly report large exposures to the Deutsche Bundesbank pursuant to sentence 3. <sup>2</sup>Section 13 (1) sentence 3 shall apply *mutatis mutandis*. <sup>3</sup>A trading book institution incurs a large exposure in overall business if its total exposure to a single borrower (borrower-related overall exposure) is equal to or exceeds 10 per cent of the institution's own funds; a trading book institution incurs a large exposure on the banking book if its total exposure to a single borrower excluding the borrower-related total trading book exposure (borrower-related total banking book exposure) is equal to or exceeds 10 per cent of the institution's liable capital. <sup>4</sup>The borrower-related total trading book exposure is the sum of its exposures to a single borrower that are assigned to the trading book.

(2) Section 13 (2) concerning decisions on large exposures of non-trading book institutions shall apply *mutatis mutandis* to trading book institutions.

(3) <sup>1</sup>Without prejudice to the validity of the legal transactions, a trading book institution shall ensure that the borrower-related total banking book exposure does not, without BaFin's permission, exceed 25 per cent of its liable capital (individual large exposure limit on the banking book). <sup>2</sup>Regardless of whether BaFin gives permission, the trading book institution shall promptly notify BaFin and the Deutsche Bundesbank if the individual large exposure limit on the banking book is exceeded and shall back the excess amount with liable capital. <sup>3</sup>The borrower-related total banking book exposure to an affiliated enterprise within the meaning of section 13 (3) sentence 3 may not, without BaFin's permission, exceed 20 per cent of the trading book institution's liable capital. <sup>4</sup>Sentence 2 shall apply *mutatis mutandis*. <sup>5</sup>The trading book institution shall ensure that the sum of its large exposures on the banking

book does not, without BaFin's permission, exceed 800 per cent of its liable capital (aggregate large exposure limit on the banking book).<sup>6</sup> Regardless of whether BaFin gives permission, the trading book institution shall promptly notify BaFin and the Deutsche Bundesbank if the aggregate large exposure limit on the banking book is exceeded and shall back the excess amount with liable capital.<sup>7</sup> Section 13 (3) sentence 7 shall apply *mutatis mutandis*.<sup>8</sup> BaFin may give permission pursuant to sentences 1, 3 and 5 at its own diligent discretion.<sup>9</sup> Section 13 (3) sentence 9 shall apply *mutatis mutandis*.

(4) <sup>1</sup>The trading book institution shall ensure that the borrower-related overall exposure does not, without BaFin's permission, exceed 25 per cent of its own funds (individual large exposure limit in overall business). <sup>2</sup>Regardless of whether BaFin gives permission, the trading book institution shall notify BaFin and the Deutsche Bundesbank if the individual large exposure limit in overall business is exceeded and shall back the excess amount with own funds pursuant to the statutory order under section 22 sentence 1. <sup>3</sup>The borrower-related overall exposure to an affiliated enterprise within the meaning of section 13 (3) sentence 3 may not exceed 20 per cent of the trading book institution's own funds. <sup>4</sup>Sentence 2 shall apply *mutatis mutandis*. <sup>5</sup>The trading book institution shall ensure that the sum of its large exposures in overall business does not, without BaFin's permission, exceed 800 per cent of its own funds (aggregate large exposure limit in overall business). <sup>6</sup>Regardless of whether BaFin gives permission, the trading book institution shall notify BaFin and the Deutsche Bundesbank if the aggregate large exposure limit in overall business is exceeded and shall back the excess amount with own funds pursuant to the statutory order under section 22 sentence 1. <sup>7</sup>Section 13 (3) sentence 7 shall apply *mutatis mutandis*. <sup>8</sup>BaFin may give permission pursuant to sentences 1, 3 and 5 at its own diligent discretion; permission pursuant to sentence 1 or 3 shall be deemed not to have been given if the borrower-related total banking book exposure exceeds the relevant limit pursuant to subsection (3) sentence 1 or 3.

(5) <sup>1</sup>Even if BaFin gives permission, if the limit pursuant to subsection (4) sentence 1 or 3 is exceeded, a trading book institution's borrower-related total trading book exposure may not exceed 500 per cent of the trading book institution's own funds that are not needed to back risks on the banking book. <sup>2</sup>The trading book institution shall promptly notify BaFin and the Deutsche Bundesbank if this limit is exceeded and shall back the excess amount with own funds pursuant to the statutory order under section 22 sentence 1. <sup>3</sup>The sum of its borrower-related overall exposures which exceed the limit pursuant to subsection (4) sentence 1 or 3 for more than ten days, after deduction of the amounts that do not exceed these limits (aggregate excess exposure), may not exceed 600 per cent of the trading book institution's own funds that are not needed to back risks on the banking book. <sup>4</sup>The trading book institution shall promptly notify BaFin and the Deutsche Bundesbank if this limit is exceeded and shall back the excess amount with own funds pursuant to the statutory order under section 22 sentence 1.

(6) Subsections (1) and (2) shall also apply to general credit line commitments subject to the proviso that the reports pursuant to subsection (1) are to be filed on dates specified by way of a statutory order pursuant to section 24 (4) sentence 1.

### **Section 13b Large exposures of groups of institutions and financial holding groups**

(1) Section 13 (1), (3) and (4) as well as section 13a (1) and (3) to (6) on the large exposures of individual institutions shall apply *mutatis mutandis* to the exposures incurred in the aggregate by the enterprises belonging to a group of institutions or a financial holding group.

(2) Section 10a (1) to (5) and (14) shall apply *mutatis mutandis* to the definition of a group of institutions or a financial holding group within the meaning of this provision.

(3) <sup>1</sup>The question of whether or not enterprises belonging to a group of institutions or a financial holding group have in the aggregate incurred a large exposure and are complying with the limits pursuant to sections 13 and 13a shall be determined by consolidating their own funds, including the shares held by other shareholders, and their exposures to a single borrower if the borrower-related overall exposure of one of the enterprises belonging to the group is equal to or exceeds 5 per cent of its liable capital. <sup>2</sup>Section 10a (6) sentences 2 to 11 and (7) to (11) shall apply *mutatis mutandis*.

(4) <sup>1</sup>The superordinated enterprise shall fulfil the notification requirements pursuant to subsection (1) in conjunction with sections 13 and 13a. <sup>2</sup>It is responsible for ensuring that the enterprises belonging to the group comply in the aggregate with the limits pursuant to sections 13 and 13a. <sup>3</sup>However, to fulfil its obligations pursuant to sentence 2, it may exert influence on the group enterprises only insofar as this does not conflict with general company law.

(5) Section 10a (13) and (14) shall apply *mutatis mutandis*.

### **Section 13c Intra-group transactions with mixed-activity holding companies**

(1) <sup>1</sup>A deposit-taking credit institution, an e-money institution or a securities trading firm which is a subsidiary of a mixed-activity holding company shall notify BaFin and the Deutsche Bundesbank of any significant intra-group transactions with mixed-activity holding companies or other subsidiaries of such mixed-activity holding companies. <sup>2</sup>The Federal Ministry of Finance shall be authorised, by way of a statutory order – not requiring the consent of the Bundesrat – to be issued in consultation with the Deutsche Bundesbank, to specify in more detail:

- 1 the types of transactions to be reported and the thresholds to identify which intra-group transactions are to be deemed significant transactions;
- 2 the limits for intra-group transactions and any restrictions with regard to the types of intra-group transactions;
- 3 the type, scope, timing and form of the information as well as the permissible data storage media and transmission channels.

<sup>3</sup>The Federal Ministry of Finance may delegate this authority to BaFin by way of a statutory order provided that the statutory order is to be issued in agreement with the Deutsche

Bundesbank. <sup>4</sup>The central associations representing the institutions shall be consulted before the statutory order is issued.

(2) The deposit-taking credit institution, e-money institution or securities trading firm within the meaning of subsection (1) sentence 1 may – without prejudice to the validity of the legal transactions – conduct significant intra-group transactions with mixed-activity holding companies or other subsidiaries of such mixed-activity holding companies only by virtue of a unanimous decision by all its senior managers; section 13 (2) sentences 2 to 5 shall apply *mutatis mutandis*.

(3) <sup>1</sup>Without prejudice to the validity of the legal transactions, the deposit-taking credit institution, e-money institution or securities trading firm within the meaning of subsection (1) sentence 1 may not, without BaFin's permission, conduct any significant intra-group transactions with mixed-activity holding companies or other subsidiaries of such mixed-activity holding companies which exceed the limits laid down in the statutory order pursuant to subsection (1) sentence 2 or violate the restrictions regarding the types of significant intra-group transactions laid down in the statutory order. <sup>2</sup>BaFin may give permission pursuant to sentence 1 at its own discretion. <sup>3</sup>Regardless of whether BaFin gives permission, the institution shall notify BaFin and the Deutsche Bundesbank promptly if the limits are exceeded or if the restrictions with regard to the types of intra-group transactions are violated. <sup>4</sup>BaFin can

- 1 require the deposit-taking credit institution, e-money institution or securities trading firm within the meaning of subsection (1) sentence 1 to back the excess amount with own funds if the limits set in the statutory order pursuant to subsection (1) sentence 2 are exceeded;
- 2 use appropriate and necessary measures to stop or prevent violations of the restrictions regarding the types of intra-group transactions laid down in the statutory order pursuant to subsection (1) sentence 2.

(4) <sup>1</sup>In order to identify, quantify, monitor and manage significant intra-group transactions within a mixed-activity group, the deposit-taking credit institutions, e-money institutions or securities trading firms belonging to a group must have an appropriate risk management structure and appropriate internal control mechanisms, including a proper reporting system and proper accounting procedures; this is without prejudice to sections 13 and 13b. <sup>2</sup>Section 10a (12) and (13) sentences 1 and 2 as well as section 25a (1) sentence 2 shall apply *mutatis mutandis*.

### **Section 13d Risk concentrations and intra-group transactions of financial conglomerates**

(1) The superordinated financial conglomerate enterprise within the meaning of section 10b (3) sentences 6 to 8 or (4) shall notify BaFin and the Deutsche Bundesbank of any significant risk concentrations at conglomerate level and significant intra-group transactions within the financial conglomerate unless a superordinated financial conglomerate enterprise is required

to submit a report pursuant to section 104q (3) sentences 6 to 8 or (4) of the Insurance Supervision Act.

(2) <sup>1</sup>The Federal Ministry of Finance shall be authorised to issue by way of a statutory order that does not require the consent of the Bundesrat, in consultation with the Deutsche Bundesbank, more detailed provisions on risk concentrations and intra-group transactions to implement Articles 7 and 8 and Annex II of Directive 2002/87/EC, in particular concerning

- 1 the types of risk concentrations and intra-group transactions to be reported as well as the thresholds to identify whether risk concentrations and intra-group transactions are to be deemed significant;
- 2 limits for significant risk concentrations and significant intra-group transactions as well as any restrictions with regard to the types of intra-group transactions;
- 3 the type, scope, timing and form of the information as well as the permissible data storage media and transmission channels.

<sup>2</sup>The Federal Ministry of Finance may delegate this authority to BaFin by way of a statutory order provided that the statutory order is to be issued in agreement with the Deutsche Bundesbank. <sup>3</sup>The central associations representing the institutions and the Insurance Advisory Council pursuant to section 92 of the Insurance Supervision Act shall be consulted before the statutory order is issued.

(3) <sup>1</sup>A regulated financial conglomerate enterprise in the banking and investment services sector may – without prejudice to the validity of the legal transactions – conduct significant intra-group transactions only by virtue of a unanimous decision by all the senior managers of this institution. <sup>2</sup>Section 13 (2) sentences 2 to 5 shall apply *mutatis mutandis*.

(4) <sup>1</sup>Without prejudice to the validity of the legal transactions, the superordinated financial conglomerate enterprise shall be responsible for ensuring that any significant risk concentrations at conglomerate level or significant intra-group transactions within the financial conglomerate do not, without BaFin's permission, exceed the limits laid down in the statutory order pursuant to subsection (2) or violate the restrictions regarding the types of intra-group transactions laid down in the statutory order. <sup>2</sup>However, to fulfil its obligations pursuant to sentence 1, it may exert influence on the conglomerate enterprises only insofar as this does not conflict with general company law; section 10b (7) and (8) shall apply *mutatis mutandis*. <sup>3</sup>BaFin may give permission pursuant to sentence 1 at its own discretion. <sup>4</sup>Regardless of whether BaFin gives permission, the enterprise required to submit reports pursuant to subsection (1) shall notify BaFin and the Deutsche Bundesbank promptly if the limits are exceeded or if the restrictions with regard to the types of intra-group transactions are violated. <sup>5</sup>BaFin can

- 1 require the financial conglomerate to back the excess amount with own funds if the limits set in the statutory order pursuant to subsection (2) sentence 1 are exceeded;

- 2 use appropriate and necessary measures to stop or prevent violations of the restrictions regarding the types of intra-group transactions laid down in the statutory order pursuant to subsection (2) sentence 1.

#### **Section 14 Loans of 1.5 million euro or more**

(1) <sup>1</sup>A credit institution, a financial services institution within the meaning of section 1 (1a) sentence 2 number 4, 9 or 10, a financial enterprise within the meaning of section 1 (3) sentence 1 number 2 and the enterprises and agencies specified in section 2 (2) (enterprises participating in the reporting procedure for loans of 1.5 million euro or more) shall report to the Deutsche Bundesbank's Central Credit Register (*Evidenzzentrale*) on a quarterly basis those borrowers whose credit volume pursuant to section 19 (1) (indebtedness) amounts to 1,500,000 euro or more (loans of 1.5 million euro or more); the contents of the reports and the reporting deadlines shall be laid down in the statutory order pursuant to section 22. <sup>2</sup>Sentence 1 shall apply *mutatis mutandis* to superordinated enterprises within the meaning of section 13b (2), which shall also report the borrowers of the enterprises belonging to the group within the meaning of section 13b (2). <sup>3</sup>This shall not apply if these enterprises are themselves required to submit reports pursuant to sentence 1 or if they are exempted or released from the reporting requirement pursuant to section 2 (4), (5), (7) or (8) or if the book value of the participating interest in the enterprises belonging to the group is deducted from the superordinated enterprise's own funds pursuant to section 10a (13) sentence 3. <sup>4</sup>Those enterprises belonging to the group which themselves are not required to submit reports pursuant to sentence 1 shall transmit the requisite data to the superordinated enterprise. <sup>5</sup>BaFin can, upon request, exempt credit institutions which solely conduct banking business pursuant to section 1 (1) sentence 2 number 12 with financial sector enterprises from the obligation pursuant to sentence 1. <sup>6</sup>Sentence 1 shall apply to syndicated loans of 1.5 million euro or more even if the individual enterprise's share does not amount to 1.5 million euro. <sup>7</sup>Section 13 (1) sentence 3 shall apply *mutatis mutandis*.

(2) <sup>1</sup>If it is found that several enterprises have granted a particular borrower loans of 1.5 million euro or more, the Deutsche Bundesbank shall notify the enterprises submitting reports. <sup>2</sup>This notification shall include information about the borrower's aggregate indebtedness and the aggregate indebtedness of the single borrower unit (group of connected clients) to which the borrower belongs, about the number of enterprises involved as well as information about the forecast probability of default within the meaning of the statutory order pursuant to section 10 (1) sentence 9 in respect of this borrower if an enterprise has itself reported information about such a probability of default. <sup>3</sup>The notification shall be structured according to the statutory order pursuant to section 22. <sup>4</sup>The Deutsche Bundesbank shall, upon request, inform an enterprise required to submit reports of the level of indebtedness of a borrower or prospective borrower or, if the borrower or prospective borrower is part of a single borrower unit, of the level of indebtedness of the single borrower unit. <sup>5</sup>In the case of a prospective borrower, the enterprise shall, upon request, inform the Deutsche Bundesbank of the amount of the intended loan and prove that the prospective borrower has consented to the disclosure of this information. <sup>6</sup>The enterprises participating in the reporting procedure for loans of 1.5 million euro or more and the Deutsche Bundesbank

may also transmit the report pursuant to subsection (1), the notification pursuant to sentence 1 and the information pursuant to sentence 4 via electronic data transfer. <sup>7</sup>The details of the procedure shall be laid down in the statutory order pursuant to section 22. <sup>8</sup>The Deutsche Bundesbank may transmit personal data relating to several borrowers to the enterprise required to submit reports insofar as this is essential for the purpose of assigning the report pursuant to subsection (1) to a particular borrower. <sup>9</sup>Such data may not contain any information about the borrowers' financial situation. <sup>10</sup>Persons employed by an enterprise required to submit reports may neither disclose to third parties any information imparted to the enterprise pursuant to this subsection nor exploit such information. <sup>11</sup>For the purpose of monitoring compliance with data protection rules on the part of the responsible parties, the Deutsche Bundesbank shall log during each data transfer the time, the data transmitted and the parties involved. <sup>12</sup>The log data may not be used for any other purposes. <sup>13</sup>The log data must be kept for at least 18 months and deleted after 24 months at the latest.

(3) <sup>1</sup>If several debtors are deemed to be a single borrower pursuant to section 19 (2), the indebtedness and information about the forecast probabilities of default of the individual debtors shall also be indicated in the reports pursuant to subsection (1). <sup>2</sup>The indebtedness of individual debtors and the information about their forecast probabilities of default shall be imparted only to those enterprises which themselves, or whose subordinated enterprises within the meaning of subsection (1) sentences 3 and 4, have incurred an exposure to these debtors or have reported information about the forecast probabilities of default of these debtors.

(4) The Deutsche Bundesbank may, in agreement with BaFin and pursuant to section 4b of the Federal Data Protection Act, make borrower data which it has stored in its database available to central credit registers in other countries, including for transmission to creditors resident in those countries.

## **Section 15 Loans to governing and related bodies**

(1) <sup>1</sup>Loans to

- 1 senior managers of the institution,
- 2 partners of the institution who are not senior managers if the institution is organised in the form of a commercial partnership or private limited company, and to general partners of an institution who are not senior managers if the institution is organised in the form of a limited partnership company,
- 3 members of a governing body of the institution appointed to monitor the management of the institution if the monitoring powers of the body are laid down by law (supervisory body),
- 4 holders of a general commercial power of attorney (*Prokuristen*) and authorised officers of the institution empowered to represent it in all aspects of its business,
- 5 spouses, civil partners and minors of the persons specified in numbers 1 to 4,

- 6 silent partners of the institution,
- 7 enterprises organised in the form of a legal person or commercial partnership if a senior manager, a holder of a general commercial power of attorney or an authorised officer of the institution empowered to represent it in all aspects of its business is a legal representative or a member of the supervisory body of the legal person or a partner in the commercial partnership,
- 8 enterprises organised in the form of a legal person or commercial partnership if a legal representative of the legal person, a partner in the commercial partnership, a holder of a general commercial power of attorney or an authorised officer of this enterprise empowered to represent it in all aspects of its business is a member of the supervisory body of the institution,
- 9 enterprises in which the institution or a senior manager holds a participating interest of more than 10 per cent of the enterprise's capital or in which the institution or a senior manager is a general partner,
- 10 enterprises which hold a participating interest in the institution of more than 10 per cent of the institution's capital,
- 11 enterprises organised in the form of a legal person or commercial partnership if a legal representative of the legal person or a partner in the commercial partnership holds a participating interest in the institution of more than 10 per cent of its capital, and
- 12 general partners, senior managers, members of the executive board or supervisory body, holders of a general commercial power of attorney and authorised officers empowered to represent all aspects of business of an enterprise controlled by or controlling the institution, as well as their spouses, civil partners and minors,

(loans to governing and related bodies) may be granted only by virtue of a unanimous decision by all of the institution's senior managers and – other than as part of staff programmes – only on market terms and only with the explicit approval of the supervisory body or, in the case of number 12, of the supervisory body of the enterprise controlling the institution; the above provisions pertaining to commercial partnerships shall apply *mutatis mutandis* to other partnerships. <sup>2</sup>A unanimous decision by all senior managers and the explicit approval of the supervisory body may be waived if, pursuant to section 10c (1), a CRSA risk weight of 0 per cent can be applied to a loan to an enterprise pursuant to sentence 1 numbers 9 and 10. <sup>3</sup>A participating interest within the meaning of sentence 1 numbers 9 to 11 shall be deemed to be any ownership of stocks or shares in the enterprise if these amount to at least a quarter of the capital (nominal capital, sum total of the capital shares) irrespective of the duration of ownership. <sup>4</sup>The authorisation of withdrawals over and above the remuneration due to a senior manager or a member of the supervisory body and, in particular, the authorisation of withdrawals of advances on such remuneration, shall be deemed to be equivalent to the granting of a loan. <sup>5</sup>Loans to governing and related bodies which are not granted on market terms shall be backed with liable capital if so ordered by BaFin.

(2) <sup>1</sup>In individual cases, BaFin can impose limits for the granting of loans to governing and related bodies; it shall also have the right to do so after such a loan has been granted. <sup>2</sup>Loans to governing and related bodies which exceed the limits imposed by BaFin shall be reduced to the stipulated limits upon a further order issued by BaFin; in the meantime, they shall be backed with liable capital.

(3) Subsection (1) shall not apply to

- 1 loans to holders of a general commercial power of attorney or authorised officers of an institution empowered to represent it in all aspects of its business as well as to their spouses, civil partners and minors if the loan does not exceed the amount of one annual salary of the holder of a general commercial power of attorney or of the authorised officer of the institution empowered to represent it in all aspects of its business,
- 2 loans to persons or enterprises specified in subsection (1) sentence 1 numbers 6 to 11 if the loan amounts to less than 1 per cent of the institution's liable capital or less than 50,000 euro, and
- 3 loans which are increased by no more than 10 per cent of the amount approved pursuant to subsection (1) sentence 1.

(4) <sup>1</sup>The decision by the senior managers and the decision on approval shall be taken before the loan is granted. <sup>2</sup>The decisions must include provisions on the interest payable on, and the repayment of, the loan. <sup>3</sup>They shall be placed on record. <sup>4</sup>If the granting of a loan pursuant to subsection (1) sentence 1 numbers 6 to 11 is urgent, it shall be deemed to be sufficient if all the senior managers and the supervisory body promptly approve the granting of the loan retrospectively. <sup>5</sup>If the decision by the senior managers has not been taken retrospectively within two months or the decision by the supervisory body has not been taken retrospectively within four months of the date on which the loan was granted, the institution shall promptly notify BaFin of this fact. <sup>6</sup>The decision by the senior managers and the decision on the approval of loans to the persons specified in subsection (1) sentence 1 numbers 1 to 5 and 12 can be taken in advance – but no more than one year in advance – for certain lending business and types of lending business.

(5) If a loan is granted to a person specified in subsection (1) sentence 1 numbers 1 to 5 and 12 contrary to subsection (1) or (4), it shall be repaid immediately, irrespective of any arrangements to the contrary, unless all of the senior managers and the supervisory body promptly approve the granting of the loan retrospectively.

## **Section 16 (Repealed)**

## **Section 17 Liability**

(1) If a loan is granted contrary to the provisions of section 15, the senior managers who thereby breach their duties and the members of the supervisory body who breach their duties by not intervening to prevent an intended loan from being granted despite being aware

thereof shall be jointly and severally liable to the institution for any ensuing damages; the onus shall be on the senior managers and members of the supervisory body to prove that they did not act culpably.

(2) <sup>1</sup>The institution's claim for damages can also be asserted by its creditors insofar as they cannot obtain satisfaction from the institution. <sup>2</sup>The liability for damages vis-à-vis the creditors shall not be terminated by a waiver or composition on the part of the institution nor, in the case of institutions organised in the form of a legal person, by the fact that the loan was granted by virtue of a decision by the institution's highest governing body (shareholders' meeting, general meeting, partners' meeting).

(3) Claims pursuant to subsection (1) shall become statute-barred after five years.

### **Section 18 Borrower documentation**

<sup>1</sup>A credit institution may grant a loan amounting in the aggregate to more than 750,000 euro or more than 10 per cent of the institution's liable capital only if it requires the borrower to disclose his/her financial situation, in particular by submitting his/her annual accounts. <sup>2</sup>The credit institution can waive this requirement if, in the light of the collateral provided or of the jointly obligated parties, there is evidently no reason to require such disclosure. <sup>3</sup>The credit institution can waive the requirement of ongoing disclosure if

- 1 the loan is secured by mortgages on residential property that is used by the borrower himself/herself,
- 2 the loan does not exceed four-fifths of the mortgage lending value of the mortgaged property within the meaning of section 16 (1) and (2) of the Pfandbrief Act, and
- 3 the borrower regularly effects the interest payments and principal repayments owed by him/her.

<sup>4</sup>Disclosure is not required in the case of loans to a foreign public sector agency within the meaning of section 20 (2) number 1 letters (a) to (c).

### **Section 19 Definition of “exposure” and “loan” in sections 13 to 13b and 14, and of “borrower”**

(1) <sup>1</sup>Exposures and loans within the meaning of sections 13 to 13b and 14 are asset items, derivatives (with the exception of short positions in call options) as well as the guarantees assumed in respect thereof, and other off-balance-sheet items. <sup>2</sup>Asset items within the meaning of sentence 1 are:

- 1 balances with central banks and post office giro institutions,
- 2 debt instruments issued by public bodies and bills of exchange eligible for refinancing with central banks,
- 3 cash items in the process of collection for which corresponding payment has already been advanced,

- 4 exposures to credit institutions and customers (including the trade exposures of credit institutions engaging in commodities trading),
- 5 debt securities and other fixed-interest securities insofar as they do not evidence any rights covered by the derivatives specified in sentence 1,
- 6 shares and other variable-yield securities insofar as they do not evidence any rights covered by the derivatives specified in sentence 1,
- 7 participating interests,
- 8 capital shares in affiliated enterprises,
- 9 assets in respect of which the lessor has concluded lease agreements, regardless of how they are shown on the balance sheet, and
- 10 other assets insofar as they are subject to a counterparty risk.

<sup>3</sup>The following are deemed to be other off-balance-sheet items within the meaning of sentence 1:

- 1 bills of exchange in circulation drawn by the credit institution, discounted and credited to borrowers,
- 2 endorsement liabilities arising from rediscounted bills,
- 3 sureties and guarantees in respect of asset items,
- 4 warranties and indemnities and other sureties and guarantees besides those specified in number 3, insofar as they do not refer to the derivatives specified in sentence 1,
- 5 the issuing and confirmation of documentary credits,
- 6 unconditional commitments by building and loan associations for the settlement of third-party interim and bridging loans to contract holders,
- 7 liability arising from the provision of collateral for third-party liabilities,
- 8 asset items deducted from the transferor's portfolio which he/she has transferred to a third party subject to an agreement that he/she shall repurchase them upon request,
- 9 sales of asset items with recourse, in respect of which the credit risk remains with the selling institution,
- 10 asset items purchased under outright forward purchase agreements,
- 11 forward deposits placed,
- 12 purchase and refinancing commitments,
- 13 undrawn credit commitments,
- 14 credit derivatives, and
- 15 off-balance-sheet items insofar as they are subject to a counterparty risk and are not covered by numbers 1 to 14.

(1a) <sup>1</sup>Derivatives within the meaning of this provision, notwithstanding section 1 (11) sentence 4, are futures or options contracts in the form of a purchase, exchange or similar transaction relating to an underlying, whose value is determined by the underlying and whose value can change in future owing to a deferred settlement date on the part of at least one contracting party, including financial contracts for differences. <sup>2</sup>The underlying within the meaning of sentence 1 can also be a derivative.

(2) <sup>1</sup>A borrower within the meaning of sections 10 and 13 to 18 is deemed to be two or more natural or legal persons or commercial partnerships which constitute a single risk because one of them can, directly or indirectly, exercise a controlling influence over the other or others, or which, in the absence of such a relationship of control, are to be regarded as constituting a single risk because they are so interconnected that, if one of these borrowers were to experience financial problems, the others would be likely to encounter payment difficulties, too. <sup>2</sup>This is especially the case for

- 1 all enterprises belonging to the same group or connected by agreements which provide that one enterprise is obliged to transfer its entire profit to another enterprise, as well as majority-owned enterprises and the enterprises or persons with a majority interest in them, with the exception of
  - (a) the Federal Government, a special fund of the Federal Government, a state government, a local government or a local government association,
  - (b) the European Communities,
  - (c) foreign central governments,
  - (d) regional governments and local authorities in other EEA states for which a zero risk weight has been announced pursuant to Article 44 of the Banking Directive,
- 2 commercial partnerships or incorporated enterprises and each general partner, as well as other partnerships and each partner, and
- 3 persons and enterprises for whose account a loan is taken out and the parties that take out this loan in their own name.

<sup>3</sup>When applying sections 13 and 13a, sentence 1 shall not apply to exposures within a group pursuant to section 13b (2) to enterprises which are included in the consolidation pursuant to section 13b (3). <sup>4</sup>Sentence 3 shall apply *mutatis mutandis* to exposures to parent enterprises domiciled in another EEA state, as well as to those enterprises' other subsidiaries, provided that the institution, its parent enterprise and their other subsidiaries are included in the monitoring of large exposures on a consolidated basis in accordance with the Banking Directive by the competent agencies of the other state.

(3) <sup>1</sup>In the case of loans from public promotional funds which the promotional institutions of the Federal Government and of state governments pass through to ultimate borrowers on the basis of independent loan agreements – if necessary via further pass-through institutions – via principal banks on predefined terms (principal bank principle), with regard to sections 13 to 13b, for the institutions concerned, the individual ultimate borrowers shall be deemed to be

the borrowers of the interbank loan granted by the institutions if the credit claims are assigned to the institutions as collateral. <sup>2</sup>This shall apply *mutatis mutandis* to interest-subsidised loans granted by the promotional institutions using their own or public funds in accordance with the principal bank principle (own resources programmes), as well as to loans granted using non-public funds which a credit institution passes through to ultimate borrowers – if necessary via further pass-through institutions – via principal banks in accordance with statutory requirements.

(4) When applying sections 13 to 13b, in the case of loans which central credit institutions pass through to ultimate borrowers via their affiliated regional cooperative institutions or central giro institutions or via registered cooperative societies or savings banks affiliated thereto, the individual ultimate borrowers shall be deemed to be the borrowers with regard to the central credit institution if the credit claims are assigned to the central credit institution as collateral.

(5) In the case of purchased monetary claims, the seller of the claims shall be deemed to be the borrower within the meaning of sections 13 to 18 if he/she is responsible for the satisfaction of the transferred claim or is obliged to repurchase it at the purchaser's request; otherwise, the claim debtor shall be deemed to be the borrower.

(6) (Repealed)

## **Section 20 Exceptions to the obligations pursuant to sections 13 to 13b and 14**

(1) The following are not deemed to be exposures within the meaning of sections 13 to 13b:

- 1 exposures arising from foreign exchange transactions which are incurred in the ordinary course of settlement during the two business days following advance payment, although this is subject to other provisions laid down in the statutory order pursuant to section 22 for borrower-related free\_delivery risk exposures in connection with a trading book institution's total trading book exposure,
- 2 exposures arising from transactions for the purchase or sale of securities which are incurred in the ordinary course of settlement during the five business days following advance payment or delivery, although this is subject to other provisions laid down in the statutory order pursuant to section 22 for borrower-related free delivery risk exposures in connection with a trading book institution's total trading book exposure,
- 3 asset items which are deducted from the liable capital pursuant to section 10 (2a) sentence 2 numbers 4 and 5, section 10 (6) sentence 1 numbers 1 to 3, 5 and 6, section 10a (13) sentence 3 or section 13b (5), and
- 4 exposures written off.

(2) <sup>1</sup>The following shall be disregarded in the reports pursuant to section 13 (1), section 13a (1) and section 13b (1):

- 1 exposures to

- (a) central governments or central banks outside Germany, the Federal Government, the Deutsche Bundesbank or a legally dependent special fund of the Federal Government if they would be assigned a credit risk standardised approach risk weight (CRSA risk weight) of 0 per cent without collateral,
  - (b) multilateral development banks or international organisations if they would be assigned a CRSA risk weight of 0 per cent without collateral,
  - (c) regional governments or local authorities outside Germany, a state government, a local government, a local government association, a legally dependent special fund of a state government, a local government or a local government association or public-sector entities if they would be assigned a CRSA risk weight of 0 per cent without collateral, as well as
  - (d) other borrowers insofar as the exposures – subject to the provisions in section 20b – are explicitly guaranteed by one of the entities specified in letters (a) to (c) and if exposures to this entity would be assigned a CRSA risk weight of 0 per cent without collateral,
- 2 exposures insofar as they – subject to the provisions in section 20b – are collateralised by
- (a) debt securities issued by one of the entities specified in number 1 if uncollateralised exposures to the issuer would be assigned a CRSA risk weight of 0 per cent,
  - (b) cash on deposit with the lending institution or a third party institution which is the parent undertaking or a subsidiary of the lending institution, or cash assimilated instruments which the institution receives under the issue of a credit linked note, or
  - (c) certificates of deposit or similar paper issued by the lending institution or a third party institution which is the parent undertaking or a subsidiary of the lending institution that are lodged with such an institution, and
- 3 repurchase or lending transactions which relate to securities or commodities and are part of the borrower-related total trading book exposure, insofar as they are secured by financial instruments pursuant to section 1a (3) or commodities which are assignable to the trading book pursuant to section 1a (1), albeit subject to the provisions in section 20b.

<sup>2</sup>The reporting requirement shall not apply if an exposure would no longer reach the defined large exposure threshold pursuant to section 13 (1) sentence 1, also in conjunction with section 13b (1), after deduction of the amounts that are to be disregarded pursuant to sentence 1. <sup>3</sup>Sentences 1 and 2 shall not apply if BaFin has, upon request, revocably permitted an institution to recognise the protective effects of financial collateral arrangements in calculating exposure amounts pursuant to sections 13 to 13b. <sup>4</sup>More detailed provisions on determining the CRSA risk weight can be laid down in the statutory order pursuant to section 10 (1) sentence 9.

(3) <sup>1</sup>Exposures within the meaning of subsection (2) shall be disregarded when calculating whether the limits have been reached pursuant to section 13 (3) and section 13a (3) to (5), also in conjunction with section 13b (1). <sup>2</sup>The following shall likewise be disregarded:

- 1 exposures to a central government or central bank which are not covered by subsection (2) sentence 1 number 1 letter (a) provided that the exposures are denominated in the currency of the debtor or issuer concerned and are financed in that currency,
- 2 exposures with a residual maturity of up to 1 year to
  - (a) credit institutions domiciled in Germany,
  - (b) securities trading firms domiciled in Germany, with the exception of investment advisers and investment brokers who, in providing financial services, are not authorised to obtain ownership or possession of funds or securities of customers and who do not trade in financial instruments for their own account,
  - (c) deposit-taking credit institutions, e-money institutions or securities trading firms, with the exception of investment advisers and investment brokers who, in providing financial services, are not authorised to obtain ownership or possession of funds or securities of customers and who do not trade in financial instruments for their own account, domiciled in another EEA state,
  - (d) deposit-taking credit institutions or e-money institutions domiciled in a non-EEA state which are authorised to operate in that non-EEA state and are subject to a prudential supervisory regime which is materially equivalent to that provided for by this Act,
  - (e) recognised securities trading firms from non-EEA states within the meaning of section 1 (29),
  - (f) central counterparties within the meaning of section 1 (31), or
  - (g) stock exchanges or futures exchanges within the meaning of section 1 (3e) provided that the exposures are not counted towards own funds; the claims of registered cooperative societies on their regional institutions, of savings banks on their central giro institutions as well as of regional cooperative institutions and central giro institutions on their central credit institutions which serve the purpose of liquidity pooling within the network may have a longer period to maturity,
- 3 covered bonds pursuant to section 20a and claims pursuant to section 4 (3) of the Pfandbrief Act,
- 4 exposures with a residual maturity of up to 1 year for which
  - (a) a credit institution domiciled in Germany,
  - (b) a securities trading firm domiciled in Germany, with the exception of investment advisers and investment brokers who, in providing financial services, are not

authorised to obtain ownership or possession of funds or securities of customers and who do not trade in financial instruments for their own account,

- (c) a deposit-taking credit institution, an e-money institution or a securities trading firm, with the exception of investment advisers and investment brokers who, in providing financial services, are not authorised to obtain ownership or possession of funds or securities of customers and who do not trade in financial instruments for their own account, domiciled in another EEA state,
- (d) a deposit-taking credit institution or an e-money institution domiciled in a non-EEA state which is authorised to operate in that non-EEA state and is subject to a prudential supervisory regime which is materially equivalent to that provided for by this Act,
- (e) a recognised securities trading firm from a non-EEA state within the meaning of section 1 (29),
- (f) a central counterparty within the meaning of section 1 (31), or
- (g) a stock exchange or futures exchange within the meaning of section 1 (3e) – subject to the provisions in section 20b – is liable as a principal, and

5 positions which are deducted from liable capital pursuant to section 10 (6a) number 4.

<sup>3</sup>Legally independent promotional institutions of the Federal Government and of state governments within the meaning of section 5 (1) number 2 of the Corporation Tax Act (*Körperschaftsteuergesetz*) can, notwithstanding sentence 2 number 2, apply a weighting of 20 per cent to exposures to other credit institutions domiciled in Germany regardless of their maturity when calculating whether the limits for large exposures have been reached pursuant to section 13 (3) and section 13a (3) to (5) if the exposures are not counted towards own funds. <sup>4</sup>The promotional institution must notify BaFin and the Deutsche Bundesbank if it makes use of this weighting method and shall carry on applying this method for a period of at least five years from the date on which BaFin receives such notification.

(4) Exposures pursuant to subsections (2) and (3) sentence 2 shall be disregarded when calculating the utilisation of the aggregate large exposure limit pursuant to section 13 (3) sentence 5 and section 13a (3) sentence and of the aggregate large exposure limit in overall business pursuant to section 13a (4) sentence 5, when calculating the borrower-related total trading book exposure pursuant to section 13a (5) sentence 1 and when calculating the aggregate excess exposure pursuant to section 13a (5) sentence 3.

(5) Section 13 (2) and (4) as well as section 13a (2) and (6) regarding decisions on large exposures shall not apply to exposures pursuant to subsections (2) and (3) sentence 2.

(6) The following are not deemed to be loans within the meaning of section 14:

- 1 exposures pursuant to subsection (1) numbers 1, 2 and 4,
- 2 exposures to

- (a) the Federal Government, the Deutsche Bundesbank, a legally dependent special fund of the Federal Government or of a state government, a state government, a local government or a local government association,
  - (b) the European Communities,
  - (c) the European Investment Bank,
  - (d) borrowers for whose liabilities the Federal Government is liable as a principal by law,
- 3 credit commitments,
- 4 capital shares in other enterprises regardless of how they are shown on the balance sheet and asset items which are deducted from liable capital pursuant to section 10a (13) sentence 3,
- 5 securities in the trading portfolio, and
- 6 drawings against credited amounts under the direct debit procedure which are marked "Subject to receipt" ("*Eingang vorbehalten*").

## **Section 20a Covered bonds**

(1) <sup>1</sup>Covered bonds are

- 1 Pfandbriefe within the meaning of section 1 (3) of the Pfandbrief Act,
- 2 bonds pursuant to Article 22 (4) of the UCITS Directive which were issued before 31 December 2007, or
- 3 bonds pursuant to Article 22 (4) of the UCITS Directive which are collateralised exclusively by the following assets:
  - (a) exposures to or explicitly guaranteed by
    - (aa) the central government or central bank of an EEA state, or
    - (bb) the central government or central bank of a non-EEA state, a multilateral development bank or an international organisation with a CRSA risk weight of 0 per cent,
  - (b) exposures to or explicitly guaranteed by
    - (aa) a regional government, local authority or public-sector entity of an EEA state,
    - (bb) a regional government or local authority of a non-EEA state with the same CRSA risk weight as the central government to whose jurisdiction the debtor belongs and which has a CRSA risk weight of 0 per cent, or
    - (cc) a regional government, local authority or public-sector entity of a non-EEA state with the same CRSA risk weight as institutions and which have a CRSA risk weight of 20 per cent,
  - (c) exposures to or explicitly guaranteed by

- (aa) the central government, the central bank, a public-sector entity, a regional government or a local authority of a non-EEA state, or
  - (bb) a multilateral development bank or an international organisation
- if, in the aggregate, they do not exceed 20 per cent of the total nominal value of the outstanding covered bonds of the issuing credit institution and the debtor or protection provider has been assigned a minimum of credit quality step 2,
- (d) exposures to
    - (aa) a credit institution domiciled in Germany,
    - (bb) a securities trading firm domiciled in Germany, with the exception of investment advisers and investment brokers who, in providing financial services, are not authorised to obtain ownership or possession of funds or securities of customers and who do not trade in financial instruments for their own account,
    - (cc) a deposit-taking credit institution, an e-money institution or a securities trading firm, with the exception of investment advisers and investment brokers who, in providing financial services, are not authorised to obtain ownership or possession of funds or securities of customers and who do not trade in financial instruments for their own account, domiciled in another EEA state,
    - (dd) a deposit-taking credit institution or an e-money institution domiciled in a non-EEA state which is authorised to operate in that non-EEA state and is subject to a prudential supervisory regime which is materially equivalent to that provided for by this Act,
    - (ee) a recognised securities trading firm from a non-EEA state within the meaning of section 1 (29),
    - (ff) a central counterparty within the meaning of section 1 (31), or
    - (gg) a stock exchange or futures exchange within the meaning of section 1 (3e), with a CRSA risk weight of 20 per cent, subject to the provisions in subsection (2),
  - (e) exposures secured by mortgages on residential real estate, provided that the mortgage amount plus any prior or equal-ranking liens does not exceed 80 per cent of the value of the encumbered residential property,
  - (f) exposures secured by mortgages on commercial real estate, provided that the mortgage amount plus any prior or equal-ranking liens does not exceed 60 per cent of the value of the encumbered commercial property, and
  - (g) exposures secured by registered ship mortgages, provided that the mortgage amount plus any prior or equal-ranking liens does not exceed 60 per cent of the value of the encumbered ship.

<sup>2</sup>More detailed provisions on determining the CRSA risk weight, on the CRSA exposures and exposure classes as well as on the credit quality steps can be laid down in the statutory order pursuant to section 10 (1) sentence 9.

(2) <sup>1</sup>Cover assets for a covered bond pursuant to subsection (1) sentence 1 number 3 letter (d) may not exceed 15 per cent of the total nominal value of all the covered bonds issued by this credit institution. <sup>2</sup>When calculating the 15 per cent limit, exposures incurred by the transmission and management of debtors' payments or revenues from the liquidation of exposures secured by real estate to the holders of covered bonds shall be disregarded. <sup>3</sup>In the case of exposures with a residual maturity of up to 100 days, the debtor's CRSA risk weight may not be greater than 50 per cent.

(3) <sup>1</sup>If cover assets for a covered bond are exposures secured by real estate mortgages or ship mortgages pursuant to subsection (1) sentence 1 number 3 letters (e) to (g), the issuer of the covered bond must fulfil the requirements set out in subsections (4) to (8). <sup>2</sup>The provisions for mortgages on commercial real estate shall apply *mutatis mutandis* to ship mortgages.

(4) <sup>1</sup>The real estate mortgage lien must be legally enforceable; this shall be documented. <sup>2</sup>The institution must be able to realise the value of the real estate mortgage within a reasonable period of time upon the occurrence of the secured event.

(5) <sup>1</sup>For a property to be recognised as a cover asset, it shall be valued by an independent valuer; the property may be valued at most at its market value pursuant to section 16 (2) sentence 4 of the Pfandbrief Act. <sup>2</sup>Where an EEA state has laid down stringent criteria for the assessment of the mortgage lending value in statutory or regulatory provisions, the institution may choose to have the property valued not at its market value but instead at its mortgage lending value pursuant to section 16 (2) sentences 1 to 3 of the Pfandbrief Act. <sup>3</sup>The value of the property shall be documented in a transparent and clear manner.

(6) <sup>1</sup>The value of the encumbered property shall be monitored at regular intervals. <sup>2</sup>These intervals may not be greater than a year for commercial real estate and three years for residential real estate. <sup>3</sup>More frequent monitoring shall be carried out if the market for the encumbered property is subject to significant fluctuations in value. <sup>4</sup>Institutions may use statistical methods to identify those properties that require revaluation and to monitor the value of the encumbered property. <sup>5</sup>Where a property is valued at its mortgage lending value, sentences 1 to 4 shall apply to the valuation bases. <sup>6</sup>The valuation of the encumbered property shall be reviewed by an independent valuer as soon as the institution has information indicating that the value of the encumbered property may have materially declined relative to the general market value of comparable properties. <sup>7</sup>In the case of exposures secured by real estate mortgages where the assessment base for the exposure and the value of the encumbered property exceeds the lower of 3 million euro or 5 per cent of the institution's liable capital pursuant to section 10 (2) sentence 2, the valuation of the encumbered property shall be reviewed by an independent valuer at least every three years. <sup>8</sup>Section 16 (1) of the Pfandbrief Act shall apply *mutatis mutandis*. <sup>9</sup>If the review of the

encumbered property's value reveals that a write-down is necessary, then the value shall be reduced accordingly; when determining the value of the real estate mortgage, any prior encumbrances shall be deducted.

(7) An institution must have written instructions on lending against real estate mortgages, in particular regarding the types of residential real estate and commercial real estate for which mortgages are accepted as collateral.

(8) An institution must have taken steps to ensure that the property serving as collateral is adequately insured against loss or damage.

### **Section 20b Recognition of credit protection instruments as exempting exposures from reporting and weighting requirements**

The following credit protection instruments shall be recognised as exempting exposures from reporting and weighting requirements if they fulfil the more detailed provisions on credit risk mitigation laid down in the statutory order pursuant to section 22:

- 1 explicit guarantees pursuant to section 20 (2) sentence 1 number 1 letter (d) or liability as a principal pursuant to section 20 (3) sentence 2 number 4,
- 2 debt securities pursuant to section 20 (2) sentence 1 number 2 letter (a),
- 3 cash on deposit or cash assimilated instruments pursuant to section 20 (2) sentence 1 number 2 letter (b),
- 4 certificates of deposit or similar paper pursuant to section 20 (2) sentence 1 number 2 letter (c),
- 5 financial instruments or commodities pursuant to section 20 (2) sentence 1 number 3, and
- 6 cover assets pursuant to section 20a (1) sentence 1 number 3.

### **Section 20c Exemption from the obligations pursuant to section 13 (3), section 13a (3) to (5) and section 13b (1)**

(1) BaFin can, upon request, revocably permit a securities trading firm domiciled in Germany, with the exception of investment advisers and investment brokers who, in providing financial services, are not authorised to obtain ownership or possession of funds or securities of customers and who do not trade in financial instruments for their own account, to allow

- 1 exposures to exceed the large exposure limits pursuant to section 13 (3) and section 13a (3) to (5), also in conjunction with section 13b (1), without BaFin's permission if the exposures are incurred exclusively
  - (a) by financial instruments within the meaning of subsection (2) number 1 in relation to the underlyings specified in section 1 (11) sentence 4 numbers 2 and 5, for

which a credit equivalent amount is to be calculated pursuant to the provisions laid down in the statutory order pursuant to section 22, or

(b) on the basis of contracts concerning the delivery of goods or the transfer of issuing rights, and

2 the amount by which an exposure within the meaning of number 1 exceeds a large exposure limit pursuant to section 13 (3) and section 13a (3) to (5), also in conjunction with section 13b (1), does not have to be backed with liable capital or with own funds.

(2) The request pursuant to subsection (1) can be granted only if the institution

1 conducts banking business and provides financial services in connection with derivatives pursuant to section 1 (11) sentence 4 numbers 2, 3 and 5,

2 does not conduct the banking business and provide the financial services pursuant to number 1 for or on behalf of retail customers,

3 has a documented strategy for managing – in particular, for controlling and limiting – concentration risk and has reported this to BaFin and the Deutsche Bundesbank, and

4 puts in place arrangements which

(a) ensure the ongoing monitoring of the borrowers' credit quality commensurate with the concentration risk, and

(b) allow a prompt response to a deterioration in the borrowers' credit quality.

(3) A securities trading firm within the meaning of subsection (1) shall notify BaFin and the Deutsche Bundesbank promptly if

1 an exposure within the meaning of subsection (1) exceeds the concentration limits which the institution has set internally in its strategy pursuant to subsection (2) number 3; the report shall specify the amount by which the limit has been exceeded, the borrower's name and information about the underlying business, or

2 material changes are made to the strategy pursuant to subsection (2) number 3 .

(4) <sup>1</sup>A securities trading firm within the meaning of subsection (1) shall, by the 15th day of each new quarter, notify BaFin and the Deutsche Bundesbank of the previous quarter's large exposures which are covered by the exemption pursuant to subsection (1) and exceed the limits pursuant to section 13 (3) and section 13a (3) to (5), also in conjunction with section 13b (1). <sup>2</sup>The report shall specify the amounts by which the limits have been exceeded, the borrowers' names and information about the performance of the exposures.

## **Section 21 Definition of "exposure" and "loan" in sections 15 to 18**

(1) <sup>1</sup>Exposures and loans within the meaning of sections 15 to 18 are:

1 money loans of all types, monetary claims acquired against payment, acceptance credits and exposures arising from registered bonds, with the exception of registered Pfandbriefe and municipal bonds;

- 2 the discounting of bills of exchange and cheques;
- 3 monetary claims arising from a credit institution's other commercial transactions, with the exception of exposures arising from the commodities trading of credit cooperatives, provided that these are not deferred beyond the period usual in commercial practice;
- 4 an institution's sureties, guarantees and other warranties as well as an institution's liability arising from the provision of collateral for third-party liabilities;
- 5 the obligation to assume responsibility for the settlement of monetary claims transferred against payment or to reacquire them at the purchaser's request;
- 6 an institution's ownership of stocks or shares in another enterprise amounting to at least a quarter of that enterprise's capital (nominal capital, sum total of the capital shares) irrespective of the duration of ownership;
- 7 assets in respect of which an institution has concluded lease agreements as the lessor, less any items created on account of the settlement or sale of claims arising from these lease agreements; such items may be deducted up to the book value of the respective leased asset.

<sup>2</sup>Any collateral held in the institution's favour as well as balances maintained with the institution by the borrower shall be disregarded.

(2) The following are not deemed to be exposures and loans within the meaning of sections 15 to 18:

- 1 exposures to the Federal Government, a legally dependent special fund of the Federal Government or of a state government, a state government, a local government or a local government association;
- 2 unsecured exposures to other institutions arising from balances maintained with those institutions and serving the sole purpose of financial investment, which mature within no more than three months; the exposures of registered cooperative societies to their regional institutions, of savings banks to their central giro institutions as well as of regional cooperative institutions and central giro institutions to their central credit institutions may mature later;
- 3 bills of exchange purchased from other institutions which an institution has accepted, endorsed or issued as promissory notes, and which have a maturity of no more than three months and are normally traded in the money market;
- 4 exposures written off.

(3) Section 15 (1) sentence 1 numbers 6 to 11 and section 18 shall not apply to

- 1 loans insofar as they satisfy the requirements of sections 14 and 16 (1) and (2) of the Pfandbrief Act (mortgages);
- 2 loans with periods to maturity of no more than 15 years secured by ship mortgages insofar as they satisfy the requirements of section 22 (1), (2) sentence 1 and (5)

sentence 3, section 23 (1) and (4) as well as section 24 (2) in conjunction with (3) of the Pfandbrief Act;

- 3 loans to a domestic legal person governed by public law not specified in subsection (2) number 1, the European Communities or the European Investment Bank;
- 4 loans which are guaranteed or secured in some other way by the Federal Government, a special fund of the Federal Government, a state government, a local government or a local government association (publicly guaranteed loans).

(4) The following are not deemed to be exposures and loans within the meaning of section 18:

- 1 loans based on the acquisition against payment of a claim arising from non-banking commercial transactions if
  - (a) claims arising from non-banking commercial transactions on the relevant debtor are acquired on an ongoing basis,
  - (b) the seller of the claim is not responsible for the settlement of the claim, and
  - (c) the claim falls due within three months of the date on which it was purchased;
- 2 loans within the meaning of section 20 (2) sentence 1 number 2 letter (b) or (c).

## **Section 22 Authority to issue statutory orders on exposures and loans**

<sup>1</sup>The Federal Ministry of Finance shall be authorised to issue by way of a statutory order, in consultation with the Deutsche Bundesbank, more detailed provisions for large exposures and loans of 1.5 million euro or more regarding the determination of the credit weightings and the borrowers, credit risk mitigation, the distinction between trading book institutions and non-trading book institutions, organisational duties and measures, decision-making requirements and the backing of breaches of large exposure limits, the total trading book exposure of a trading book institution and the valuation of trading book positions, the notification requirements in the procedure for loans of 1.5 million euro or more, and the reporting of large exposures and loans of 1.5 million euro or more incurred or granted by the institutions, in particular with respect to

- 1 calculating the exposure or loan amounts,
- 2 calculating the credit equivalent amounts of derivatives as well as of repurchase and lending transactions and of other transactions comparable thereto as well as calculating the warranties assumed for these transactions,
- 3 divergent provisions on sections 20 to 20b as well as more detailed provisions for institutions stipulating that they may, upon request, be permitted to recognise the protective effects of financial collateral arrangements when calculating the exposure or loan amounts pursuant to sections 13 to 13b if they conduct periodic stress tests and have developed strategies for managing concentration risk,
- 4 assigning exposures or loans to borrowers,

- 5 counting exposures and loans towards the large exposure limits and within the framework of reports on loans of 1.5 million euro or more,
- 6 recognising, including and calculating credit protection instruments (credit risk mitigation provisions),
- 7 the notification requirements vis-à-vis a collateral provider in the case of concentration risk,
- 8 the decision-making requirements in connection with large exposures,
- 9 the type, scope, timing and form of the information as well as the permissible data storage media, transmission channels and data formats for the large exposure reports pursuant to sections 13 to 13b, and the reporting requirements under these provisions, which can be supplemented with the obligation to submit summary reports insofar as this is necessary to enable BaFin to perform its functions, especially to obtain standardised documentation for assessing the positions opened by the institutions,
- 10 calculating the total trading book exposure,
- 11 divergent provisions on section 20 concerning borrower-related free delivery risk,
- 12 backing the excess amount pursuant to section 13a (4) sentences 2, 4 and 6 as well as subsection (5) sentences 2 and 4,
- 13 the contents of the reports, reporting deadlines and observation period pursuant to section 14 (1) sentence 1,
- 14 additional data to be provided in the notification pursuant to section 14 (2) sentence 1 insofar as this is necessary owing to information which the Deutsche Bundesbank has received from central credit registers in other countries,
- 15 details concerning the data to be provided in the notification pursuant to section 14 (2) sentence 2, in particular the prerequisites for and the contents of the information feedback on the forecast probabilities of default, as well as the structure of the notification pursuant to section 14 (2) sentence 3,
- 16 details concerning the electronic data transfer process pursuant to section 14 (2) sentence 6.

<sup>2</sup>The Federal Ministry of Finance may delegate this authority to BaFin by way of a statutory order, subject to the proviso that the statutory order is issued in agreement with the Deutsche Bundesbank. <sup>3</sup>The central associations of the institutions shall be consulted before the statutory order is issued.

## **Division 2a      REFINANCING REGISTER**

### **Section 22a   Register-keeping enterprise**

(1) <sup>1</sup>If the refinancing enterprise is a credit institution or one of the entities mentioned in section 2 (1) numbers 1 to 3a and if a special purpose vehicle, a refinancing intermediary, a

credit institution domiciled in an EEA state or one of the entities mentioned in section 2 (1) number 1 or 3a has a claim to the transfer of an exposure of the refinancing enterprise or a lien held by the refinancing enterprise by way of collateral, these assets may be entered in a refinancing register kept by the refinancing enterprise; this shall apply *mutatis mutandis* to registered liens on aircraft and ship mortgages. <sup>2</sup>Each refinancing transaction is to be entered in a separate section.

(2) <sup>1</sup>This division shall not create an obligation on the part of the refinancing enterprise or the refinancing intermediary to keep a refinancing register. <sup>2</sup>The keeping of a register may be terminated or transferred only under the conditions set out in section 22k.

(3) Register-keeping shall not be outsourced.

(4) Subsections (1) to (3) shall apply *mutatis mutandis* to refinancing intermediaries which are a credit institution or one of the entities mentioned in section 2 (1) numbers 1 to 3a.

### **Section 22b Keeping a refinancing register for third parties**

(1) <sup>1</sup>If the refinancing enterprise is neither a credit institution nor one of the entities mentioned in section 2 (1) numbers 1 to 3a, the refinancing enterprise's assets mentioned in section 22a (1) sentence 1, to which a special purpose vehicle, a refinancing intermediary or a credit institution domiciled in an EEA state has a transfer claim, may be entered in a refinancing register kept by a credit institution or the KfW banking group. <sup>2</sup>If the refinancing register also contains assets which the register-keeping enterprise or another enterprise is obliged to transfer, then each obligor of transfer is to be entered in a separate section within the same refinancing register and each refinancing transaction is to be entered in a subsection of this section.

(2) <sup>1</sup>If the refinancing enterprise is a credit institution for which the keeping of its own refinancing register constitutes an undue burden in terms of the nature and scope of its business operations, BaFin shall, at the refinancing enterprise's request, give permission for the refinancing register to be kept by another credit institution. <sup>2</sup>BaFin's permission shall be deemed to have been given if it is not denied within one month of the request having been submitted.

(3) Entries made for other credit institutions without BaFin's permission pursuant to subsection (2) shall be invalid.

(4) Section 22a (2) and (3), also in conjunction with (4), shall apply *mutatis mutandis*.

### **Section 22c Refinancing intermediaries**

Sections 22d to 22o shall apply *mutatis mutandis* to refinancing registers which are kept by a refinancing intermediary pursuant to section 22a (4) or for a refinancing intermediary pursuant to section 22b (4).

## Section 22d Refinancing registers

(1) <sup>1</sup>A refinancing register may be kept in electronic form provided that it is ensured that adequate arrangements have been put in place to prevent a loss of data. <sup>2</sup>The Federal Ministry of Finance must, by way of a statutory order not requiring the consent of the Bundesrat, lay down details regarding the form which a refinancing register should take as well as the way in which entries are to be made. <sup>3</sup>The Federal Ministry of Finance may delegate this authority to BaFin by way of a statutory order.

(2) <sup>1</sup>The register-keeping enterprise shall record the following in the refinancing register:

- 1 the exposures or collateral to which the special purpose vehicles, refinancing intermediaries, credit institutions domiciled in an EEA state or entities mentioned in section 2 (1) number 1 or 3a entered in the register as the parties entitled to transfer (transferees) have a transfer claim,
- 2 the transferee,
- 3 the date and time of the entry,
- 4 if an asset is held by way of collateral, the legal reason therefor, the scope and ranking of the collateral as well as the date on which the contract containing the legal reason for the collateralisation was concluded.

<sup>2</sup>With regard to numbers 1 and 4, the entries shall be deemed to be adequate if third parties, in particular, the administrator (*Verwalter*), the creditors' trustee (*Sachwalter*), BaFin or an insolvency administrator, are able to clearly define and identify the information concerned. <sup>3</sup>If the transferee is a Pfandbrief bank, then it as well as the cover pool monitor appointed pursuant to section 7 (1) of the Pfandbrief Act shall be informed of the entry.

(3) If data required pursuant to subsection (2) are lacking or if entries are incorrect or do not allow the details to be clearly defined and identified, the assets concerned shall be deemed not to have been entered properly.

(4) <sup>1</sup>Exposures can also be entered in the register and assigned to the transferee after registration if assignment has been excluded through a verbal or implied agreement with the debtor. <sup>2</sup>This is without prejudice to section 354a of the Commercial Code as well as any statutory restraints on disposition.

(5) <sup>1</sup>Entries can be deleted only with the consent of the transferee and, if the transferee is a Pfandbrief bank, the consent of the Pfandbrief bank's cover pool monitor, whereby the date and time of deletion must be recorded. <sup>2</sup>Incorrect entries can be deleted with the administrator's consent, however; subsection (2) sentence 3 shall apply *mutatis mutandis*. <sup>3</sup>The correction, the date and time of said correction, and the administrator's consent are to be entered in the refinancing register. <sup>4</sup>Re-registration without deletion of the previous entry shall not produce any legal effects.

## **Section 22e Appointment of an administrator**

(1) <sup>1</sup>Every register-keeping enterprise must appoint a natural person as an administrator of the refinancing register (administrator). <sup>2</sup>The tenure of office shall expire upon cessation of the register or when a different person is appointed as the creditors' trustee of the refinancing register pursuant to section 22l (4) sentence 1.

(2) <sup>1</sup>The administrator shall be appointed by BaFin based on a proposal from the register-keeping enterprise. <sup>2</sup>BaFin shall appoint the nominated person as the administrator if he/she appears to have the required independence, trustworthiness and expertise. <sup>3</sup>In making its decision, BaFin shall take due account of the interests of the transferee entered or to be entered in the refinancing register.

(3) <sup>1</sup>BaFin can dismiss the administrator at any time if it is suspected that he/she is not properly fulfilling his/her tasks. <sup>2</sup>Subsection (2) sentence 3 shall apply *mutatis mutandis*. <sup>3</sup>If the administrator has an employment or client relationship with a party involved in a specific refinancing transaction, his/her office shall be suspended for the term of this refinancing transaction.

(4) <sup>1</sup>A deputy administrator shall be appointed at the register-keeping enterprise's request. <sup>2</sup>A request is permissible at any time. <sup>3</sup>Subsections (2) and (3) shall apply *mutatis mutandis* to the appointment and dismissal of a deputy administrator. <sup>4</sup>If the administrator is dismissed pursuant to subsection (3) sentence 1, if his/her office is suspended or if he/she is prevented from performing his/her tasks, the deputy administrator shall take his/her place.

(5) <sup>1</sup>If an administrator is not on hand for a considerable period of time, if he/she is prevented from performing his/her tasks or if his/her office is suspended without a deputy administrator taking his/her place, BaFin shall appoint a suitable administrator without consulting the register-keeping enterprise. <sup>2</sup>Subsection (2) sentence 3 shall apply *mutatis mutandis*. <sup>3</sup>The register-keeping enterprise shall inform BaFin promptly if any of the circumstances listed in sentence 1 arises.

## **Section 22f Administrator's relationship with BaFin**

(1) The administrator shall provide BaFin with information about any findings and observations made in performing his/her tasks and shall also notify BaFin on his/her own initiative if circumstances exist which suggest that the register is not being kept properly.

(2) The administrator is not bound by BaFin's instructions.

## **Section 22g Administrator's tasks**

(1) <sup>1</sup>The administrator shall ensure that the refinancing register is kept properly. <sup>2</sup>However, his/her tasks shall not include checking whether the registered assets are the refinancing enterprise's assets or registrable assets pursuant to section 22d (2).

(2) <sup>1</sup>The administrator of the refinancing register shall ensure, in particular, that

- 1 the refinancing register contains the information required pursuant to section 22d (2),
- 2 the dates and times given in the refinancing register are correct, and
- 3 the entries are not altered subsequently.

<sup>2</sup>In all other respects, the administrator of the refinancing register shall not be obliged to verify the factual accuracy of the refinancing register's contents.

(3) The administrator may make use of other persons and entities in performing his/her tasks.

### **Section 22h Administrator's relationship with the register-keeping enterprise and the refinancing enterprise**

(1) <sup>1</sup>The administrator shall be authorised to inspect the register-keeping enterprise's books and papers at any time unless these are in no way connected with the keeping of the refinancing register. <sup>2</sup>In the cases specified in section 22b, the administrator shall also have the same powers vis-à-vis the refinancing enterprise.

(2) <sup>1</sup>The administrator shall be obliged to maintain confidentiality with regard to any facts of which he/she obtains knowledge when inspecting the books and papers of the register-keeping enterprise or, if different, of the refinancing enterprise. <sup>2</sup>He/she may provide BaFin with information or notify BaFin only about facts connected with the monitoring of the refinancing register.

(3) Disputes between the administrator and the register-keeping enterprise or, if different, the refinancing enterprise shall be settled by BaFin.

### **Section 22i Administrator's remuneration**

(1) <sup>1</sup>The administrator shall receive appropriate remuneration and reimbursement of his/her expenses from BaFin. <sup>2</sup>The amounts paid shall be refunded separately to BaFin by the register-keeping enterprise and, at BaFin's request, shall be provided in advance.

(2) BaFin can instruct a register-keeping enterprise to pay an amount laid down by BaFin directly to the administrator of a refinancing register on BaFin's behalf if there is no reason to suspect that this may affect the administrator's independence.

(3) <sup>1</sup>Other than in the case specified in subsection (2), the register-keeping enterprise, the refinancing enterprise for which the register is kept and the transferees shall not make payments to the administrator of the refinancing register. <sup>2</sup>If the administrator has nevertheless received such payments, he/she shall be dismissed by BaFin.

### **Section 22j Effects of entry in the refinancing register**

(1) <sup>1</sup>A refinancing enterprise's assets which have been properly entered in a refinancing register can, in the event of the refinancing enterprise's insolvency, be separated from the insolvent's estate by the transferee pursuant to section 47 of the German Insolvency Code (*Insolvenzordnung*). <sup>2</sup>The same shall apply to assets which supersede the assets properly entered in a refinancing register. <sup>3</sup>A transferee can raise an objection to orders or injunctions issued as part of judicial enforcement or execution of attachment by way of litigation pursuant to section 771 of the Code of Civil Procedure (*Zivilprozessordnung*).

(2) <sup>1</sup>Entry in the refinancing register shall not limit the objections and pleas of third parties with regard to registered exposures and rights. <sup>2</sup>If the assets entered in the refinancing register are separated from the insolvent's estate or are transferred to the transferee or to a third party by the transferee, all objections and pleas can be raised in the same way as in the event of assignment. <sup>3</sup>Section 1156 sentence 1 of the German Civil Code shall not apply. <sup>4</sup>If assets entered in the refinancing register serve as collateral for other assets, the collateral provider can raise all objections and pleas laid down in the contract containing the legal reason for the collateralisation vis-à-vis the transferee. <sup>5</sup>Section 1157 sentence 2 of the German Civil Code shall not apply. <sup>6</sup>This is without prejudice to section 22d (4) in conjunction with section 22j (1) sentences 1 and 2, however.

(3) <sup>1</sup>The refinancing enterprise cannot offset any counterclaims against the transferee's claims for the transfer of assets properly entered in a refinancing register and cannot assert any rights of retention. <sup>2</sup>This is without prejudice to any rights of avoidance on the part of the transferee's creditors pursuant to the Creditors' Avoidance of Transfers Act (*Anfechtungsgesetz*) and sections 129 to 147 of the Insolvency Code.

### **Section 22k Cessation and transfer of register-keeping activities**

(1) <sup>1</sup>If all of the transferees entered in a refinancing register as well as their creditors consent thereto, the keeping of the refinancing register can cease one month after BaFin has been notified thereof. <sup>2</sup>If all of the transferees entered in a refinancing register as well as their creditors consent thereto, the keeping of the register can be transferred, under BaFin's supervision, to a suitable credit institution provided that the registered assets are those of the credit institution taking over the register-keeping activities or the conditions set out in section 22b regarding the keeping of a refinancing register for third parties have been fulfilled.

(2) <sup>1</sup>The keeping of the register shall furthermore cease if BaFin deems the register-keeping enterprise to be unsuitable for this activity. <sup>2</sup>In this case, the keeping of the register shall be transferred, under BaFin's supervision, to a credit institution which BaFin deems to be suitable for this activity. <sup>3</sup>The provisions of section 22b regarding the keeping of a refinancing register for third parties shall apply *mutatis mutandis*.

(3) Subsection (2) shall not apply if insolvency proceedings are initiated over the assets of an enterprise which keeps a refinancing register not only for third parties.

## **Section 22l Appointment of a creditors' trustee upon the initiation of insolvency proceedings**

(1) <sup>1</sup>If insolvency proceedings are initiated over the assets of an enterprise which keeps a refinancing register not only for third parties, the insolvency court, at BaFin's request, shall appoint one or two natural persons proposed by BaFin as the creditors' trustee(s) of the refinancing register (the creditors' trustee(s)). <sup>2</sup>The court can deviate from BaFin's proposal if this appears necessary to ensure proper cooperation between the insolvency administrator and the creditors' trustee(s). <sup>3</sup>The creditors' trustee shall receive a certificate of appointment, which he/she must return to the insolvency court at the end of his/her tenure.

(2) <sup>1</sup>BaFin shall submit a request pursuant to subsection (1) sentence 1 if, after consulting the transferees, this appears necessary for the proper management of the assets entered in the refinancing register. <sup>2</sup>BaFin shall nominate the administrator of the refinancing register as the creditors' trustee of the refinancing register or, if the administrator is not available or permanently prevented from performing his/her tasks, his/her deputy or another suitable natural person. <sup>3</sup>The creditors' trustee of the refinancing register shall be dismissed at BaFin's request if there is a good reason for doing so.

(3) <sup>1</sup>If it appears necessary to appoint a second creditors' trustee of the refinancing register to ensure the proper management of the assets entered in the refinancing register, BaFin, after consulting the transferees, can submit a further request pursuant to subsection (1) sentence 1. <sup>2</sup>If BaFin submits such a request, it shall nominate the deputy administrator of the refinancing register or, if there is no deputy, another suitable natural person.

(4) <sup>1</sup>If a person other than the administrator is appointed as the creditors' trustee, then the administrator's tenure shall end. <sup>2</sup>The creditors' trustee of the refinancing register shall take up this office. <sup>3</sup>Sentences 1 and 2 shall apply *mutatis mutandis* to the deputy administrator.

## **Section 22m Announcement of the appointment of a creditors' trustee**

(1) <sup>1</sup>The insolvency court shall publicly announce and inform the relevant court of registration about the appointment or dismissal of a creditors' trustee promptly. <sup>2</sup>The appointment or dismissal of a creditors' trustee shall be entered officially in the commercial register (*Handelsregister*) following announcement. <sup>3</sup>These entries shall not be publicly announced. <sup>4</sup>The provisions of section 15 of the Commercial Code shall not apply.

(2) <sup>1</sup>If rights on the part of the register-keeping enterprise which are already entered in the land register (*Grundbuch*) are entered in the refinancing register, then the appointment of a creditors' trustee shall be entered in the land register at the request of either the insolvency court or the creditors' trustee if the type of rights concerned and circumstances suggest that the transferees' interests could be at risk without such registration. <sup>2</sup>Sentence 1 shall apply *mutatis mutandis* to rights on the part of the register-keeping enterprise which are entered in the shipping register (*Schiffsregister*), the shipbuilding register (*Schiffsbauregister*) or the register of liens on aircraft (*Register für Pfandrechte an Luftfahrzeugen*).

## **Section 22n Legal position of the creditors' trustee**

(1) <sup>1</sup>The creditors' trustee shall be subject to supervision by the insolvency court. <sup>2</sup>The insolvency court can, in particular, ask the creditors' trustee for specific information or a report on the situation and the management at any time. <sup>3</sup>In addition, it shall be incumbent upon the creditors' trustee to perform the duties of an administrator. <sup>4</sup>The creditors' trustee and the insolvency administrator shall provide one another with all information which may be of significance for the insolvency proceedings over the assets of the register-keeping enterprise and for managing the assets entered in the refinancing register.

(2) <sup>1</sup>If the register-keeping enterprise was authorised to manage and dispose of the assets entered in the refinancing register, this right shall pass to the creditors' trustee. <sup>2</sup>In consultation with the insolvency administrator, the creditors' trustee shall use all of the register-keeping enterprise's facilities that are required to manage the registered assets.

(3) <sup>1</sup>If the register-keeping enterprise has disposed of an asset entered in the refinancing register after the creditors' trustee has been appointed, this disposal shall be invalid. <sup>2</sup>This is without prejudice to the provisions of sections 892 and 893 of the German Civil Code, sections 16 and 17 of the Act Governing Rights in Registered Ships and Ships Under Construction (*Gesetz über Rechte an eingetragenen Schiffen und Schiffsbauwerken*) and sections 16 and 17 of the Act Governing Rights in Aircraft (*Gesetz über Rechte an Luftfahrzeugen*). <sup>3</sup>If the register-keeping enterprise has disposed of an asset on the day on which the creditors' trustee of the refinancing register was appointed, it shall be assumed that the disposal occurred after the appointment.

(4) <sup>1</sup>In performing his/her management functions, the creditors' trustee of the refinancing register shall exercise the diligence of a prudent and conscientious creditors' trustee. <sup>2</sup>If the creditors' trustee of the refinancing register breaches his/her duties, the transferees and the register-keeping enterprise can demand compensation for damages resulting therefrom. <sup>3</sup>This shall not apply if the creditors' trustee of the refinancing register is not responsible for the breach of duty.

(5) <sup>1</sup>The creditors' trustee of the refinancing register shall receive appropriate remuneration and reimbursement of his/her expenses from BaFin. <sup>2</sup>The amounts paid shall be refunded separately to BaFin by the transferees on a *pro rata* basis depending on the number of assets registered on their behalf and, at BaFin's request, shall be provided in advance. <sup>3</sup>If the refinancing register is kept for third parties, these parties as well as the transferees, as joint and several debtors, shall be obliged to make refunds and provide advance payments. <sup>4</sup>Section 22i (2) and (3) sentence 1 shall apply *mutatis mutandis*. <sup>5</sup>Section 22i (3) sentence 2 shall apply *mutatis mutandis* subject to the proviso that BaFin is to file an application for dismissal with the insolvency court.

## **Section 22o Appointment of a creditors' trustee in the event of imminent insolvency**

(1) <sup>1</sup>Under the conditions set out in section 46a, at BaFin's request, the court with jurisdiction at the register-keeping enterprise's domicile shall appoint one or two persons as the

creditors' trustee(s). <sup>2</sup>BaFin shall submit a request pursuant to sentence 1 if, after consulting the transferees, this appears necessary for the proper management of the assets entered in the refinancing register. <sup>3</sup>In the event of imminent risk, this consultation shall be waived. <sup>4</sup>In this case, the transferees shall be consulted promptly thereafter.

(2) <sup>1</sup>The provisions of sections 22l to 22n shall apply *mutatis mutandis* to the appointment and dismissal as well as to the legal position of a creditors' trustee appointed under these circumstances subject to the proviso that the court with jurisdiction at the register-keeping enterprise's domicile takes the place of the insolvency court. <sup>2</sup>A good reason within the meaning of section 22l (2) sentence 3 shall be deemed to exist, in particular, if the conditions set out in section 46a are no longer applicable. <sup>3</sup>In this case, BaFin shall appoint an administrator from among the creditors' trustees.

(3) <sup>1</sup>If insolvency proceedings are initiated over the assets of a register-keeping enterprise after a creditors' trustee has been appointed pursuant to subsections (1) and (2) then, for the period following the initiation of insolvency proceedings, the creditors' trustee shall be regarded as having been appointed by the insolvency court upon the initiation of insolvency proceedings. <sup>2</sup>The insolvency court shall take the place of the court with jurisdiction at the register-keeping enterprise's domicile. <sup>3</sup>The court with jurisdiction at the register-keeping enterprise's domicile must hand over to the insolvency court all documentation in connection with the appointment and supervision of the creditors' trustee of the refinancing register.

## **Division 3 CUSTOMERS' RIGHTS**

### **Section 22p Redeemability of electronic money**

(1) Holders of electronic money, for the duration of its validity, may demand that the issuer redeem it at par value in banknotes and coins or in the form of a credit transfer to an account, without the issuer being permitted to charge any costs other than those absolutely necessary to perform the transaction.

(2) The redemption conditions must be explicitly stated in the contract between the issuer and the holder.

(3) <sup>1</sup>The contract may stipulate a minimum redemption amount. <sup>2</sup>This amount may not be more than 10 euro.

## **Division 4 ADVERTISING, AND INSTITUTIONS' DUTIES OF INFORMATION**

### **Section 23 Advertising**

(1) In order to counteract undesirable developments in advertising by institutions, BaFin may prohibit certain types of advertising.

(2) Before general measures are introduced pursuant to subsection (1), the central associations of the institutions and the consumer protection associations shall be consulted.

## **Section 23a Guarantee scheme**

(1) <sup>1</sup>An institution which conducts banking business within the meaning of section 1 (1) sentence 2 numbers 1, 4 or 10, or provides financial services within the meaning of section 1 (1a) sentence 2 numbers 1 to 4 shall inform customers who are not institutions in its price list of its membership of a scheme to safeguard the claims of depositors and investors (guarantee scheme). <sup>2</sup>In addition, prior to commencing a business relationship, the institution shall inform customers who are not institutions about the guarantee provisions, including the scope and amount of the guarantee, in writing in an easily comprehensible form. <sup>3</sup>If deposits and other repayable funds are not guaranteed, the institution shall draw attention to this fact in its general terms and conditions, in its price list and in a prominent position in the contract documents prior to commencing a business relationship, unless the repayable funds are securitised by Pfandbriefe, municipal bonds or other debt securities which fulfil the conditions of Article 22 (4) sentences 1 and 2 of the UCITS Directive. <sup>4</sup>The information in the contract documents pursuant to sentence 3 shall not include any other declarations, and must be signed separately by the customer. <sup>5</sup>Furthermore, upon request, information must be available on the terms and conditions of the guarantee scheme, including the requisite formalities for asserting compensation claims.

(2) If an institution ceases to be a member of a guarantee scheme, it shall promptly inform its customers who are not institutions, BaFin and the Deutsche Bundesbank of this fact in writing.

## **Division 5 SPECIAL DUTIES OF INSTITUTIONS, THEIR SENIOR MANAGERS, FINANCIAL HOLDING COMPANIES AND MIXED-ACTIVITY HOLDING COMPANIES**

### **Section 24 Reports**

(1) An institution shall promptly report to BaFin and the Deutsche Bundesbank

- 1 the intention to appoint a senior manager or to authorise a person to represent the institution in all aspects of its business, stating the facts which are germane to assessing his/her trustworthiness and professional qualifications, as well as the realisation of such an intention;
- 2 the retirement of a senior manager and the revocation of the authorisation to represent the institution in all aspects of its business;
- 3 changes in the legal form, unless authorisation is already required under section 32 (1), and changes in the firm name;
- 4 a loss amounting to 25 per cent of the liable capital;
- 5 the relocation of the office or domicile;
- 6 the establishment, relocation and closure of a branch in a non-EEA state and the commencement and termination of the provision of cross-border services without establishing a branch;
- 7 the discontinuation of business operations;
- 8 the intention of its governing bodies appointed according to law and its articles of association to bring about a decision on the institution's liquidation;
- 9 a fall in the initial capital below the minimum requirements defined in section 33 (1) sentence 1 number 1, and the discontinuation of appropriate insurance cover pursuant to section 33 (1) sentences 2 and 3;
- 10 the acquisition or disposal of a major participating interest in its own institution, the reaching, exceeding or falling below the thresholds for participating interests of 20 per cent, 30 per cent and 50 per cent of the voting rights or capital, and the fact that the institution becomes or ceases to be the subsidiary of another enterprise, as soon as the forthcoming change in these participatory relationships comes to the institution's attention;
- 11 each case in which the counterparty to a securities repurchase agreement, reverse repo, or a lending transaction in securities or commodities did not discharge his/her settlement obligations;
- 12 the emergence of, change in or termination of a close link with another natural person or another enterprise;
- 13 the emergence of, change in the level or termination of a qualifying participating interest in other enterprises;

- 14 the finding that when determining the effects of a sudden and unexpected change in interest rates as stipulated by BaFin pursuant to section 25a (1) sentence 7, the institution's present value declines by more than 20 per cent of own funds pursuant to section 10 (2);
- 15 the appointment of a member of the supervisory body, stating the facts which are germane to assessing his/her trustworthiness and professional expertise;
- 16 a change in the ratio of balance sheet capital to the sum of total assets and off-balance-sheet liabilities and the replacement cost for claims arising from off-balance-sheet transactions (modified balance sheet capital ratio) of at least 5 per cent based on a monthly return pursuant to section 25 (1) sentence 1 or the monthly balance sheet statistics pursuant to section 25 (1) sentence 3, in each case at the end of a quarter, in relation to the institution's approved annual accounts; where the institution prepares its accounts according to international accounting standards or is required to prepare interim accounts under the German Securities Trading Act, a corresponding change in the modified balance sheet capital ratio must also be reported based on the interim accounts in relation to the approved annual accounts according to international accounting standards.

(1a) An institution shall report to BaFin and the Deutsche Bundesbank annually

- 1 its close links with other natural persons or enterprises,
- 2 its qualifying participating interests in other enterprises,
- 3 the name and address of any holder of a major participating interest in the reporting institution and in the enterprises subordinated to it as described in section 10a that are domiciled abroad, as well as the amounts of these participating interests,
- 4 the number of its domestic branches, and
- 5 the modified balance sheet capital ratio based on the approved annual accounts.

(2) An institution intending to merge with another institution shall promptly report this to BaFin and the Deutsche Bundesbank.

(3) <sup>1</sup>A senior manager of an institution and the persons who actually manage the business of a financial holding company or a mixed financial holding company shall promptly report to BaFin and the Deutsche Bundesbank

- 1 the commencement and termination of activities as a senior manager or member of the supervisory board of another enterprise, and
- 2 the acquisition and disposal of a direct participating interest in an enterprise, as well as any changes in the amount of such a participating interest.

<sup>2</sup>A direct participating interest within the meaning of sentence 1 number 2 shall be deemed to be the holding of at least 25 per cent of the enterprise's capital.

(3a) <sup>1</sup>A financial holding company shall promptly report to BaFin and the Deutsche Bundesbank

- 1 the intention to appoint a person who is actually to manage the business of the financial holding company, stating the facts which are germane to assessing his/her trustworthiness and professional qualifications, as well as the realisation of such an intention;
- 2 the retirement of any person who has actually managed the business of the financial holding company;
- 3 changes to the structure of the financial holding group which mean that the group will, in future, be active across sectors;
- 4 the appointment of a member of the supervisory body, stating the facts which are germane to assessing his/her trustworthiness and professional expertise.

<sup>2</sup>A financial holding company shall submit to BaFin and the Deutsche Bundesbank annually a summary report of those institutions, German asset management companies, financial enterprises, ancillary service providers and payment institutions within the meaning of the Payment Services Oversight Act (*Zahlungsdiensteaufsichtsgesetz*) that are subordinated enterprises within the meaning of section 10a (3) to (5). <sup>3</sup>BaFin shall transmit a list of these to the competent authorities of the other EEA states and to the Commission of the European Communities. <sup>4</sup>The establishment, modification or discontinuation of such participating interests or corporate relationships shall be promptly reported to BaFin and the Deutsche Bundesbank. <sup>5</sup>Sentence 1 numbers 1 and 2 shall apply *mutatis mutandis* to a mixed financial holding company in respect of the persons who actually manage the business of this company; sentences 2 and 4 shall apply *mutatis mutandis* to conglomerate enterprises.

(3b) BaFin and the Deutsche Bundesbank may impose additional notification and reporting requirements on institutions or certain types or categories of institutions, in particular in order to obtain more in-depth insights into developments in the institutions' financial situation where this is necessary to fulfil the tasks of BaFin and the Deutsche Bundesbank.

(4) <sup>1</sup>The Federal Ministry of Finance, acting in consultation with the Deutsche Bundesbank, may issue by way of a statutory order more detailed provisions on the nature, scope, timing and form of the reports and on the submission of the documentation provided for in this Act, as well as on the permissible data carriers, transmission channels and data formats, and may supplement the existing reporting requirements by the obligation to submit summary reports and summary lists, insofar as this is necessary for the performance of BaFin's tasks and especially to enable it to obtain consistent records for assessing the banking business conducted and financial services provided by institutions. <sup>2</sup>It may delegate this authority by way of a statutory order to BaFin, provided that statutory orders of BaFin are issued in agreement with the Deutsche Bundesbank. <sup>3</sup>The central associations of the institutions shall be consulted before the statutory order is issued.

## **Section 24a Establishment of a branch and provision of cross-border services in other EEA states**

(1) <sup>1</sup>A deposit-taking credit institution, an e-money institution and a securities trading firm shall promptly report the intention to establish a branch in another EEA state to BaFin and the Deutsche Bundesbank pursuant to sentence 2. <sup>2</sup>The report shall contain the following particulars:

- 1 the member state in which the branch is to be established,
- 2 a business plan indicating the nature of the planned business and the organisational structure of the branch and any intention to use tied agents,
- 3 the address from which the institution's records can be requested in the host member state and to which documents can be delivered, and
- 4 the names of the managers of the branch.

(2) <sup>1</sup>If there is no reason to doubt the suitability of the institution's organisational structure and financial standing, BaFin forwards the particulars pursuant to subsection (1) sentence 2 to the competent authorities of the host state within two months of receiving the complete documentation and informs the reporting institution of this. <sup>2</sup>BaFin also informs the competent authorities of the host state about the amount of own funds and the adequacy of own funds and, if applicable, about the deposit guarantee scheme or investor compensation scheme to which the institution belongs or about its comparable protection arrangements within the meaning of section 23a (1) sentence 1. <sup>3</sup>If BaFin does not forward the particulars pursuant to subsection (1) sentence 2 to the competent authorities of the host state, it notifies the institution of its reasons for not doing so within two months of receiving all the particulars pursuant to subsection (1) sentence 2. <sup>4</sup>After the report has been forwarded to the competent authorities of the host state, the institution may take up activities in the other state after receiving a corresponding notification from these authorities or after the expiry of a two-month period at the latest.

(3) <sup>1</sup>Subsection (1) sentence 1 shall apply *mutatis mutandis* to the intention to conduct banking business, to provide financial services within the meaning of section 1 (1a) sentence 2 numbers 1, 1a, 1c, 2 to 4, 9 and 10 or sentence 3 or to engage in activities pursuant to section 1 (3) sentence 1 numbers 2 to 8 or to provide credit reports or offer to rent out safe deposit boxes, or, in the case of deposit-taking credit institutions or e-money institutions, to provide payment services within the meaning of the Payment Services Oversight Act in another EEA state by way of cross-border services. <sup>2</sup>The report shall specify the state in which the cross-border service is to be provided and shall contain a business plan specifying the intended activities and whether tied agents are to be used in this state. <sup>3</sup>If there is no reason to doubt the suitability of the institution's organisational structure and financial standing, BaFin notifies the competent authorities of the host state within one month of receiving the report. <sup>4</sup>The institution must wait until the competent authorities of the host state have been notified within this period before it takes up activities in the other state.

<sup>5</sup>Otherwise, BaFin promptly informs the institution of its non-notification and its reasons for such non-notification.

(3a) <sup>1</sup>If the operator of a multilateral trading system intends to grant trading participants in other states direct access to its trading system, it shall notify BaFin if this is the first time a trading participant in the country in question has been granted access. <sup>2</sup>BaFin notifies the competent authorities in the host state of such intention within one month of receiving the report. <sup>3</sup>Upon request, the operator shall provide BaFin with the names of the trading participants from this state which have been granted access. <sup>4</sup>At the request of the competent authorities in the host state, BaFin discloses this information within a reasonable period.

(3b) <sup>1</sup>If a financial services institution within the meaning of section 1 (1a) sentence 2 numbers 1 to 4 intends to use tied agents for an activity within the meaning of subsection (3), BaFin, at the request of the competent authorities in the host state, informs them, within a reasonable period of time, of the name or names of the tied agents which the institution in this state intends to use. <sup>2</sup>Sentence 1 shall apply *mutatis mutandis* to the request of a host state that it be advised of the names of the members of or participants in a domestically domiciled multilateral trading system which intends to provide such systems in this host state.

(4) <sup>1</sup>If changes occur in the circumstances reported pursuant to subsection (1) sentence 2 or subsection (3) sentence 2, the institution shall notify BaFin, the Deutsche Bundesbank and the competent authorities of the host state of these changes in writing at least one month before the changes become effective. <sup>2</sup>The notification requirement pursuant to sentence 1 shall apply *mutatis mutandis* to an institution which has established its branch in another EEA state prior to the date on which it comes under the obligation to submit a report pursuant to subsection (1). <sup>3</sup>An institution which has established a branch pursuant to subsection (1) shall report any changes in the circumstances regarding the deposit guarantee scheme or investor compensation scheme or the comparable protection arrangements within the meaning of section 23a (1) sentence 1 to BaFin, the Deutsche Bundesbank and the competent authorities of the host state at least one month before the changes become effective. <sup>4</sup>BaFin informs the competent authorities of the host state of the changes pursuant to sentence 3.

(5) The Federal Ministry of Finance is authorised, by way of a statutory order, to lay down whether subsections (1), (2) and (4) shall apply *mutatis mutandis* to the use of a tied agent that is domiciled or habitually resident in another EEA state and that subsections (2) and (4) shall apply *mutatis mutandis* to the establishment of a branch in a non-EEA state, insofar as this is necessary in the context of the right of establishment under agreements of the European Communities with non-EEA states.

(6) (Repealed)

## **Section 24b Participation in payment and securities transfer and settlement systems as well as interoperable systems**

<sup>1</sup>An institution shall promptly report the intention to operate a system pursuant to section 1 (16) to BaFin and the Deutsche Bundesbank and shall name the participants. <sup>2</sup>This also applies to any subsequent change in the group of participants and to agreements on the operation of interoperable systems. <sup>3</sup>The Deutsche Bundesbank notifies the Commission of the European Communities of the systems reported to it after having satisfied itself of the appropriateness of the rules governing the system. <sup>4</sup>In the case of an agreement on the operation of interoperable systems, the Deutsche Bundesbank verifies whether the rules of the systems involved concerning the timing of submission and the irrevocability of orders are compatible.

(2) The institution shall provide information on the systems within the meaning of subsection (1) in which it is involved and on the basic rules governing their mode of operation to all parties which can demonstrate that they have a legitimate interest in the matter.

(3) <sup>1</sup>An institution that operates a system pursuant to section 1 (16) shall grant deposit-taking credit institutions or securities trading firms domiciled in another EEA state equal access to the system according to the same transparent and objective criteria as apply to domestic participants in this system. <sup>2</sup>This is without prejudice to the institution's right to deny access for justified commercial reasons.

(4) The Federal Ministry of Finance is authorised to issue a statutory order in consultation with the Deutsche Bundesbank regulating the details of the reporting requirements, notification of the Commission of the European Communities pursuant to subsection (1), the right to information pursuant to subsection (2) and the right to access pursuant to subsection (3).

(5) Subsections (1) to (4) shall apply *mutatis mutandis* to system operators which are not an institution.

## **Section 24c Automated access to account details**

(1) <sup>1</sup>Credit institutions shall maintain a data file in which they must promptly store the following data:

- 1 the number of any account which is subject to the obligation to verify proof of identity within the meaning of section 154 (2) sentence 1 of the Fiscal Code or of a safe custody account, as well as the dates on which the account was opened and closed,
- 2 the name – and for natural persons the date of birth – of the holder and of any party authorised to draw on the account, as well as – in the cases specified in section 3 (1) number 3 of the Money Laundering Act – the name and, if available, the address of any other economic beneficiary within the meaning of section 1 (6) of the Money Laundering Act.

<sup>2</sup>A new data record shall be created promptly for each change in the data entered pursuant to sentence 1. <sup>3</sup>The data shall be deleted three years after the account or safe custody account has been closed. <sup>4</sup>In the case of sentence 2, the previous data record shall be deleted three years after the new data record has been created. <sup>5</sup>The credit institution shall ensure that BaFin has automated access at all times to the data entered in the data file pursuant to sentence 1 by means of a procedure of BaFin's choice. <sup>6</sup>The institution shall ensure by means of technical and organisational measures that it cannot monitor such data retrievals.

(2) BaFin may access individual data entered in the data file pursuant to subsection (1) sentence 1 insofar as this is necessary to enable it to perform its prudential functions under this Act or the Money Laundering Act, in particular with respect to unauthorised banking business and financial services or the misuse of the institutions by means of money laundering or fraudulent activities to the detriment of the institutions, and if there is particular urgency in individual cases.

(3) <sup>1</sup>Upon request, BaFin provides information entered in the data file pursuant to subsection (1) sentence 1 to

- 1 the supervisory authorities pursuant to section 9 (1) sentence 4 number 2 insofar as this is necessary to enable them to perform their prudential functions under the conditions set out in subsection (2),
- 2 the authorities or courts responsible for providing international judicial assistance in criminal cases, and otherwise for the prosecution and punishment of criminal offences, insofar as this is necessary to enable them to perform their statutory functions,
- 3 the national authority responsible for imposing restrictions on capital transfers and payment transactions pursuant to the Foreign Trade and Payments Act insofar as this is necessary to enable it to perform its functions ensuing from the Foreign Trade and Payments Act or from legal instruments of the European Communities in connection with restrictions on economic and financial relations.

<sup>2</sup>BaFin shall access the data stored in the data files by means of an automated procedure and transmit them to the agency making the request. <sup>3</sup>BaFin verifies the permissibility of such transmission only if it has particular grounds for doing so. <sup>4</sup>Responsibility for the permissibility of the transmission shall lie with the agency making the request. <sup>5</sup>BaFin may, pursuant to section 4b of the Federal Data Protection Act, provide foreign agencies with information from the data file pursuant to subsection (1) sentence 1 for the purposes described in sentence 1. <sup>6</sup>Section 9 (1) sentences 5 and 6 and subsection (2) shall apply *mutatis mutandis*. <sup>7</sup>This is without prejudice to the provisions on international judicial assistance in criminal cases.

(4) <sup>1</sup>For the purpose of monitoring compliance with data protection rules on the part of the competent agency, BaFin logs the time of each data retrieval, the data used during the retrieval, the data retrieved, the name of the retriever, the reference number and, if the data are retrieved at the request of another agency, the name of that agency and its reference

number. <sup>2</sup>The log data may not be used for any other purposes. <sup>3</sup>The log data shall be kept for at least 18 months and deleted after two years at the latest.

(5) <sup>1</sup>The credit institution shall, at its own expense, put in place all the procedures necessary for the automated data access within its area of responsibility. <sup>2</sup>These include, in each case in accordance with the relevant BaFin provisions, the procurement of the equipment necessary to ensure confidentiality and protection against unauthorised access, the installation of a suitable telecommunications link and participation in the closed user system, as well as the ongoing provision of these facilities.

(6) <sup>1</sup>The credit institution and BaFin shall put in place state-of-the-art measures to safeguard data protection and data security, which in particular shall guarantee the confidentiality and integrity of the retrieved and transmitted data. <sup>2</sup>The state of the art shall be defined by BaFin in consultation with the Federal Office for Information Security (*Bundesamt für Sicherheit in der Informationstechnik*) by a procedure of BaFin's choice.

(7) <sup>1</sup>The Federal Ministry of Finance may, by way of a statutory order, permit exemptions from the obligation to transmit data by means of an automated procedure. <sup>2</sup>It may delegate this authority to BaFin by way of a statutory order.

(8) Insofar as the Deutsche Bundesbank and the Federal Republic of Germany – Finance Agency (*Bundesrepublik Deutschland – Finanzagentur GmbH*) maintain accounts and safe custody accounts for third parties, they shall be deemed to be credit institutions within the meaning of subsections (1), (5) and (6).

## **Section 25 Monthly returns and additional information**

(1) <sup>1</sup>Institutions shall submit a monthly return to the Deutsche Bundesbank promptly after the end of each month. <sup>2</sup>The Deutsche Bundesbank shall forward these returns to BaFin along with its comments; BaFin may waive the forwarding of certain returns. <sup>3</sup>If monthly balance sheet statistics are collected by the Deutsche Bundesbank pursuant to section 18 of the Bundesbank Act or Article 5 of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank, the returns to be submitted for that purpose shall also be deemed to be monthly returns pursuant to sentence 1.

(2) <sup>1</sup>Superordinated enterprises within the meaning of section 13b (2) shall also submit a consolidated monthly return to the Deutsche Bundesbank promptly after the end of each month. <sup>2</sup>Subsection (1) sentence 2 and section 10a (6), (7) and (11) on the consolidation methodology, section 10a (13) on the duty to provide information, and section 10a (14) on the subconsolidation of subsidiaries in non-EEA states shall apply *mutatis mutandis*.

(3) <sup>1</sup>The Federal Ministry of Finance may, in consultation with the Deutsche Bundesbank, issue by way of a statutory order more detailed provisions on the type and scope of the monthly returns as well as on the permissible data storage media, transmission channels and data formats, insofar as monthly balance sheet statistics are not collected pursuant to section 18 of the Bundesbank Act, in particular to gain an insight into developments in institutions'

assets and liabilities position and profitability, and on additional information, insofar as this is necessary to enable BaFin to perform its functions. <sup>2</sup>The information may also relate to subordinated enterprises within the meaning of section 13b (2), to subsidiaries domiciled in or outside Germany which are not included in supervision on a consolidated basis and to mixed-activity holding companies with subordinated institutions; the mixed-activity holding companies shall transmit the requisite data to the institutions. <sup>3</sup>The Federal Ministry of Finance may delegate the authority to issue a statutory order to BaFin by way of a statutory order, subject to the proviso that the statutory order is issued in agreement with the Deutsche Bundesbank.

## **Section 25a Particular governance duties of institutions**

(1) <sup>1</sup>An institution must have in place a proper business organisation which ensures compliance with the legal provisions to be observed by the institution as well as fulfilment of business necessities. <sup>2</sup>The persons specified in section 1 (2) sentence 1 are responsible for the institution's proper business organisation. <sup>3</sup>A proper business organisation encompasses, in particular, appropriate and effective risk management, which

- 1 based on methodologies for gauging and safeguarding resilience, includes the definition of strategies as well as the establishment of internal control mechanisms with an internal control system and an internal auditing function, whereby the internal control system comprises, in particular,
  - (a) structural and operational arrangements with a clear definition of the areas of responsibility, and
  - (b) processes for identifying, assessing, managing as well as monitoring and reporting risks in accordance with the criteria laid down in Annex V of the Banking Directive;
- 2 requires the institution to have suitable staffing levels and technical and organisational resources, and
- 3 includes the definition of an adequate contingency plan, especially for IT systems.

<sup>4</sup>The risk management structure shall depend on the type, scope, complexity and risk content of the business operations performed. <sup>5</sup>The institution shall regularly review its appropriateness and effectiveness. <sup>6</sup>In addition, a proper business organisation encompasses

- 1 appropriate arrangements by means of which the institution's financial situation can be gauged with sufficient accuracy at all times;
- 2 complete documentation of business operations which permits full tracking and monitoring by BaFin for its area of responsibility; requisite records must be retained for at least five years; this is without prejudice to section 257 (4) of the Commercial Code, section 257 (3) and (5) of the Commercial Code shall apply *mutatis mutandis*.

<sup>7</sup>BaFin can lay down provisions on the modelling of a sudden and unexpected change in the interest rate and on the methodology for computing the impact on the present value of the interest rate risk in the banking book. <sup>8</sup>In individual cases, BaFin may issue orders to an institution that are appropriate and necessary for putting into place arrangements within the meaning of sentences 3, 6 and 7.

(1a) <sup>1</sup>Subsection (1) shall apply *mutatis mutandis* to groups of institutions, financial holding groups, institutions within the meaning of section 10a (14) and financial conglomerates subject to the proviso that the persons specified in section 1 (2) sentence 1 or section 2d (1) of the superordinated enterprise or the superordinated financial conglomerate enterprise are responsible for the proper business organisation of the group of institutions, the financial holding group or the financial conglomerate. <sup>2</sup>Section 10a (12) as well as (13) sentences 1 and 2 shall apply *mutatis mutandis* to groups of institutions and financial holding groups; section 10b (6) as well as (7) sentences 1 and 2 shall apply *mutatis mutandis* to financial conglomerates.

(2) <sup>1</sup>An institution must, depending on the type, scope, complexity and risk content of outsourcing to another enterprise activities and processes that are material to conducting banking business or providing financial services or any of an institution's other typical services, make appropriate arrangements in order to avoid incurring excessive additional risks. <sup>2</sup>The outsourcing must impair neither the proper conduct of such business and services nor the business organisation within the meaning of subsection (1). <sup>3</sup>In particular, the institution must ensure ongoing appropriate and effective risk management that includes the outsourced activities and processes. <sup>4</sup>The outsourcing must not lead to a delegation of responsibility on the part of the persons specified in section 1 (2) sentence 1 to the external service provider. <sup>5</sup>In the event of outsourcing, the institution shall remain responsible for ensuring compliance with the legal provisions to be observed by the institution. <sup>6</sup>The outsourcing must not prevent BaFin from performing its tasks; its right to request information, right to audit and ability to monitor must be ensured by means of suitable arrangements with regard to the outsourced activities and processes, including in the event of outsourcing to an enterprise domiciled in another EEA state or in a non-EEA state. <sup>7</sup>This shall apply *mutatis mutandis* to the performance of the tasks of the institution's auditors. <sup>8</sup>Outsourcing requires a written agreement which lays down the institution's rights to ensure compliance with the aforementioned conditions, including the right to give instructions and the right to give notice, as well as the corresponding duties on the part of the external service provider.

(3) <sup>1</sup>If BaFin's right to audit and ability to monitor are impaired in respect of outsourcing pursuant to subsection (2), BaFin can, in individual cases, issue orders that are appropriate and necessary for eliminating this impairment. <sup>2</sup>This is without prejudice to BaFin's powers pursuant to subsection (1) sentence 8.

(4) <sup>1</sup>If a deposit-taking credit institution or a securities trading firm avails itself of a tied agent within the meaning of section 2 (10) sentence 1, it must ensure that he/she is trustworthy and has the necessary professional qualifications, fulfils the statutory requirements when providing financial services, informs customers about his/her status pursuant to section 2

(10) sentences 1 and 2 prior to commencing business relationships and notifies customers about the termination of this status promptly. <sup>2</sup>The deposit-taking credit institution or securities trading firm must keep the necessary evidence of the fulfilment of its duties pursuant to sentence 1 for at least five years after the termination of the tied agent's status. <sup>3</sup>More detailed provisions on the evidence required can be issued by way of a statutory order pursuant to section 24 (4).

## **Division 5a      PREVENTION OF MONEY LAUNDERING, TERRORIST FINANCING AND FRAUDULENT ACTIVITIES TO THE DETRIMENT OF INSTITUTIONS**

### **Section 25b Fulfilment of particular organisational duties in connection with cashless payments**

BaFin shall monitor the fulfilment of the duties contained in Regulation (EC) No 1781/2006 of the European Parliament and of the Council of 15 November 2006 on information on the payer accompanying transfers of funds (OJ EU L 345/1) incumbent upon the credit institutions and financial services institutions which provide money transmission services pursuant to section 1 (1a) sentence 2 number 6.

### **Section 25c Internal safeguards**

(1) Notwithstanding the duties cited in section 25a (1) of this Act and section 9 (1) and (2) of the Money Laundering Act, institutions as well as financial holding companies and mixed financial holding companies which are deemed to be superordinated enterprises pursuant to section 10a (3) sentence 6 or sentence 7 or section 10b (3) sentence 8 must – as part of their proper business organisation and appropriate risk management to prevent fraudulent activities to their detriment – create and update internal policies and adequate business and customer-related safeguards, and conduct checks.

(2) <sup>1</sup>Credit institutions must operate and update appropriate IT systems which enable them to identify business relationships and individual transactions in payment operations that appear dubious or unusual in the light of knowledge of money laundering methods, terrorist financing and fraudulent activities to the detriment of institutions available publicly or within the credit institution. <sup>2</sup>Where such circumstances are identified, they must be investigated in the context of the current business relationship and individual transactions in order to be able to monitor and assess the risk involved in the relevant business relationships and transactions and, if necessary, examine whether there are grounds for suspicion. <sup>3</sup>The credit institutions may collect, process and use personal data insofar as this is necessary to fulfil this duty. <sup>4</sup>BaFin can lay down criteria which, if they are met, allow credit institutions to waive the use of systems pursuant to sentence 1.

## Section 25d Simplified due diligence

(1) <sup>1</sup>Where the conditions specified in section 25f of this Act and section 6 of the Money Laundering Act do not exist, a low risk of money laundering or terrorist financing shall be deemed to exist at institutions, over and above section 5 of the Money Laundering Act, in the following cases:

- 1 in the issuance or administration of electronic money within the meaning of section 1 (14), insofar as it is guaranteed that
  - (a) in the case of a non-rechargeable data storage medium, the stored amount does not come to more than 150 euro, or
  - (b) in the case of a rechargeable data storage medium, the total amount issued or administered in a calendar year does not come to more than 2,500 euro, unless the holder within the meaning of section 22p (1) redeems an amount of 1,000 euro or more in the same calendar year;
- 2 subject to sentence 2, upon the conclusion of
  - (a) a government-subsidised funded pension agreement,
  - (b) an agreement on the investment of capital formation benefits, insofar as the agreement fulfils the conditions for a government subsidy,
  - (c) a loan agreement, finance lease agreement or an instalment credit transaction with a consumer (sections 491, 500 and 501 of the German Civil Code),
  - (d) a credit agreement as part of a government promotion programme that is processed via a Federal Government or state government promotional bank and whose loan principal must be used for a specific purpose,
  - (e) a credit agreement for sales financing,
  - (f) any other credit agreement in which the credit account is used solely to process the loan and the loan is repaid from an account held by the borrower with a credit institution within the meaning of section 1 (1) with the exception of the enterprises specified in section 2 (1) numbers 3 to 8, with a credit institution in another member state of the European Union or with a branch in Germany of a credit institution domiciled outside Germany,
  - (g) a savings agreement, and
  - (h) a lease agreement;
- 3 subject to sentence 2, in any other cases insofar as the following conditions are met:
  - (a) the agreement is in writing,
  - (b) the transactions in question are settled via an account held by the customer with a credit institution within the meaning of section 1 (1) with the exception of the enterprises specified in section 2 (1) numbers 3 to 8, with a credit institution in another member state of the European Union or with a branch in Germany of a

credit institution domiciled outside Germany or via a credit institution domiciled in a non-EEA state to which requirements equivalent to those in Directive 2005/60/EC apply,

- (c) the product or the related transaction is not anonymous and enables section 3 (2) sentence 1 number 3 of the Money Laundering Act to be applied in good time, and
  - (d) the payments under the agreement or the related transaction cannot be made in favour of a third party except in the event of death or impairment, if a certain age limit is exceeded or in comparable cases;
- 4 subject to sentence 2, in the case of products or related transactions allowing investment in financial assets or claims, such as insurance or any other contingent claims, if over and above the conditions specified in number 3
- (a) the payments under the product or the transaction can be made only in the long term,
  - (b) the product or the transaction cannot be used as collateral, and
  - (c) it is not possible to make premature payments and apply buyback clauses during the term of the agreement and the agreement cannot be terminated prematurely.

<sup>2</sup>However, a low risk shall be deemed to exist in the cases specified in sentence 1 numbers 2 to 4 only if the following thresholds are not exceeded:

- 1 for agreements within the meaning of sentence 1 number 2 letters (a), (b), (d) and (f) or for agreements within the meaning of sentence 1 numbers 3 and 4, payments totalling 15,000 euro,
- 2 for agreements within the meaning of sentence 1 number 2 letters (c), (e) and (h) or for any other agreements involving the financing of assets or their use and in which ownership of the asset is not transferred to the contracting party or the user until the agreement is completed, payments totalling 15,000 euro per calendar year,
- 3 for savings agreements within the meaning of sentence 1 number 2 letter (g), 1,000 euro per calendar year in the case of periodic payments or 2,500 euro for a one-off payment.

(2) Subsection (1) shall not apply if an institution has information with regard to a specific transaction or business relationship which indicates that the risk of money laundering or terrorist financing is not low.

### **Section 25e Simplified identification procedure**

<sup>1</sup>Notwithstanding section 4 (1) of the Money Laundering Act, verification of the identity of the contracting party and the economic beneficiary can also be completed promptly after an account or a safe custody account has been opened. <sup>2</sup>In this case, it must be ensured that no funds can be withdrawn from the account or safe custody account before the verification of identity has been completed.

## Section 25f Enhanced due diligence

(1) <sup>1</sup>Over and above section 6 of the Money Laundering Act, institutions must comply with enhanced due diligence standards commensurate with a higher risk also in the settlement of payment transactions as part of business relationships with correspondent institutions domiciled in a non-EEA state. <sup>2</sup>Insofar as these business relationships do not concern the settlement of payment transactions, this is without prejudice to section 5 (2) number 1 of the Money Laundering Act. <sup>3</sup>Section 3 (4) sentence 2 of the Money Laundering Act shall apply *mutatis mutandis*.

(2) In the cases cited in subsection (1), institutions shall

- 1 obtain sufficient publicly available information about the correspondent institution and its business and management structure in order to be able to understand fully, both before and during such a business relationship, the nature of the business operations conducted by the correspondent institution and assess its reputation and controls for combating money laundering and terrorist financing as well as the quality of its supervision,
- 2 lay down and document the respective responsibilities of both institutions with regard to compliance with the due diligence standards before establishing such a business relationship,
- 3 ensure that, before such a business relationship is established by an agent acting on the obligated party's behalf, he/she obtains the approval of his/her immediate superior or the next highest management level,
- 4 take measures to ensure that the correspondent institution does not establish or maintain a business relationship with a credit institution of which it is known that its accounts are used by a shell bank within the meaning of Article 3 (10) of Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (OJ EU L 309/15) as last amended by Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 (OJ EU L 319/1), and
- 5 take measures to ensure that the correspondent institution does not permit transactions via pass-through accounts.

(3) Notwithstanding section 3 (2) sentence 1 number 2 of the Money Laundering Act, the due diligence pursuant to section 3 (1) numbers 1 and 3 of the Money Laundering Act shall apply to obligated parties pursuant to section 2 (1) numbers 1 and 2 of the Money Laundering Act when accepting cash irrespective of any thresholds specified in the Money Laundering Act or in this Act, insofar as a customer's order in the context of money transmission services within the meaning of section 1 (1a) sentence 2 number 6 or foreign currency dealing within the meaning of section 1 (1a) sentence 2 number 7 is not settled via a customer account opened with the obligated party and the transaction with regard to foreign currency dealing involves a value of 2,500 euro or more.

## **Section 25g Group-wide compliance with due diligence standards**

(1) <sup>1</sup>The institutions and enterprises specified in section 25c (1), as superordinated enterprises, shall develop group-wide internal safeguards pursuant to section 9 of the Money Laundering Act and section 25c (1) of this Act and must ensure compliance with the due diligence standards pursuant to sections 3, 5 and 6 of the Money Laundering Act and sections 25d and 25f of this Act as well as the record-keeping obligation pursuant to section 8 of the Money Laundering Act with regard to their subordinated enterprises and branches.

<sup>2</sup>The senior managers within the meaning of section 1 (2) sentence 1 shall be responsible for the proper fulfilment of the duties pursuant to sentence 1. <sup>3</sup>Insofar as the measures to be taken pursuant to sentence 1 as part of establishing or conducting business relationships or transactions are *de jure* not permissible under local law or *de facto* not possible in a non-EEA state in which the enterprise is domiciled, the superordinated enterprise or the parent enterprise shall ensure that a subordinated enterprise or branch does not establish or maintain any business relationships or conduct any transactions in this non-EEA state. <sup>4</sup>If a business relationship already exists, the superordinated enterprise or the parent enterprise shall ensure that the subordinated enterprise or branch ends this relationship by termination of contract or in some other way regardless of any other statutory or contractual provisions. <sup>5</sup>If stricter obligations apply in the foreign state in which a subordinated enterprise or branch is domiciled, these stricter obligations must be fulfilled there.

(2) <sup>1</sup>Financial holding companies or mixed financial holding companies which are deemed to be superordinated enterprises pursuant to section 10a (3) sentence 6 or sentence 7 or section 10b (3) sentence 8 are obligated parties within the meaning of section 2 (1) number 1 of the Money Laundering Act. <sup>2</sup>In this respect, they shall also be subject to supervision by BaFin pursuant to section 16 (1) in conjunction with subsection (2) number 2 of the Money Laundering Act.

## **Section 25h Prohibited business**

The following activities are prohibited:

- 1 the establishment or maintenance of a correspondent banking relationship or any other business relationship with a shell bank within the meaning of Article 3 (10) of Directive 2005/60/EC, and
- 2 the setting-up and maintenance of accounts in the name of the institution or for third-party institutions which customers can operate independently to conduct their own transactions; this is without prejudice to section 154 (1) of the Fiscal Code.

## **Division 5b SUBMISSION OF ACCOUNTING DOCUMENTS**

### **Section 26 Submission of annual accounts, management report and audit reports**

(1) <sup>1</sup>Institutions shall draw up their annual accounts for the previous financial year in the first three months of the current financial year, and submit their annual accounts as drawn up,

and subsequently also as approved, and their management report to BaFin and the Deutsche Bundesbank promptly pursuant to sentence 2. <sup>2</sup>The annual accounts must bear an audit certificate or a note accounting for the withholding of such a certificate. <sup>3</sup>The auditor shall submit his/her report on the audit of the annual accounts (audit report) to BaFin and the Deutsche Bundesbank promptly after completing the audit. <sup>4</sup>In the case of credit institutions which belong to a credit cooperative audit association or are audited by the auditing agency of a savings bank and giro association, the auditor shall submit the audit report only if requested to do so by BaFin.

(2) If an additional audit has been carried out in connection with a guarantee scheme, the auditor or audit association shall submit the report on this audit to BaFin and the Deutsche Bundesbank promptly.

(3) <sup>1</sup>An institution which draws up group accounts or a group management report shall submit these documents to BaFin and the Deutsche Bundesbank promptly. <sup>2</sup>The superordinated enterprise of a financial holding group within the meaning of section 10a (3) or of a financial conglomerate shall submit group accounts or a group management report promptly if the financial holding company at the head of the group or the mixed financial holding company at the head of the financial conglomerate draws up group accounts or a group management report. <sup>3</sup>The group auditor shall submit the audit reports concerning the group accounts and group management reports specified in sentences 1 and 2 to BaFin and the Deutsche Bundesbank promptly upon completing the audit. <sup>4</sup>In the case of credit institutions which belong to a credit cooperative audit association or are audited by the auditing agency of a savings bank and giro association, the auditor shall submit the audit report only if requested to do so by BaFin.

(4) The provisions of subsection (3) shall apply *mutatis mutandis* to single-entity annual accounts pursuant to section 325 (2a) of the German Commercial Code.

## **Division 5c      DISCLOSURE**

### **Section 26a   Disclosure by institutions**

(1) <sup>1</sup>An institution must publish, at regular intervals, qualitative and quantitative information on its capital, risks incurred and risk management procedures, including the internal models used pursuant to section 10 (1) sentence 2, credit risk mitigation techniques and securitisation transactions, and have formal procedures and rules in place for fulfilling these disclosure requirements. <sup>2</sup>The rules must also provide for a regular review of the adequacy and appropriateness of the institution's disclosure practices. <sup>3</sup>More detailed requirements regarding the content of the information to be disclosed and the procedures and rules for fulfilling the disclosure requirement may be laid down in the statutory order pursuant to section 10 (1) sentence 9 number 7.

(2) <sup>1</sup>A disclosure requirement does not exist in respect of information which is immaterial, protected by law or confidential. <sup>2</sup>In particular, information is regarded as being

- 1 material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information when taking economic decisions;
- 2 protected by law if its public announcement would weaken the institution's competitive position;
- 3 confidential if it was made available on a contractual basis or results from a business relationship.

<sup>3</sup>In such cases the institution shall explain the reason for not disclosing such information and publish more general data with regard to the information pursuant to sentence 2 numbers 2 and 3, unless such data are also to be regarded as protected by law or confidential under the criteria pursuant to sentence 2 numbers 2 and 3.

(3) If an institution does not fulfil its disclosure requirements in cases other than those specified in subsection (2), or does not fulfil with them correctly, in full or in time, BaFin can, in individual cases, issue orders that are appropriate and necessary in order to have the information duly disclosed.

(4) <sup>1</sup>Subsections (1) to (3) shall apply *mutatis mutandis* to groups of institutions and financial holding groups pursuant to section 10a (1) to (5) subject to the proviso that the persons specified in section 1 (2) sentence 1 of the superordinated enterprise are responsible for proper disclosure by the group of institutions or the financial holding group. <sup>2</sup>Section 10a (12) and (13) sentences 1 and 2 shall apply *mutatis mutandis*. <sup>3</sup>In the cases pursuant to sentence 1, the disclosure of information pursuant to subsections (1) to (3) shall not apply to the single-entity institution.

## **Division 6 AUDITS AND THE APPOINTMENT OF AUDITORS**

### **Section 27 (Repealed)**

### **Section 28 Appointment of the auditor in special cases**

(1) <sup>1</sup>Institutions shall notify BaFin and the Deutsche Bundesbank of the auditor they have appointed promptly after making the appointment. <sup>2</sup>Within one month of receiving such notification, BaFin may request the appointment of a different auditor if this appears necessary to achieve the object of the audit. <sup>3</sup>If an institution has appointed as auditor an auditing firm which was the institution's auditor in one of the institution's two preceding financial years, BaFin can demand a change of the responsible auditor if the preceding audit including the audit report did not achieve the object of the audit; section 319a (1) sentence 5 of the German Commercial Code shall apply *mutatis mutandis*. <sup>4</sup>Objections to and appeals against measures pursuant to sentence 2 or sentence 3 have no postponing effect.

(2) <sup>1</sup>The court of registration having jurisdiction at the institution's domicile shall appoint an auditor at BaFin's request if

- 1 the notification pursuant to subsection (1) sentence 1 is not effected promptly after the end of the financial year;
- 2 the institution does not comply promptly with the request to appoint a different auditor pursuant to subsection (1) sentence 2;
- 3 the auditor chosen has declined to accept the auditing mandate, is no longer active or is unable to conclude the audit in time, and the institution has not promptly appointed a different auditor.

<sup>2</sup>The appointment by the court shall be final. <sup>3</sup>Section 318 (5) of the German Commercial Code shall apply *mutatis mutandis*. <sup>4</sup>At BaFin's request, the court of registration of may terminate the appointment of an auditor appointed pursuant to sentence 1.

(3) Subsections (1) and (2) shall not apply to credit institutions which are members of a credit cooperative audit association or are audited by an auditing agency of a savings bank or giro association.

## **Section 29 Special duties of the auditor**

(1) <sup>1</sup>When auditing the annual accounts or interim accounts, the auditor shall also examine the institution's financial situation. <sup>2</sup>When auditing the annual accounts, he/she must ascertain in particular whether the institution has complied with the reporting requirements pursuant to sections 10, 10b, 11, 12a, 13 to 13d and 14 (1), pursuant to sections 15, 24 and 24a, in each case also in conjunction with a statutory order pursuant to section 24 (4) sentence 1, pursuant to section 24a also in conjunction with a statutory order pursuant to section 24a (5), and also whether the institution has satisfied the requirements pursuant to section 1a (4) to (8), in each case also in conjunction with a statutory order pursuant to section 1a (9), pursuant to sections 10 to 10b, 11, 12, 13 to 13d, 18, 25a (1) sentence 3 and sentence 6 number 1, section 1a and 2 and section 26a, as well as pursuant to sections 13 to 13c and 14 (1), in each case also in conjunction with a statutory order pursuant to section 22. <sup>3</sup>If an institution makes use of the exception pursuant to section 2a, the auditor shall examine whether the conditions specified therein have been met. <sup>4</sup>If BaFin has, pursuant to section 30, issued provisions vis-à-vis the institution regarding the contents of the audit, the auditor shall take these provisions into consideration. <sup>5</sup>If unrealised reserves are included in the institution's liable capital, the auditor, when auditing the annual accounts, shall also examine whether section 10 (4a) to (4c) was complied with when determining those reserves. <sup>6</sup>The findings shall be included in the audit report.

(2) <sup>1</sup>The auditor shall likewise examine whether the institution has fulfilled its obligations pursuant to sections 24c and 25c to 25h, the Money Laundering Act and Regulation (EC) No 1781/2006. <sup>2</sup>In the case of institutions which conduct safe custody business, he/she shall audit that business specifically unless it is to be audited pursuant to section 36 (1) sentence 2 of the Securities Trading Act; this audit shall also cover compliance with section 128 of the Companies Act regarding disclosure requirements and section 135 of the Companies Act regarding the exercising of voting rights. <sup>3</sup>The auditor shall report separately on the audits

pursuant to sentences 1 and 2, respectively; section 26 (1) sentence 3 shall apply *mutatis mutandis*.

(3) <sup>1</sup>The auditor shall notify BaFin and the Deutsche Bundesbank promptly if, in the course of the audit, he/she becomes aware of facts which might warrant the qualification or withholding of the audit certificate, jeopardise the institution's existence or materially impair its development, which constitute a major infringement of the provisions relating to the institution's approval criteria or the pursuit of business under this Act, or which indicate that the senior managers have seriously infringed the law, the articles of association, the articles of incorporation or the partnership agreement. <sup>2</sup>At the request of BaFin or the Deutsche Bundesbank, the auditor shall explain the audit report to them, and inform them of any other facts which have come to his/her attention in the course of the audit which suggest that the institution's business is not being conducted properly. <sup>3</sup>The notification, explanation and disclosure requirements pursuant to sentences 1 and 2 shall also apply in relation to an enterprise which is closely linked to the institution if the auditor becomes aware of the relevant facts while auditing the institution. <sup>4</sup>The auditor shall not be liable for the accuracy of facts which he/she reports in good faith pursuant to this subsection.

(4) <sup>1</sup>The Federal Ministry of Finance shall be authorised, in agreement with the Federal Ministry of Justice (*Bundesministerium der Justiz*) and after consulting the Deutsche Bundesbank, to issue by way of a statutory order more detailed provisions concerning

- 1 the object of the audit pursuant to subsections (1) and (2),
- 2 the time at which it is to be carried out, and
- 3 the contents of the audit reports

insofar as this is necessary for the performance of BaFin's functions, and especially in order to enable it to identify irregularities which may jeopardise the safety of the assets entrusted to the institution or which may impair the proper conduct of banking business or provision of financial services, and to obtain consistent records for assessing the business conducted by institutions. <sup>2</sup>The statutory order may provide that the requirements set forth in subsections (1) to (3) are to be fulfilled also when auditing the group accounts of a group of institutions or a financial holding group or of a financial conglomerate; more detailed requirements on the object of the audit, the time at which it is to be carried out and the contents of the audit reports can be issued in accordance with sentence 1. <sup>3</sup>The Federal Ministry of Finance may delegate this authority to BaFin by way of a statutory order.

### **Section 30 Determination of audit contents**

<sup>1</sup>Notwithstanding the special duties of the auditor pursuant to section 29, BaFin can also issue requirements vis-à-vis the institution regarding the contents of the audit, which the auditor must take into consideration when auditing the annual accounts. <sup>2</sup>In particular, BaFin can determine focal points of the audits.

## Division 7 EXEMPTIONS

### Section 31 ....

(1) <sup>1</sup>The Federal Ministry of Finance, after consulting the Deutsche Bundesbank, can by way of a statutory order

- 1 exempt all institutions, or certain types or categories of institutions, from the duty to report specific exposures and facts pursuant to section 10 (8) sentence 3, section 13 (1), section 13a (1), section 14 (1) and section 24 (1) numbers 1 to 4 and 6 and (1a), exempt certain types or categories of institutions from the duty to submit monthly returns pursuant to section 25, or from the obligation pursuant to section 26 (1) sentence 2 to elucidate the annual accounts in notes thereon, and the senior managers of an institution from the duty to report participating interests pursuant to section 24 (3) number 2, if these particulars are immaterial for supervisory purposes;
- 2 exempt certain types or categories of institutions from complying with the provisions pursuant to section 13 (3) and section 26 if this is warranted by the particular nature of their business.

<sup>2</sup>The Federal Ministry of Finance may delegate this authority to BaFin by way of a statutory order subject to the proviso that the statutory order is issued in agreement with the Deutsche Bundesbank.

(2) <sup>1</sup>BaFin may exempt individual institutions from requirements pursuant to section 13 (1) and (2), section 13a (1) and (2), section 15 (1) sentence 1 numbers 6 to 11 and (2), section 24 (1) numbers 1 to 4, sections 25, 26 and 29 (2) sentence 2 as well as from the requirement pursuant to section 15 (1) sentence 1 to grant loans only on market terms if this appears appropriate for special reasons, in particular due to the nature or scale of the business conducted. <sup>2</sup>Exemption can be granted at the institution's request or *ex officio*.

(3) <sup>1</sup>A superordinated enterprise within the meaning of section 10a (1) to (3) and section 13b (2) need not include individual subordinated enterprises within the meaning of section 10a (1) to (5) and section 13b (2) in the consolidation pursuant to section 10a (6) to (12), section 12a (1) sentence 1, section 13b (3) and (4) and section 25 (2) if and as long as the total assets of the individual subordinated enterprise are less than the lower of the following amounts.

- 1 10 million euro, or
- 2 1 per cent of the total assets of the superordinated enterprise of a group of institutions or of the financial holding company holding the participating interest.

<sup>2</sup>The superordinated enterprise shall promptly notify BaFin and the Deutsche Bundesbank of its intention to avail itself of the possibility pursuant to sentence 1 in respect of an enterprise and inform them once a year in a summary report which enterprises it has excluded pursuant to sentence 1 from inclusion in the consolidation pursuant to section 10a (6) to (12), section 12a (1) sentence 1, section 13b (3) and (4) and section 25 (2). <sup>3</sup>BaFin can order that individual or several subordinated enterprises excluded from the consolidation pursuant to

sentence 1 be re-incorporated in the consolidation if these enterprises as a whole are not insignificant for supervision on a consolidated basis. <sup>4</sup>In cases other than those specified in sentence 1, BaFin can, upon request, exempt individual superordinated enterprises within the meaning of section 10a (1) to (3) and section 13b (2) from obligations pursuant to section 10a (6) to (12), section 12a (1) sentence 1, section 13b (3) and (4) and section 25 (2) in respect of individual subordinated enterprises within the meaning of section 10a (1) to (5) and section 13b (2) if the inclusion of the enterprises in supervision on a consolidated basis is not significant or of minor significance. <sup>5</sup>Exemption is likewise permissible at the superordinated institution's request or *ex officio* for individual enterprises belonging to a group if, in BaFin's opinion, their inclusion in supervision on a consolidated basis would be inappropriate or misleading. <sup>6</sup>Sentences 1 to 5 shall apply *mutatis mutandis* to institutions which, pursuant to section 10a (14), are obligated to determine their consolidated own funds.

(4) <sup>1</sup>BaFin can exempt individual groups of institutions and financial holding groups from the requirement set forth in section 10 (1) sentence 1 to determine the adequacy of their own funds on a consolidated basis under the following conditions.

- 1 The group does not own any deposit-taking credit institutions, e-money institutions or institutions which engage in underwriting business or trade in financial instruments for their own account.
- 2 Each group institution which is domiciled within the EEA determines its own funds within the meaning of section 10 (2), less all the contingent liabilities that it has assumed on behalf of group enterprises.
- 3 Each group institution which is domiciled within the EEA fulfils the requirement set forth in section 10 (1) sentence 1 on a single-entity basis.
- 4 The positions pursuant to section 10 (2a) sentence 1 numbers 1 to 10 and (2b) sentence 1 numbers 1 to 8 of a financial holding company which is a group enterprise must be at least equivalent to the sum-total of the positions listed in section 10a (6) sentence 3 number 1 and the contingent liabilities that it has assumed on behalf of group enterprises.
- 5 Each financial holding company which heads a financial holding group must have capital which is at least equivalent to the sum-total of the positions listed in section 10a (6) sentence 3 number 1 and the contingent liabilities that it has assumed on behalf of group enterprises.
- 6 Each group institution which is domiciled within the EEA must have systems in place with which to monitor and manage the source of own funds and the other sources of funding of all group institutions.
- 7 The superordinated enterprise of the group informs BaFin and the Deutsche Bundesbank about all risks which might impair the financial situation of the group of institutions or the financial holding group.

<sup>2</sup>Notwithstanding sentence 1 numbers 4 and 5, BaFin can also grant exemption pursuant to sentence 1 if the financial holding company which is the parent enterprise of a financial

services institution of this group has capital which is equivalent to the sum-total of the requirements of section 10 (1) sentence 1 on a single-entity basis for the financial services institutions which are subordinated to the financial holding company and the contingent liabilities assumed on behalf of group enterprises; notional own funds requirements shall be calculated for securities trading firms from non-EEA countries.<sup>3</sup>Institutions which belong to a group of institutions or a financial holding group that is exempt pursuant to sentence 1 must deduct the positions in group enterprises which are listed in section 10 (6) sentence 1, and which are allocated to these group enterprises' tier 1 capital, from the tier 1 capital when calculating the ratios pursuant to section 10 (2) sentences 6 and 7 and determining free tier 1 capital pursuant to section 10 (2c); illiquid assets pursuant to section 10 (2c) sentence 4 and the losses of their subsidiaries shall be deducted from the own funds.

(5) <sup>1</sup>BaFin can exempt individual superordinated financial conglomerate enterprises within the meaning of section 10b (3) sentences 6 to 8 or (4) from obligations pursuant to section 10b with regard to individual subordinated financial conglomerate enterprises within the meaning of section 10b (3) sentence 5 if and as long as the inclusion of these enterprises is insignificant for supervision at conglomerate level and BaFin is enabled to monitor compliance with these conditions. <sup>2</sup>BaFin shall refrain from granting exemption pursuant to sentence 1 if several subordinated financial conglomerate enterprises fulfil the conditions for exemption, but these enterprises as a whole are not of secondary significance for supervision at conglomerate level. <sup>3</sup>Exemption is likewise permissible for individual subordinated financial conglomerate enterprises within the meaning of section 10b (3) sentence 5 if, in BaFin's opinion, their inclusion in supervision at conglomerate level would be inappropriate or misleading. <sup>4</sup>Exemptions pursuant to sentences 1 or 3 can be granted at the request of the superordinated financial conglomerate enterprise or *ex officio*.

(6) BaFin can temporarily suspend the requirements pursuant to section 18a (1) and (2) in times when market liquidity is generally tense.

## Part III

# Provisions concerning the supervision of institutions

## Division 1 APPROVAL FOR BUSINESS OPERATIONS

### Section 32 Authorisation

(1) <sup>1</sup>Anyone wishing to conduct banking business or to provide financial services in Germany commercially or on a scale which requires a commercially organised business undertaking needs written authorisation from BaFin; section 37 (4) of the Act on Administrative Procedures (*Verwaltungsverfahrensgesetz*) shall apply. <sup>2</sup>The application for authorisation must contain the following particulars:

- 1 suitable evidence of having the resources needed for business operations;
- 2 the names of the senior managers;
- 3 the data required to assess the trustworthiness of the applicants and of the persons specified in section 1 (2) sentence 1;
- 4 the data required to assess the professional qualifications for managing the institution needed by the proprietors and the persons specified in section 1 (2) sentence 1;
- 5 a viable business plan showing the nature of the planned business, the organisational structure and the planned internal control mechanisms of the institution;
- 6 if major participating interests are held in the institution:
  - (a) the names of the holders of the major participating interests,
  - (b) the amount of these participating interests,
  - (c) the data required to assess the trustworthiness of these holders or of the legal representatives or of the general partners,
  - (d) if these holders are required to draw up annual accounts: their annual accounts for the past three financial years, along with the audit reports compiled by independent external auditors if such reports are to be prepared, and
  - (e) if these holders belong to a group: particulars of the structure of the group and, if such accounts are to be drawn up, the consolidated group accounts for the past three financial years, along with the audit reports compiled by independent external auditors if such reports are to be prepared;
- 7 the facts indicating a close relationship between the institution and other natural persons or other enterprises.

<sup>3</sup>The reports and documentation to be submitted pursuant to sentence 2 shall be specified in more detail by way of a statutory order pursuant to section 24 (4). <sup>4</sup>The requirements under sentence 2 number 6 letters (d) and (e) shall not apply to financial services institutions.

(2) BaFin may grant authorisation subject to conditions which must be consistent with the objective pursued by this Act. <sup>2</sup>It may limit the authorisation to specific types of banking business or financial services.

(3) Before granting authorisation, BaFin shall consult the guarantee scheme appropriate for the institution.

(3a) On being granted authorisation, the institution, if it is liable to pay contributions pursuant to section 8 (1) of the Deposit Guarantee and Investor Compensation Act (*Einlagensicherungs- und Anlegerentschädigungsgesetz*), shall be informed of the compensation scheme to which it is assigned.

(4) BaFin shall publicise the granting of authorisation in the electronic Federal Gazette.

(5) <sup>1</sup>BaFin shall keep a register of institutions on its website in which it shall enter all the domestic institutions which have been granted authorisation pursuant to subsection (1), also in conjunction with section 53 (1) and (2), along with the date on which authorisation was granted, the scope of the authorisation and, if applicable, the date of the authorisation's expiry or revocation. <sup>2</sup>The Federal Ministry of Finance may, by way of a statutory order not requiring the consent of the Bundesrat, issue more detailed provisions on the contents of the register and the institutions' duties to cooperate with regard to the keeping of the register.

### **Section 33 Refusal of authorisation**

(1) <sup>1</sup>Authorisation shall be refused if

- 1 the resources needed for business operations, in particular sufficient initial capital within the meaning of section 10 (2a) sentence 1 numbers 1 to 6, are not available in Germany; the initial capital which must be available is as follows:
  - (a) in the case of investment advisers, investment brokers, contract brokers, asset managers and portfolio managers, operators of multilateral trading systems or enterprises engaging in placement business who, in providing financial services, are not authorised to obtain ownership or possession of funds or securities of customers and who do not trade in financial instruments for their own account: an amount equivalent to at least 50,000 euro,
  - (b) in the case of other financial services institutions which do not trade in financial instruments for their own account: an amount equivalent to at least 125,000 euro,
  - (c) in the case of financial services institutions which trade in financial instruments for their own account as well as in the case of securities trading banks: an amount equivalent to at least 730,000 euro,
  - (d) in the case of deposit-taking credit institutions and central counterparties within the meaning of section 1 (31): an amount equivalent to at least 5 million euro,
  - (e) in the case of institutions which solely conduct e-money business: an amount equivalent to at least 1 million euro, and

- (f) in the case of investment advisers, investment brokers and contract brokers who, in providing financial services, are not authorised to obtain ownership or possession of funds or securities of customers and who do not trade in financial instruments for their own account, the amount of 25,000 euro if they are also entered in a register as an insurance intermediary pursuant to Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation (OJ EU L 9/3) and fulfil the requirements of Article 4 (3) of Directive 2002/92/EC, and
- (g) in the case of enterprises which conduct proprietary business also on foreign derivatives markets and on spot markets only for the purpose of hedging these positions, which engage in principal broking services or investment broking only for other members of these markets or which determine prices for other members of these markets through proprietary trading as a market maker within the meaning of section 23 (4) of the Securities Trading Act, the amount of 25,000 euro if clearing members of these markets or trading systems are liable for the fulfilment of the contracts which the aforementioned enterprises conclude on the said markets or in the said trading systems;
- 2 facts are known which reveal that an applicant or one of the persons specified in section 1 (2) sentence 1 is not trustworthy;
- 3 facts are known which warrant the assumption that the holder of a major participating interest or, if this is a legal person, a legal representative or representative pursuant to the articles of association or articles of incorporation or, in the case of a commercial partnership, a partner is not trustworthy or, for other reasons, fails to satisfy the requirements to be set in the interests of the sound and prudent management of the institution;
- 4 facts are known which reveal that the proprietor or one of the persons specified in section 1 (2) sentence 1 does not have the professional qualifications required to manage the institution and if no other person has been designated as senior manager pursuant to section 1 (2) sentence 2 or 3;
- 4a the institution, after having been granted authorisation, becomes a subsidiary of a financial holding company within the meaning of section 1 (3a) sentence 1 or of a mixed financial holding company within the meaning of section 1 (3a) sentence 2 and facts are known which warrant the assumption that a person within the meaning of section 2d is not trustworthy or does not have the professional qualifications required to manage the business of the financial holding company or of the mixed financial holding company;
- 5 a credit institution or a financial services institution which, in providing financial services, is authorised to obtain ownership or possession of funds or securities of customers or which, in accordance with an attestation from BaFin pursuant to section 4 (1) number 2 of the Act Governing the Certification of Old-Age Pension Contracts (*Gesetz über die Zertifizierung von Altersvorsorgeverträgen*), is authorised to offer

old-age pension contracts, does not have at least two senior managers who work for the institution not merely in an honorary capacity;

- 6 the institution has its head office outside Germany;
- 7 the institution is not prepared or in a position to put in place the organisational arrangements necessary for the proper conduct of the business for which it is seeking authorisation;
- 8 the applicant is a subsidiary of a foreign credit institution and the foreign supervisory authority responsible for overseeing this credit institution has not given permission for the establishment of the subsidiary.

<sup>2</sup>An investment adviser, investment broker or a contract broker who, in providing financial services, is not authorised to obtain ownership or possession of funds or securities of customers and who does not trade in financial instruments for his/her own account shall not be refused authorisation pursuant to sentence 1 letter (a) if, instead of the initial capital, he/she can demonstrate that, for the protection of customers, he/she has taken out appropriate insurance with an indemnity of at least 1,000,000 euro for each insured loss and at least 1,500,000 euro for all insured losses in an insurance year. <sup>3</sup>Sentence 2 shall apply *mutatis mutandis* to investment advisers and investment brokers who are also entered in a register as insurance intermediaries pursuant to Directive 2002/92/EC and fulfil the requirements of Article 4 (3) of Directive 2002/92/EC subject to the proviso that an indemnity of at least 500,000 euro for each insured loss and at least 750,000 euro for all insured losses in an insurance year is envisaged.

(2) <sup>1</sup>A prerequisite of the professional qualifications for managing an institution needed by the persons specified in subsection (1) sentence 1 number 4 is that they have adequate theoretical and practical knowledge of the business concerned, as well as managerial experience. <sup>2</sup>A person shall normally be assumed to have the professional qualifications necessary for managing an institution if he/she can demonstrate three years' managerial experience at an institution of comparable size and type of business.

(3) <sup>1</sup>BaFin may refuse authorisation if facts are known which warrant the assumption that effective supervision of the institution will be impaired. <sup>2</sup>This is especially the case if

- 1 the institution is integrated in a corporate network with other individuals or enterprises or is closely linked to such a network which, owing to the structure of cross-shareholdings or because of inadequate economic transparency, hampers the effective supervision of the institution;
- 2 effective supervision of the institution is impaired by the statutory or regulatory provisions of a non-EEA state applicable to such individuals or enterprises;
- 3 the institution is a subsidiary of an institution domiciled in a non-EEA state that is not effectively supervised in the state where it is domiciled or has its head office or whose competent supervisory agency is not willing to cooperate satisfactorily with BaFin;

<sup>3</sup>BaFin may also refuse to grant authorisation if, contrary to section 32 (1) sentence 2, the application contains insufficient data or documentation.

(4) Authorisation may not be refused for reasons other than those specified in subsections (1) and (3).

(5) BaFin must inform the applicant whether authorisation will be granted or refused within six months of the applicant having submitted the complete documentation required for an application for authorisation pursuant to section 32 (1) sentence 2.

### **Section 33a Deferral or restriction of authorisation in the case of enterprises domiciled outside the European Communities**

<sup>1</sup>BaFin shall defer the decision on an application for authorisation submitted by enterprises domiciled outside the European Communities or by subsidiaries of such enterprises, or shall restrict the authorisation, if a decision to this effect has been taken by the Commission or the Council of the European Communities pursuant to Article 151 of the Banking Directive. <sup>2</sup>The period of deferral or restriction may not last for more than three months from the date of the decision. <sup>3</sup>Sentences 1 and 2 shall also apply to applications for authorisation submitted after the date of the decision. <sup>4</sup>If the Council of the European Communities decides to prolong the period pursuant to sentence 2, BaFin shall take due account of this prolongation and prolong the deferral or restriction accordingly.

### **Section 33b Consultation of the competent agencies of another EEA state**

<sup>1</sup>If authorisation is to be granted to conduct banking business pursuant to section 1 (1) sentence 2 number 1, 2, 4, 10 or 11 or to provide financial services pursuant to section 1 (1a) sentence 2 numbers 1 to 4 to an enterprise which

- 1 is a subsidiary or an affiliate of a deposit-taking credit institution, an e-money institution, a securities trading firm or a primary insurance company and whose parent enterprise is authorised to operate in another EEA state, or
- 2 is controlled by the same natural persons or enterprises which control a deposit-taking credit institution, an e-money institution, a securities trading firm or a primary insurance company domiciled in another EEA state,

BaFin shall consult the competent agencies in the home state before granting authorisation.

<sup>2</sup>The consultation shall include, in particular, the information required to assess the trustworthiness and professional qualifications of the persons specified in section 1 (2) sentence 1 as well as to assess the trustworthiness of the holders of a major participating interest in enterprises of the same group domiciled in the EEA state in question.

### **Section 34 Representation and continuation of business in the event of death**

(1) Section 45 of the Industrial Code (*Gewerbeordnung*) shall not apply to institutions.

(2) <sup>1</sup>In the event of the death of the holder of authorisation, an institution's business may be continued on behalf of the heirs by two representatives without authorisation for a period of up to one year. <sup>2</sup>The representatives shall be designated promptly following the death of the holder of authorisation; they shall be deemed to be senior managers. <sup>3</sup>If a representative is not trustworthy or does not have the necessary professional qualifications, BaFin can prohibit the continuation of business. <sup>4</sup>BaFin can prolong the period pursuant to sentence 1 if there are special reasons for doing so. <sup>5</sup>One representative shall suffice in the case of financial services institutions which, in providing financial services, are not authorised to obtain ownership or possession of funds or securities of customers.

### **Section 35 Expiry and revocation of authorisation**

(1) <sup>1</sup>Authorisation shall expire if it is not used within one year from the date on which it is granted. <sup>2</sup>Authorisation shall likewise expire if the institution has been excluded from the compensation scheme pursuant to section 11 of the Deposit Guarantee and Investor Compensation Act.

(2) BaFin may revoke authorisation pursuant to the provisions of the Act on Administrative Procedures, and also if

- 1 the business operations to which the authorisation relates have not been conducted for more than six months;
- 2 a credit institution is operated in the legal form of a sole proprietorship;
- 3 it becomes aware of facts which would warrant refusal of authorisation pursuant to section 33 (1) sentence 1 numbers 1 to 8 or (3) numbers 1 to 3;
- 4 insolvency proceedings have been initiated over an institution or there is any other danger to the discharge of an institution's obligations to its creditors, in particular to the safety of the assets entrusted to it, and the danger cannot be averted by taking other measures under this Act; the safety of the assets entrusted to the institution is jeopardised, *inter alia*, by
  - (a) a loss amounting to half of its liable capital calculated pursuant to section 10, or
  - (b) a loss amounting to more than 10 per cent of its liable capital calculated pursuant to section 10 in each of at least three successive financial years;
- 5 the own funds of a securities trading firm do not amount to at least a quarter of its costs within the meaning of section 10 (9);
- 6 the institution has persistently contravened provisions of this Act, the Securities Trading Act or the regulations or orders issued to implement these Acts.

(3) Section 48 (4) sentence 1 and section 49 (2) sentence 2 of the Act on Administrative Procedures concerning the period of one year shall not apply.

(4) If an institution's authorisation to conduct banking business or provide financial services is revoked, BaFin shall inform the competent agencies of the other EEA states in which the institution has established branches or has been providing cross-border services.

### **Section 36 Removal of senior managers, transfer of powers of the governing bodies to special representatives**

(1) <sup>1</sup>In the cases specified in section 35 (2) numbers 3, 4, and 6, BaFin, instead of revoking authorisation, may demand that the senior managers responsible are removed and may also prohibit these senior managers from carrying out their activities at institutions organised in the form of a legal person. <sup>2</sup>For the purposes of sentence 1, section 35 (2) number 4 shall apply subject to the proviso that, when calculating the amount of the loss, accounting conveniences used to reduce or avoid a balance sheet loss are disregarded.

(1a) <sup>1</sup>Under the conditions set out in subsection (1), BaFin may also transfer, in full or in part, powers incumbent upon the institution's governing bodies to a special representative who is deemed competent to exercise these powers; the powers of a cover pool administrator pursuant to sections 32 to 35 of the Pfandbrief Act may also be transferred to the special representative. <sup>2</sup>The costs incurred through the appointment of the special representative, including the remuneration which he/she is to be paid, shall be borne by the institution. <sup>3</sup>The amount of this remuneration shall be determined by BaFin. <sup>4</sup>If the institution is temporarily unable to pay the remuneration, BaFin may make advance payments to the special representative. <sup>5</sup>If the special representative acts without remuneration, he/she shall be liable only for wilful intent and gross negligence. <sup>6</sup>In the case of negligent conduct, the special representative's liability for damages shall be limited to 1 million euro for an activity at an institution. <sup>7</sup>If this institution is a public limited company whose shares are admitted to trading on the regulated market, liability for damages within the meaning of sentence 6 shall be limited to 4 million euro. <sup>8</sup>The limitations pursuant to sentences 6 and 7 shall also apply where the powers of more than one governing body have been transferred to the special representative or the special representative has committed more than one act giving rise to liability for damages.

(2) BaFin may also demand the removal of a senior manager and prohibit that senior manager from carrying out his/her activities at institutions organised in the form of a legal person if he/she has intentionally or recklessly contravened the provisions of this Act, the Act on Building and Loan Associations, the Safe Custody Act (*Depotgesetz*), the Money Laundering Act, the Investment Act, the Pfandbrief Act or the Securities Trading Act, the regulations issued to implement these Acts or orders issued by BaFin, and if he/she persists in such behaviour despite having been duly warned by BaFin.

### **Section 37 Intervention against unlawful business**

(1) <sup>1</sup>If banking business is carried out or financial services are provided without the authorisation required pursuant to section 32 or if business prohibited under section 3 is conducted, BaFin can order the enterprise and the members of its governing bodies to cease

business operations immediately and to settle this business promptly. <sup>2</sup>It may issue instructions for the settlement of the business and appoint a suitable person as the liquidator. <sup>3</sup>It may publicise its measures pursuant to sentences 1 and 2. <sup>4</sup>BaFin's powers pursuant to sentences 1 to 3 shall also apply vis-à-vis the enterprise involved in the initiation, conclusion or settlement of such business.

(2) The liquidator shall be authorised to file a petition for the initiation of insolvency proceedings over the enterprise's assets.

### **Section 38 Consequences of the revocation and expiry of authorisation; measures in the event of liquidation**

(1) <sup>1</sup>If BaFin revokes authorisation or if authorisation expires, in the case of legal persons and commercial partnerships it may decide that the institution is to be liquidated. <sup>2</sup>BaFin's decision shall have the effect of a dissolution order. <sup>3</sup>The court of registration shall be informed of the decision and shall enter it accordingly in the commercial register or register of cooperative societies (*Genossenschaftsregister*).

(2) <sup>1</sup>BaFin may issue general instructions with regard to the liquidation of an institution. <sup>2</sup>The court shall appoint liquidators at BaFin's request if the persons otherwise appointed to liquidate the institution offer no guarantee of proper liquidation. <sup>3</sup>If responsibility therefor does not lie with the court, BaFin shall appoint the liquidator.

(3) <sup>1</sup>BaFin shall publicise the revocation or expiry of authorisation in the electronic Federal Gazette. <sup>2</sup>It shall inform the competent agencies of the other EEA states in which the institution has established branches or has been providing cross-border services.

(4) Subsections (1) and (2) shall not apply to legal persons governed by public law.

## **Division 2 PROTECTED TERMS**

### **Section 39 The terms "bank" and "banker"**

(1) The terms "bank" ("Bank") or "banker" ("Bankier") or a term in which the words "bank" or "banker" appear, unless otherwise stipulated by law, may be used in the corporate name, as an addendum to the corporate name, to describe the business purpose or for advertising purposes only by

- 1 credit institutions with authorisation pursuant to section 32 or branches of enterprises pursuant to section 53b (1) sentences 1 and 2 or (7);
- 2 other enterprises which, upon this Act coming into force, were legitimately using such a term pursuant to previous provisions.

(2) The term "people's bank" ("Volksbank") or a term in which the words "people's bank" appear may be newly taken up only by credit institutions operating in the legal form of a registered cooperative society and belonging to an audit association.

(3) When granting authorisation, BaFin may decide that the terms specified in subsection (1) may not be used if, according to generally accepted standards, the nature or volume of the business conducted by the credit institution does not warrant the use of such a term.

#### **Section 40 The term “savings bank”**

(1) The term “savings bank” (“Sparkasse”) or a term in which the words “savings bank” appear may be used in the corporate name, as an addendum to the corporate name, to describe the business purpose or for advertising purposes only by

- 1 public savings banks with authorisation pursuant to section 32;
- 2 other enterprises which, upon this Act coming into force, were legitimately using such a term pursuant to previous provisions;
- 3 enterprises which are newly established by restructuring the enterprises specified in number 2 as long as they, by virtue of their articles of association or articles of incorporation, exhibit specific features (in particular, tasks geared towards public welfare and a restriction of their principal business operations to the economic area in which the enterprise is domiciled) to the same extent as before restructuring.

(2) Credit institutions within the meaning of section 1 of the Act on Building and Loan Associations may use the term “building and loan association” (“Bausparkasse”); registered cooperative societies which belong to an audit association may use the term “savings and loans bank” (“Spar- und Darlehenskasse”).

#### **Section 41 Exceptions**

<sup>1</sup>Sections 39 and 40 shall not apply to enterprises that use the words “bank”, “banker” or “savings bank” in a context which precludes the impression that they conduct banking business. <sup>2</sup>Credit institutions domiciled outside Germany may use the terms specified in section 39 (2) and section 40 in their corporate name, as an addendum to their corporate name, to describe their business purpose or for advertising purposes for their operations in Germany if they are entitled to use these terms in their country of domicile and append an addendum to the term referring to their country of domicile.

#### **Section 42 BaFin’s decision**

<sup>1</sup>In cases of doubt, BaFin shall decide whether an enterprise is authorised to use the terms specified in sections 39 and 40. <sup>2</sup>It shall inform the court of registration of its decisions.

#### **Section 43 Registration provisions**

(1) If authorisation is required to conduct banking business or provide financial services pursuant to section 32, entries in public registers may be made only if the court of registration has been furnished with evidence of such authorisation.

(2) <sup>1</sup>If an enterprise uses a corporate name or an addendum to a corporate name which it is impermissible to use pursuant to sections 39 to 41, the court of registration shall compel the enterprise to refrain from using the corporate name or addendum to the corporate name by imposing an administrative fine; section 392 of the Act on the Procedure in Cases Involving Family Law and on Matters of Non-Contentious Jurisdiction (*Gesetz über das Verfahren in Familiensachen und in den Angelegenheiten der freiwilligen Gerichtsbarkeit*) shall apply *mutatis mutandis*. <sup>2</sup>This is without prejudice to section 395 of the Act on the Procedure in Cases Involving Family Law and on Matters of Non-Contentious Jurisdiction.

(3) BaFin shall be entitled to file petitions in proceedings before the court of registration regarding the entry or amendment of the legal relationships or corporate name of credit institutions or enterprises using terms that are impermissible pursuant to sections 39 to 41, and may also seek the legal remedies permissible under the Act on the Procedure in Cases Involving Family Law and on Matters of Non-Contentious Jurisdiction.

### **Division 3 INFORMATION AND INSPECTIONS**

#### **Section 44 Information from and inspections of institutions, ancillary service providers, financial holding companies and enterprises included in supervision on a consolidated basis**

(1) <sup>1</sup>An institution or a superordinated enterprise, the members of its governing bodies and its employees shall, upon request, provide information about all business activities and submit documentation to BaFin, the persons and entities which BaFin uses in performing its functions and the Deutsche Bundesbank. <sup>2</sup>BaFin may perform inspections at the institutions and superordinated enterprises, with or without a special reason, and may entrust the Deutsche Bundesbank with the task of carrying out such inspections; this shall include enterprises to which an institution or superordinated enterprise has outsourced material areas within the meaning of section 25a (2) (external service provider). <sup>3</sup>BaFin's staff, the staff of the Deutsche Bundesbank as well as any other persons whom BaFin uses to perform the inspections may enter and inspect the business premises of the institution, the external service provider and the superordinated enterprise for this purpose during ordinary office and business hours. <sup>4</sup>The parties affected shall acquiesce to the measures taken under sentences 2 and 3.

(2) <sup>1</sup>A subordinated enterprise within the meaning of section 10a (1) to (5), a financial holding company at the head of a financial holding group within the meaning of section 10a (3) and a member of a governing body of such an enterprise shall, upon request, provide information and submit documentation to BaFin, the persons and entities which BaFin uses in performing its functions and the Deutsche Bundesbank in order to enable them to verify the accuracy of the information or data supplied and which are required for supervision on a consolidated basis or which are to be supplied in connection with a statutory order pursuant to section 25 (3) sentence 1. <sup>2</sup>BaFin may perform inspections at the enterprises specified in sentence 1, with or without a special reason, and may entrust the Deutsche Bundesbank with the task of carrying out such inspections; subsection (1) sentence 2 clause 2 shall apply *mutatis*

*mutandis*.<sup>3</sup> BaFin's staff, the staff of the Deutsche Bundesbank as well as any other persons whom BaFin uses to perform the inspections may enter and inspect the enterprises' business premises for this purpose during ordinary office and business hours.<sup>4</sup> The parties affected shall acquiesce to the measures taken under sentences 2 and 3.<sup>5</sup> Sentences 1 to 4 shall apply *mutatis mutandis* to a subsidiary not included in the consolidation and to a mixed-activity holding company and its subsidiaries.

(2a) <sup>1</sup>If, in the supervision of a group of institutions or a financial holding group, BaFin requires information which has already been submitted to another competent authority, it shall initially address its request for information to that competent authority.<sup>2</sup> When supervising institutions which are subordinated to an EU parent institution pursuant to section 10a (1) sentence 2, (4) or (5), BaFin shall routinely address its initial requests for information on the implementation of the approaches and measures under the Banking Directive to the authority responsible for consolidated supervision.

(3) <sup>1</sup>Enterprises domiciled outside Germany which are included in the consolidation shall, upon request, allow BaFin to carry out the inspections permitted under this Act, in particular verification of the accuracy of the data supplied for the consolidation pursuant to section 10a (6) to (11), section 13b (3) and section 25 (2) and (3), insofar as this is both necessary to enable BaFin to perform its functions and permissible under the laws of the other state.<sup>2</sup> This shall also apply to subsidiaries domiciled outside Germany which are not included in the consolidation.

(3a) <sup>1</sup>Subsection (2) sentences 1 to 4 and sentence 5 first alternative shall apply *mutatis mutandis* to subordinated financial conglomerate enterprises within the meaning of section 10b (3) sentence 5 and mixed financial holding companies as well as to the members of the governing bodies of such enterprises.<sup>2</sup> Subsection (3) shall apply *mutatis mutandis* to subordinated financial conglomerate enterprises within the meaning of section 10b (3) sentence 5 domiciled outside Germany.

(4) <sup>1</sup>BaFin can send representatives to shareholders' meetings, general meetings or partners' meetings, as well as to meetings of the supervisory bodies of institutions organised in the form of a legal person.<sup>2</sup> They may address these meetings.<sup>3</sup> The parties affected shall acquiesce to the measures taken under sentences 1 and 2.

(5) <sup>1</sup>Institutions organised in the form of a legal person shall, at BaFin's request, call the meetings specified in subsection (4) sentence 1, call meetings of the supervisory bodies and announce subjects on which decisions are to be taken.<sup>2</sup> BaFin can send representatives to a meeting called pursuant to sentence 1.<sup>3</sup> They may address the meeting.<sup>4</sup> The parties affected shall acquiesce to the measures taken under sentences 2 and 3.<sup>5</sup> This is without prejudice to subsection (4).

(6) A person obliged to furnish information may refuse to do so in respect of any questions, the answering of which would place him/her or one of his/her relatives as designated in section 383 (1) numbers 1 to 3 of the Code of Civil Procedure at risk of criminal prosecution

or proceedings under the Act on Breaches of Administrative Regulations (*Gesetz über Ordnungswidrigkeiten*).

#### **Section 44a Cross-border information and inspections**

(1) <sup>1</sup>Legislation that hinders the transmission of data shall not apply to the transmission of data between an institution, a German asset management company, a financial enterprise, a financial holding company, a mixed financial holding company, an ancillary service provider or an enterprise not included in the consolidation or in supplementary supervision at conglomerate level and an enterprise domiciled outside Germany which directly or indirectly holds at least 20 per cent of the capital shares or voting rights in the enterprise, is a parent enterprise or can exercise a controlling influence, or between a mixed-activity holding company and its subsidiaries domiciled outside Germany, if such transmission of data is necessary to comply with the prudential provisions according to the Banking Directive or Directive 2002/87/EC for the enterprise domiciled outside Germany. <sup>2</sup>BaFin can prohibit an institution from transmitting data to a non-EEA state.

(2) <sup>1</sup>At the request of an authority responsible for the supervision of an enterprise domiciled in another EEA state, BaFin shall verify the accuracy of the data transmitted by an enterprise within the meaning of subsection (1) sentence 1 for that supervisory authority according to the Banking Directive or Directive 2002/87/EC, or shall permit the authority making the request, an external auditor or an expert to verify such data; BaFin may, at its own diligent discretion, adopt the same procedure vis-à-vis supervisory authorities in non-EEA states provided that reciprocity is assured. <sup>2</sup>Section 5 (2) of the Act on Administrative Procedures regarding the limits to administrative assistance shall apply *mutatis mutandis*. <sup>3</sup>The enterprises within the meaning of subsection (1) sentence 1 shall acquiesce to the verification.

(3) <sup>1</sup>BaFin can request from deposit-taking credit institutions, e-money institutions, securities trading firms, German asset management companies, financial holding companies or mixed financial holding companies domiciled in another EEA state that it be given information that facilitates the supervision of institutions which are subsidiaries of these enterprises and which are not included in supervision on a consolidated basis by the competent authorities of the other state for reasons corresponding to those specified in section 31 (3) sentence 1 or 4. <sup>2</sup>Sentence 1 shall apply *mutatis mutandis* where subordinated financial conglomerate enterprises are not included in supplementary supervision at conglomerate level by the competent authority of another EEA state acting as the coordinator for reasons corresponding to those specified in section 31 (5) sentence 1 or 3.

#### **Section 44b Information from and inspections of the holders of major participating interests**

(1) <sup>1</sup>The obligations vis-à-vis BaFin and the Deutsche Bundesbank to provide information and submit documentation pursuant to section 44 (1) sentence 1 shall also apply to

- 1 persons and enterprises who report the intention to acquire a participating interest pursuant to section 2c or who are named as holders of major participating interests in connection with an application for authorisation pursuant to section 32 (1) sentence 2 number 6 or a supplementary report pursuant to section 64e (2) sentence 4,
- 2 the holders of a major participating interest in an institution and the enterprises controlled by them,
- 3 persons and enterprises about whom facts are known which warrant the assumption that they are persons or enterprises within the meaning of number 2, and
- 4 persons and enterprises who are associated with a person or an enterprise within the meaning of numbers 1 to 3 pursuant to section 15 of the Companies Act.

<sup>2</sup>At BaFin's request, the party obliged to present documentation shall, at its own expense, arrange for the documentation to be submitted pursuant to section 2c (1) sentence 2 to be examined by an external auditor determined by BaFin.

(2) <sup>1</sup>BaFin and the Deutsche Bundesbank may take measures pursuant to section 44 (1) sentences 2 and 3 in respect of the persons and enterprises specified in subsection (1) if there is evidence of grounds for a prohibition pursuant to section 2c (1b) sentence 1 numbers 1 to 6. <sup>2</sup>The parties affected shall acquiesce to these measures.

(3) A person obliged to furnish information pursuant to subsections (1) or (2) may refuse to do so in respect of any questions, the answering of which would place him/her or one of his/her relatives as designated in section 383 (1) numbers 1 to 3 of the Code of Civil Procedure at risk of criminal prosecution or proceedings under the Act on Breaches of Administrative Regulations.

### **Section 44c Prosecution of unauthorised banking business and financial services**

(1) <sup>1</sup>An enterprise about which facts are known which warrant the assumption that it conducts banking business or provides financial services without the authorisation required under this Act or that it conducts business prohibited under section 3, a member of its governing bodies, an employee of this enterprise as well as other enterprises which are or were involved in performing such business shall, upon request, provide information about all of the enterprise's business activities and submit documentation to BaFin and the Deutsche Bundesbank. <sup>2</sup>A member of a governing body and an employee shall, upon request, provide information even after they have left the governing body or the enterprise.

(2) <sup>1</sup>BaFin can carry out inspections on the premises of the enterprise as well as on the premises of the persons and enterprises obliged to provide information and submit documentation pursuant to subsection (1) sentence 1 insofar as this is necessary to determine the nature or volume of the business or activities, and it may entrust the Deutsche Bundesbank with the task of carrying out such inspections. <sup>2</sup>To this end, BaFin's staff and the staff of the Deutsche Bundesbank may enter and inspect these premises during ordinary office and business hours. <sup>3</sup>In order to prevent imminent risks to public order and safety, they shall be authorised to enter and inspect these premises also outside ordinary office and

business hours, and may enter and inspect premises which also serve as living accommodation; the basic right enshrined in Article 13 of the Basic Law (*Grundgesetz*) shall be limited in this respect.

(3) <sup>1</sup>BaFin's staff and the staff of the Deutsche Bundesbank may search these premises of the enterprise as well as those of the persons and enterprises obliged to provide information and submit documentation pursuant to subsection (1) sentence 1. <sup>2</sup>The basic right enshrined in Article 13 of the Basic Law shall be limited in this respect. <sup>3</sup>Searches of business premises shall require a judicial order except in the event of imminent danger. <sup>4</sup>Searches of premises which serve as living accommodation shall require a judicial order. <sup>5</sup>The court responsible shall be the local court (*Amtsgericht*) in whose area of jurisdiction the premises are located. <sup>6</sup>An appeal may be lodged against the judicial decision; sections 306 to 310 and 311a of the Code of Criminal Procedure (*Strafprozessordnung*) shall apply *mutatis mutandis*. <sup>7</sup>A written record shall be made of the search. <sup>8</sup>It must specify which official agency was responsible for carrying out the search, the reason, time and place of the search and its outcome and, if no judicial order was issued, the facts substantiating the presumption of imminent danger.

(4) BaFin's staff and the staff of the Deutsche Bundesbank may seize items which could be of importance as evidence in their investigations.

(5) <sup>1</sup>The parties affected shall acquiesce to measures taken pursuant to subsection (2), subsection (3) sentence 1 and subsection (4). <sup>2</sup>Section 44 (6) shall apply.

(6) <sup>1</sup>The rights of BaFin and the Deutsche Bundesbank as well as the duties to cooperate and acquiesce incumbent upon the parties affected shall also apply to the enterprises and persons about which facts are known which warrant the assumption that they are involved in the initiation, conclusion or settlement of unauthorised banking business or financial services. <sup>2</sup>If the competent authority of another state makes an appropriate request to BaFin, the aforementioned rights and duties shall also apply in respect of the enterprises and persons about which facts are known which warrant the assumption that the enterprises or persons are involved in the initiation, conclusion or settlement of banking business or financial services which are being conducted or provided in the other state contrary to a prohibition in effect in that state.

## **Division 4 MEASURES IN SPECIAL CASES**

### **Section 45 Measures in the case of inadequate own funds or inadequate liquidity**

(1) If an institution's own funds do not meet the requirements laid down in section 10 (1) or if the investment of its funds does not meet the requirements laid down in section 11 (1), BaFin can

- 1 prohibit or limit both withdrawals by the proprietors or partners and the distribution of profits,
- 2 prohibit or limit lending within the meaning of section 19 (1), and

3 order the institution to take measures to reduce risks insofar as they arise from certain types of activities and products or through the use of certain systems.

(2) <sup>1</sup>Subsection (1) numbers 1 and 3 shall apply *mutatis mutandis* to superordinated enterprises within the meaning of section 10a (1) to (5) as well as to institutions within the meaning of section 10a (14) if the consolidated own funds of the enterprises belonging to the group do not meet the requirements laid down in section 10 (1). <sup>2</sup>In these cases, BaFin can also lower the large exposure limits pursuant to section 13 (3) sentence 5, section 13a (3) sentence 3 and section 13a (4) sentence 5 applicable to the group of institutions or the financial holding group pursuant to section 13b.

(3) If a financial conglomerate's own funds do not meet the requirements laid down in section 10b (1), BaFin can

1 take measures pursuant to subsection (1) vis-à-vis a superordinated financial conglomerate enterprise operating in the banking and investment services sector within the meaning of section 10b (3) sentences 6 to 8 or section 10b (4);

2 take necessary and suitable measures vis-à-vis a mixed financial holding company; it can, in particular, prohibit or limit both withdrawals by the proprietor or partner and the distribution of profits.

(4) <sup>1</sup>BaFin may issue the orders specified in subsections (1) to (3) only if the institution or the mixed financial holding company has failed to remedy the deficiency within a period set by BaFin. <sup>2</sup>Decisions on the distribution of profits shall be void insofar as they contradict an order issued pursuant to subsections (1) to (3).

#### **Section 45a Measures vis-à-vis financial holding companies and mixed financial holding companies**

(1) <sup>1</sup>BaFin can prohibit a financial holding company at the head of a financial holding group within the meaning of section 10a (3) sentence 1 or 2 or section 13b (2) from exercising its voting rights in the superordinated enterprise and the other subordinated enterprises if

1 the financial holding company fails to transmit to the superordinated enterprise the data pursuant to section 10a (13) sentence 2 or section 13b (5) in conjunction with section 10a (13) sentence 2 required for consolidation pursuant to section 10a or section 13b, unless the supervisory consolidation requirements can be satisfied in some other way;

2 facts are known which reveal that a person who actually manages the business of the financial holding company is not trustworthy or does not have the professional qualifications required to manage the business.

<sup>2</sup>Sentence 1 shall apply *mutatis mutandis* to a mixed financial holding company which fails to transmit to the enterprise required to submit reports pursuant to section 10b (2) and section 13d (1) the data pursuant to section 10b (7) sentence 2, also in conjunction with section 13d (4) sentence 2, required for supervision at conglomerate level pursuant to section 10b or

section 13d, or if facts are known which reveal that a person who actually manages the business of the mixed financial holding company is not trustworthy or does not have the professional qualifications required to manage the business.

(1a) In the cases cited in subsection (1) sentence 1 number 2 or subsection (1) sentence 2 second alternative, BaFin can also order the superordinated enterprise of a financial holding group or the superordinated financial conglomerate enterprise not to comply with the instructions of the financial holding company or of the mixed financial holding company if the possibilities under company law for removing the persons who actually manage the business of the financial holding company or of the mixed financial holding company cannot be used or if such can be used but have been without success.

(2) <sup>1</sup>In the case of a prohibition pursuant to subsection (1), at BaFin's request, the court with jurisdiction at the domicile of the superordinated enterprise pursuant to section 10a (1) to (5) or of the superordinated financial conglomerate enterprise pursuant to section 10b (3) sentences 6 to 8 or section 10b (4) shall appoint a trustee to whom it shall transfer the exercise of voting rights. <sup>2</sup>In exercising the voting rights, the trustee must take due account of the interests of a sound management of the enterprises concerned, in conformity with banking supervisory requirements. <sup>3</sup>BaFin may request the appointment of a different trustee for good cause. <sup>4</sup>If the prerequisites specified in subsection (1) no longer exist, BaFin shall apply for the appointment of the trustee to be revoked. <sup>5</sup>The trustee shall be entitled to the reimbursement of reasonable expenses and remuneration for his/her activities. <sup>6</sup>The court shall determine such expenses and remuneration at the trustee's request; an appeal on a point of law against the fixing of remuneration by the court shall not be permissible. <sup>7</sup>The Federal Government shall advance such expenses and remuneration; the financial holding company or the mixed financial holding company and the enterprises concerned shall be jointly and severally liable to the Federal Government in respect of its outlays.

(3) <sup>1</sup>As long as the prohibition order pursuant to subsection (1) is enforceable, the enterprises concerned shall not be deemed to be subordinated enterprises of the financial holding company within the meaning of sections 10a and 13b. <sup>2</sup>Sentence 1 shall apply *mutatis mutandis* to the subordinated enterprises of a mixed financial holding company within the meaning of section 10b (2) sentence 5.

#### **Section 45b Measures in the case of organisational deficiencies**

(1) If an institution does not have a proper business organisation within the meaning of section 25a (1) and if the institution has failed to remedy the deficiencies on the basis of an order issued pursuant to section 25a (1) sentence 8 within an appropriate period set by BaFin, BaFin can order, in particular, that the institution

- 1 must hold additional own funds in excess of the capital base required pursuant to section 10 (1) and the statutory order pursuant to section 10 (1) sentence 9,
- 2 must take measures to reduce risks insofar as they arise from certain types of activities and products or through the use of certain systems,

- 3 may establish further branches only with BaFin's approval, and
- 4 may not engage in certain types of business, in particular the acceptance of deposits, funds or securities of customers and lending pursuant to section 19 (1), or may engage in such business only to a limited extent.

(2) Subsection (1) shall apply *mutatis mutandis* to the relevant superordinated enterprise within the meaning of section 10a (1) to (5) as well as to an institution within the meaning of section 10a (14) if a group of institutions or a financial holding group does not have a proper business organisation in contradiction of section 25a (1) and (1a); subsection (1) number 4 shall apply *mutatis mutandis* provided that, instead of prohibiting or limiting lending, BaFin can lower the large exposure limits pursuant to section 13 (3) sentence 5, section 13a (3) sentence 4 and section 13a (4) sentence 5 applicable to the group of institutions or financial holding group pursuant to section 13b.

(3) In individual cases, BaFin can also give the orders specified in subsections (1) and (2) before the issue of an order pursuant to section 25a (1) sentence 8 or can combine them with such an order if this is called for by the risk situation at the institution, group of institutions or financial holding group so as to avert a real danger to proper business management.

#### **Section 46 Measures in the case of danger**

(1) <sup>1</sup>If there is any danger to the discharge of an institution's obligations to its creditors, especially to the safety of the assets entrusted to it, or if there are grounds for suspecting that effective supervision of the institution is not possible (section 33 (3) numbers 1 to 3), BaFin may take temporary measures to avert this danger. <sup>2</sup>In particular, it can

- 1 issue instructions on the institution's management,
- 2 forbid the acceptance of deposits, funds or securities of customers and lending (section 19 (1)),
- 3 prohibit proprietors and senior managers from carrying out their activities, or limit the performance of these activities, and
- 4 appoint supervisors.

<sup>3</sup>Decisions on the distribution of profits shall be void insofar as they contradict an order issued pursuant to sentences 1 and 2. <sup>4</sup>In the case of institutions operating in a legal form other than that of a sole proprietorship, senior managers who have been prohibited from carrying out their activities shall be debarred from managing and representing the institution for the duration of the prohibition. <sup>5</sup>The general provisions shall apply to any claims arising from the employment contract or from other terms governing the activities of the senior manager. <sup>6</sup>Any rights enabling a senior manager to participate as a partner or in other ways in decisions on management measures at the institution may not be exercised for the duration of the prohibition.

(2) <sup>1</sup>If senior managers have been prohibited from carrying out their activities pursuant to subsection (1) sentence 2 number 3, the court having jurisdiction at the institution's domicile, at BaFin's request, shall appoint the necessary persons with powers of management and representation if, owing to the prohibition, the institution no longer has the requisite number of persons authorised to manage and represent it. <sup>2</sup>Section 46a (2) sentences 2 and 3, section 46a (3) sentence 1 and section 46a (4) to (7) shall apply *mutatis mutandis*.

#### **Section 46a Measures in the event of imminent insolvency, appointment of persons with powers of representation**

(1) <sup>1</sup>If the conditions specified in section 46 (1) sentence 1 exist, in order to avert insolvency proceedings, BaFin can temporarily

- 1 impose a ban on sales and payments by the institution,
- 2 order that the institution be closed for business with customers, and
- 3 prohibit the acceptance of payments not intended for the discharge of debt vis-à-vis the institution, unless the competent deposit guarantee scheme or investor compensation scheme warrants that the obligees will be satisfied in full.

<sup>2</sup>The deposit guarantee scheme or investor compensation scheme can make its commitment subject to the condition that incoming payments not intended for the discharge of debt vis-à-vis the institution are held and managed – for the benefit of the scheme – separately from the institution's assets in existence at the time when the ban on sales and payments pursuant to sentence 1 number 1 was imposed. <sup>3</sup>After the imposition of a ban on sales and payments pursuant to sentence 1 number 1, the institution may settle any business in progress when the ban was imposed and enter into new business insofar as this is necessary for settlement purposes if and insofar as the competent deposit guarantee scheme or investor compensation scheme makes available the funds required to conduct this business or undertakes to reimburse the institution for all and any diminution in its assets resulting from this business as a whole if this is necessary to satisfy all of the creditors in full. <sup>4</sup>Moreover, BaFin can allow exceptions to the ban on sales and payments pursuant to sentence 1 number 1 if this is necessary for the administration of the institution. <sup>5</sup>Compulsory enforcements, attachments and temporary injunctions against the institution's assets shall not be permissible for the duration of measures pursuant to sentence 1. <sup>6</sup>The provisions of the Insolvency Code relating to the protection of payment and securities delivery and settlement systems as well as of central banks' collateral security and of financial collateral arrangements shall apply *mutatis mutandis*.

(2) <sup>1</sup>If measures pursuant to subsection (1) sentence 1 have been ordered for institutions operating in a legal form other than that of a sole proprietorship and if senior managers have been prohibited from carrying out their activities, then the court having jurisdiction at the institution's domicile, at BaFin's request, shall appoint the necessary persons with powers of management and representation if, owing to the prohibition, the institution no longer has the requisite number of persons authorised to manage and represent it. <sup>2</sup>In the case of institutions entered in a public register, the appointment or removal by the court of persons

with powers of representation, the scope of their powers of representation as well as the termination of their tenure of office shall be recorded officially. <sup>3</sup>While the conditions specified in sentence 1 exist, any persons or bodies entitled under other legislation to appoint persons with powers of management and representation may not exercise this right.

(3) <sup>1</sup>The scope of the powers of representation of the person whom the court has appointed shall be determined by the scope of the powers of representation of the senior manager to whose position he/she has been appointed. <sup>2</sup>His/her powers of management – unless extended by the institution's competent governing bodies – shall be limited to the implementation of the measures necessary to avert insolvency proceedings and protect the creditors.

(4) <sup>1</sup>The person with powers of management and representation whom the court has appointed shall be entitled to the reimbursement of reasonable out-of-pocket expenses and remuneration for his/her activities. <sup>2</sup>The court having jurisdiction at the institution's domicile shall determine such expenses and remuneration at the request of the person with powers of management and representation whom the court has appointed. <sup>3</sup>An appeal on a point of law shall not be permissible. <sup>4</sup>The final and absolute decision shall result in compulsory enforcement pursuant to the Code of Civil Procedure.

(5) For the duration of measures ordered pursuant to subsection (1) sentence 1, a person with powers of management and representation whom the court has appointed may be removed only by the court at the request of BaFin or the institution's governing body responsible for the debarment of partners from the management and representation of the institution or for the removal of persons with powers of management and representation, and only for good cause.

(6) <sup>1</sup>The tenure of office of a person with powers of management and representation whom the court has appointed shall end at all events when the measures pursuant to subsection (1) sentence 1 and the order prohibiting the senior manager – to whose position the person has been appointed – from carrying out his/her activities are rescinded. <sup>2</sup>If only the measures pursuant to subsection (1) sentence 1 are rescinded, the tenure of office of a person with powers of management and representation whom the court has appointed shall end as soon as the persons or bodies entitled under other legislation to appoint a person with powers of management and representation have done so and this person, if necessary, has been granted authorisation pursuant to section 32.

(7) Subsections (2) to (6) shall not apply to legal persons governed by public law.

### **Section 46b Insolvency petition**

(1) <sup>1</sup>If an institution or a financial holding company which is deemed to be a superordinated enterprise pursuant to section 10a (3) sentence 6 or sentence 7 becomes insolvent or overindebted, the senior managers, the proprietor in the case of an institution operating in the form of a sole proprietorship and the persons who actually manage the business of the financial holding company shall report this fact to BaFin promptly, enclosing informative

documentation; the aforementioned persons must also provide such notification along with the corresponding documentation if the institution or the financial holding company which is deemed to be a superordinated enterprise pursuant to section 10a (3) sentence 6 or sentence 7 is not expected to be in a position to fulfil its existing payment obligations when they fall due (imminent insolvency). <sup>2</sup>Insofar as these persons are required under other legislation to file a petition for the initiation of insolvency proceedings in the event of insolvency or overindebtedness, the notification requirement pursuant to sentence 1 shall replace the requirement to file such a petition. <sup>3</sup>Insolvency proceedings over the assets of an institution or a financial holding company which is deemed to be a superordinated enterprise pursuant to section 10a (3) sentence 6 or sentence 7 shall be initiated in the event of insolvency, overindebtedness or, under the conditions set out in sentence 5, also in the event of imminent insolvency. <sup>4</sup>The petition for the initiation of insolvency proceedings over the assets of an institution or a financial holding company which is deemed to be a superordinated enterprise pursuant to section 10a (3) sentence 6 or sentence 7 may be filed only by BaFin. <sup>5</sup>In the event of imminent insolvency, however, BaFin may file a petition for insolvency only with the permission of the institution or the financial holding company which is deemed to be a superordinated enterprise pursuant to section 10a (3) sentence 6 or sentence 7, and only if measures pursuant to sections 46 and 46a do not hold out the promise of success. <sup>6</sup>The insolvency court must consult BaFin before appointing an insolvency administrator. <sup>7</sup>The court order to initiate insolvency proceedings shall be specially delivered to BaFin.

(2) <sup>1</sup>If insolvency proceedings are initiated against an institution which is a participant in a system within the meaning of section 24b (1), BaFin shall promptly notify the agencies whose names have been communicated by the other EEA states to the Commission of the European Communities. <sup>2</sup>Sentence 1 shall apply *mutatis mutandis* to system operators within the meaning of section 24b (5).

#### **Section 46c Calculation of prescribed periods**

The periods to be calculated pursuant to sections 88 and 130 to 136 of the Insolvency Code from the date on which the petition for the initiation of insolvency proceedings is filed shall be calculated from the date on which a measure pursuant to section 46a (1) is ordered.

#### **Section 46d Notification of the other EEA states with regard to reorganisation measures**

(1) <sup>1</sup>BaFin shall notify the competent authorities in the other EEA states before it orders reorganisation measures, in particular measures pursuant to section 46 or section 46a (1) sentence 1 numbers 1 to 3, to be carried out at a deposit-taking credit institution or an e-money institution. <sup>2</sup>If this is not possible, the competent authorities shall be informed immediately after such measures have been ordered. <sup>3</sup>The same shall apply insofar as measures pursuant to section 46 or section 46a (1) are taken against a branch of an enterprise within the meaning of section 53 domiciled in a non-EEA state. <sup>4</sup>In this case, BaFin shall inform the competent authorities in the other EEA states in which the enterprise

has established further branches. <sup>5</sup>This is without prejudice to the provisions under section 8 (3) to (7).

(2) <sup>1</sup>Reorganisation measures which prejudice the rights of third parties in a host state and against which legal remedies may be sought must be announced promptly without an accompanying statement of reasons in the Official Journal of the European Union and in at least two national newspapers of the host states in the official language or languages of the relevant EEA states. <sup>2</sup>This announcement must stipulate which agency or authority has received the statement of reasons, the subject matter of and legal basis for the decision, the time limits for legal remedies including deadlines, BaFin's address as the authority which would decide if an objection were filed and the address of the competent administrative court. <sup>3</sup>Such announcement is not a prerequisite for validity.

(3) <sup>1</sup>Reorganisation measures within the meaning of subsections (1) and (2) are measures pursuant to section 46 or section 46a (1) as well as section 6 (3) by means of which the financial situation of a deposit-taking credit institution or an e-money institution is to be reinforced or restored and which could prejudice the existing rights of third parties in a host EEA state, including measures which allow a suspension of payments or which serve to bolster the reorganisation measures ordered by supervisory authorities in the EEA. <sup>2</sup>Reorganisation measures are to be designated as such. <sup>3</sup>With due regard for the reorganisation measures, sections 336, 337, 338, 340 and 351 (2) of the Insolvency Code shall apply *mutatis mutandis* to contracts on the use or purchase of an immovable object, to employment contracts and employment relationships, to set-offs, to repurchase transactions within the meaning of section 340b of the Commercial Code, to debt rescheduling contracts and netting agreements as well as to the rights in rem of third parties unless otherwise stipulated in this Act.

(4) <sup>1</sup>Subsections (1) and (2) shall not apply if and insofar as only the rights of persons involved in the internal corporate structure as well as those of senior managers and shareholders of a deposit-taking credit institution or an e-money institution may be prejudiced in one of these capacities. <sup>2</sup>Notification and announcement pursuant to subsections (1) and (2) are not necessary in the case of deposit-taking credit institutions or e-money institutions which are not involved in cross-border activities.

(5) <sup>1</sup>BaFin shall support reorganisation measures ordered by the authorities of the home state to be carried out at a deposit-taking credit institution or an e-money institution domiciled in another EEA state. <sup>2</sup>If it considers it necessary to carry out reorganisation measures at a deposit-taking credit institution or an e-money institution domiciled in another EEA state, it shall inform the competent authorities of this state accordingly.

#### **Section 46e Insolvency proceedings in EEA states**

(1) <sup>1</sup>The relevant authorities or courts of the home state shall be solely responsible for initiating insolvency proceedings over the assets of a deposit-taking credit institution or an e-money institution within the EEA. <sup>2</sup>If another EEA state is the home state of a deposit-taking

credit institution or an e-money institution and insolvency proceedings are initiated there over the assets of this institution, then these proceedings shall be recognised irrespective of the provisions under section 343 (1) of the Insolvency Code.

(2) Secondary insolvency proceedings pursuant to section 356 of the Insolvency Code and any other territorial insolvency proceedings pursuant to section 354 of the Insolvency Code are not permissible with regard to deposit-taking credit institutions or e-money institutions which are domiciled in another EEA state.

(3) <sup>1</sup>The office of the insolvency court shall immediately forward the court order to initiate proceedings to BaFin, which in turn shall promptly inform the competent authorities in the other host EEA states that proceedings have been initiated. <sup>2</sup>Without prejudice to the announcement laid down in section 30 of the Insolvency Code, the insolvency court must publish extracts from the court order to initiate proceedings in the Official Journal of the European Union and in at least two national newspapers of the host states in which the credit institution concerned has a branch or provides services. <sup>3</sup>This publication is to be preceded by the form pursuant to section 46f (1) of this Act.

(4) <sup>1</sup>BaFin can request information about the status of the insolvency proceedings from the insolvency court and the insolvency administrator at any time. <sup>2</sup>It is obliged, upon the request of the competent authorities in other EEA states, to inform the said authorities about the status of the insolvency proceedings.

(5) <sup>1</sup>If BaFin files a petition for the initiation of insolvency proceedings over the assets of a branch of an enterprise domiciled in a non-EEA state, it shall promptly notify the competent authorities in the EEA states in which the enterprise has a further branch or provides services. <sup>2</sup>The notification given must also include information about the contents and legal validity of the authorisation pursuant to section 32. <sup>3</sup>The persons and agencies involved shall endeavour to take a concerted approach.

#### **Section 46f Notification of creditors in insolvency proceedings**

(1) <sup>1</sup>On issuing the court order to initiate insolvency proceedings, the office of the insolvency court shall send the creditors a form bearing the heading “Invitation to lodge a claim and submit observations relating to a claim. Time limits to be observed!” in all of the official languages of the EEA. <sup>2</sup>The form shall be published in the Federal Gazette by the Federal Ministry of Justice and shall contain the following information in particular.

- 1 The time limits which are to be observed and the penalties for breaching these time limits.
- 2 The body or authority empowered to accept the lodgement of claims or observations relating to claims.
- 3 Other measures which have been laid down.

4 How important it is for creditors whose claims are preferential or secured in rem to lodge these claims and the extent to which they must do so.

(2) <sup>1</sup>Creditors whose place of habitual abode, residence or domicile is in another EEA state can lodge their claims in the official language or one of the official languages of that state.

<sup>2</sup>The lodgement of claims must bear the heading “Lodgement of claim and submission of observations relating to claims” in German, ie “Anmeldung und Erläuterung einer Forderung”.

<sup>3</sup>Upon request, the creditor must provide a translation of the lodgement of claim and submission of observations relating to claims, which is to be certified by a person authorised to do so in the state relevant to sentence 1.

(3) The insolvency administrator must regularly inform the creditors about developments in the insolvency proceedings in an appropriate form.

#### **Section 47 Moratorium, suspension of banking and stock exchange business**

(1) If there is reason to fear that credit institutions may encounter financial difficulties which are likely to pose grave dangers to the economy as a whole, and particularly to the proper functioning of the general payment system, the Federal Government may by way of a statutory order

1 grant a credit institution an extension of time to discharge its obligations and order that compulsory enforcements, attachments and temporary injunctions against the credit institution as well as the initiation of insolvency proceedings over the credit institution’s assets are not permissible for the duration of the extension;

2 order that credit institutions be temporarily closed for business with customers and that they may neither make nor accept payments and credit transfers connected with such customer business; it may limit this order to certain types or categories of credit institutions and to particular types of banking business;

3 order that the stock exchanges within the meaning of the Stock Exchange Act (*Börsengesetz*) be temporarily closed.

(2) Before taking measures pursuant to subsection (1), the Federal Government shall consult the Deutsche Bundesbank.

(3) If the Federal Government takes measures pursuant to subsection (1), it shall specify by way of a statutory order the legal consequences of these measures for prescribed periods and deadlines in the fields of civil law, commercial law, company law, bill of exchange law, cheque law and procedural law.

#### **Section 48 Resumption of banking and stock exchange business**

(1) <sup>1</sup>The Federal Government, after consulting the Deutsche Bundesbank, may issue by way of a statutory order provisions on the resumption of payments, credit transfers and stock exchange business for the period following a temporary closure of credit institutions and stock exchanges pursuant to section 47 (1) numbers 2 and 3. <sup>2</sup>In particular, it may stipulate

that the withdrawal of credit balances is subject to temporary restrictions. <sup>3</sup>Such restrictions may not be imposed in respect of monetary amounts accepted after a temporary closure of credit institutions.

(2) The statutory orders issued pursuant to subsection (1) and section 47 (1) shall become inoperative three months after the date of their promulgation if they have not already been rescinded.

## **Division 5 ENFORCEABILITY, SANCTIONS, COSTS AND CHARGES**

### **Section 49 Immediate Enforceability**

Objections to and appeals against measures taken by BaFin on the basis of section 2c (1b) sentences 1 and 2, (2) sentence 1 and (4), section 6a, section 10b (5), section 12a (2), section 13 (3), section 13a (3) to (5), in each case also in conjunction with section 13b (4) sentence 2, of section 13c (3) sentence 4, section 13d (4) sentence 5, section 28 (1), section 35 (2) numbers 2 to 6, sections 36, 37, and 44 (1), also in conjunction with section 44b (2) and (3a) sentence 1, of section 44a (2) sentence 1, sections 44c, 45 (1), 45a (1) and section 45b (1), sections 46 and 46a (1) and section 46b have no postponing effect.

### **Section 50 (Repealed)**

### **Section 51 Costs and charges**

(1) <sup>1</sup>Institutions shall refund to the Federal Government 90 per cent of the costs incurred by BaFin that are not covered by charges or separate refunds pursuant to subsection (3). <sup>2</sup>The costs shall be apportioned among the individual institutions according to the scale of their business and collected by BaFin as provided in the Administration Enforcement Act (*Verwaltungsvollstreckungsgesetz*). <sup>3</sup>From the period from 12 March 1999 to 30 December 2000, the provisions contained in the Regulation on the allocation of costs incurred by the Federal Banking Supervisory Office for the banking and financial services sector (*Umlage-Verordnung Kredit- und Finanzdienstleistungswesen*) of 8 March 1999 (Federal Law Gazette I, page 314) in the wording of 12 March 1999 shall apply with the force of law. <sup>4</sup>For the period from 31 December 2000 to 31 December 2001, the provisions contained in the Regulation on the allocation of costs incurred by the Federal Banking Supervisory Office for the banking and financial services sector as amended on 31 December 2000 shall apply with the force of law. <sup>5</sup>For the period from 1 January 2002 to 30 April 2002, the provisions contained in the Regulation on the allocation of costs incurred by the Federal Banking Supervisory Office for the banking and financial services sector as amended on 1 January 2002 shall apply with the force of law. <sup>6</sup>The costs shall include refundable amounts that could not be collected and shortfalls from the previous year's cost apportionment for which costs are to be refunded; refunds or shortfalls on which no final and absolute or incontestable ruling has yet been made shall be excepted from this provision. <sup>7</sup>The details concerning the apportionment of costs, especially regarding the apportionment key and date, the minimum assessment, the apportionment procedure including an appropriate estimation method, the payment deadlines

and the amount of late payment penalties, and concerning the collection shall be determined by the Federal Ministry of Finance by way of a statutory order; such statutory order may also contain provisions governing the provisional setting of the apportionment amount. <sup>8</sup>The Federal Ministry of Finance may transfer such authority to BaFin by way of a statutory order.

(2) <sup>1</sup>For decisions pursuant to section 2 (4) or (5), section 10 (3b) sentence 1, section 31 (2), sections 32 and 34 (2) and sections 35 to 37, BaFin may levy charges of between 250 euro and 50,000 euro. <sup>2</sup>The sum charged should depend in each case on the amount of work required for the decision and the scale of business of the enterprise concerned.

(3) <sup>1</sup>The costs incurred by the Federal Government as a result of appointing a liquidator pursuant to section 37 sentence 2 and section 38 (2) sentences 2 and 4, a supervisor pursuant to section 46 (1) sentence 2, as a result of an announcement pursuant to section 32 (4), section 37 sentence 3 or section 38 (3) or of an audit carried out pursuant to section 44 (1) or (2), section 44b sentence 2 or section 44c (2) shall be refunded separately by the enterprise concerned, and at the request of BaFin they shall be paid in advance. <sup>2</sup>The costs incurred by the Federal Government as a result of checks pursuant to section 44 (3) of the accuracy of the data transmitted for the aggregation pursuant to section 10a (6) and (7), section 13b (3) and section 25 (2) shall be refunded separately by the superordinated institution required to effect the aggregation, and at the request of BaFin they shall be paid in advance.

(4) <sup>1</sup>For the period from 12 March 1999 to 30 April 2002, subsection (1) sentences 3 to 5 in the wording of the Act amending the Insurance Supervision Act (*Versicherungsaufsichtsgesetz*) and of other acts of 15 December 2004 (Federal Law Gazette I, page 3416) shall apply to costs incurred by BaFin. <sup>2</sup>Moreover, for the period prior to 30 April 2002, subsections (1) to (3) in the wording valid prior to 30 April 2002 shall apply to costs incurred by BaFin.

## Part IV

# Special provisions applying to financial conglomerates

### Section 51a Determination of the existence of a financial conglomerate; thresholds

(1) BaFin shall determine whether groups of enterprises which are active in various sectors are to be classified as financial conglomerates.

(2) A group shall be deemed within the meaning of section 1 (20) sentence 1 number 2 clause 2 to be predominantly active in the financial sector if the ratio of the balance sheet total of the group enterprises active in the financial sector to the balance sheet total of the group exceeds 40 per cent.

(3) The consolidated or aggregated activities and/or the consolidated or aggregated activities of the enterprises active in the insurance sector and the banking and investment services sector are significant within the meaning of section 1 (20) sentence 1 number 4 if

- 1 (a) the ratio of the balance sheet total of the enterprises active in the insurance sector to the balance sheet total of all group enterprises active in both financial sectors and the ratio of the solvency requirements of the enterprises active in the insurance sector to the aggregate solvency requirements of all group enterprises active in both financial sectors exceeds 10 per cent on average, and  
(b) the ratio of the balance sheet total of the enterprises active in the banking and investment services sector to the balance sheet total of all group enterprises active in both financial sectors and the ratio of the solvency requirements of the enterprises active in the banking and investment services sector to the aggregate solvency requirements of all group enterprises active in both financial sectors exceed 10 per cent on average, or
- 2 the balance sheet total of the enterprises active in the insurance sector and that of the enterprises active in the banking and investment services sector exceeds 6 billion euro in each case.

(4) <sup>1</sup>When carrying out the calculations pursuant to subsections (2) and (3), BaFin may in individual cases disregard individual conglomerate enterprises if and as long as

- 1 the enterprise is domiciled in a non-EEA state in which there are impediments to the transmission of the information required for the calculations,
- 2 subject to sentence 2, inclusion of the enterprise is immaterial for supervision at conglomerate level, or
- 3 the enterprise's inclusion in supplementary supervision at conglomerate level would be inappropriate or misleading.

<sup>2</sup>Where several enterprises belonging to the conglomerate satisfy the conditions in the cases described in sentence 1 number 2 but, taken together, they are not immaterial for the

supplementary supervision of the group, BaFin shall include these enterprises in the calculations pursuant to subsections (2) and (3).

(5) If, within a group of enterprises which according to section 1 (20) as well as to subsections (2) and (3) is classified as a financial conglomerate and is already subject to supplementary supervision within the meaning of this Act, the ratios pursuant to subsections (2) and (3) number 1 fall or the amount pursuant to subsection (3) number 2 falls below the thresholds laid down there during a financial year, the group shall continue to be deemed a financial conglomerate if, in the three subsequent financial years,

- 1 in cases described in subsection (2) a threshold of 35 per cent;
- 2 in cases described in subsection (3) number 1 a threshold of 8 per cent;
- 3 in cases described in subsection (3) number 2 a threshold of 5 billion euro is exceeded.

(6) <sup>1</sup>The aggregated balance sheet totals of the group enterprises which are calculated on the basis of their annual accounts shall be assumed to be the balance sheet total within the meaning of subsections (2) and (3). <sup>2</sup>Enterprises in which a participating interest is held shall be included according to the share of their balance sheet totals that is equivalent to the aggregated proportional share held by the group. <sup>3</sup>If a set of consolidated accounts is available, this shall be used as the basis instead of the aggregated balance sheet totals of the single-entity accounts of the individual enterprises. <sup>4</sup>Notwithstanding sentences 1 and 2, BaFin may, in individual cases, permit the income structure or off-balance-sheet business to be used for calculating the thresholds instead of or in addition to the balance sheet total. <sup>5</sup>The solvency requirements to be taken into account when making the calculations shall be determined in accordance with sections 10 and 10a of this Act and sections 53c and 104g of the Insurance Supervision Act; where an enterprise domiciled in another EEA state or in a non-EEA state is to be included in the calculation and is not already included in the calculation pursuant to section 10a of this Act or section 104g of the Insurance Supervision Act, the solvency requirement provisions of the respective country of domicile shall apply.

### **Section 51b Classification as a financial conglomerate**

(1) <sup>1</sup>BaFin shall be responsible for classifying a group of enterprises operating in different sectors as a financial conglomerate. <sup>2</sup>It shall inform the parent enterprise at the head of the group that the group has been classified as a financial conglomerate and of the appointment of the superordinated financial conglomerate enterprise; where the group is not headed by a parent enterprise, BaFin shall inform the regulated financial conglomerate enterprise active in the banking and investment services sector with the highest balance sheet total, unless a primary insurance company belonging to the conglomerate with a higher balance sheet total is to be notified pursuant to section 104o (1) sentence 2 of the Insurance Supervision Act (*Versicherungsaufsichtsgesetz*).

(2) BaFin shall revoke the classification of a group of enterprises as a financial conglomerate and the appointment of the superordinated financial conglomerate enterprise if the conditions

pursuant to section 1 (20) are no longer fulfilled, in particular if within the group the relevant ratios pursuant to subsection 51a (2) and (3) number 1 or the amount pursuant to section 51a (3) number 2 fall

- 1 below a threshold of 35 per cent in the case described in section 51a (2);
- 2 below a threshold of 8 per cent in the case described in section 51a (3) number 1;
- 3 below a threshold of 5 billion euro in the case described in section 51a (3) number 2. Subsection (1) sentence 2 shall apply *mutatis mutandis*.

(3) Subject to the provisions of subsection (2), in the cases described in section 51a (5) BaFin may revoke the classification as a financial conglomerate and the appointment of the superordinated financial conglomerate enterprise for the applicable period of three years; subsection (1) sentence 2 shall apply *mutatis mutandis*.

### **Section 51c Exemptions**

BaFin may revocably waive the classification of a group of enterprises as a financial conglomerate or exempt the superordinated financial conglomerate enterprise from all or some of its duties pursuant to sections 13d and 25a (1a) if

- 1 in the case described in section 51a (3) number 2 the group does not reach the threshold laid down in section 51a (3) number 1 and supplementary supervision at conglomerate level is unnecessary, inappropriate or misleading; this may be assumed in particular if
  - (a) the relative size of the smallest financial sector represented, measured in terms either of the average ratio pursuant to section 51a (3) No. 1 or of the balance sheet total or of the solvability requirements of this financial sector, does not exceed 5 per cent, or
  - (b) the market share, measured in terms of the balance sheet total in the banking and investment services sector and in terms of the gross premiums in the insurance sector, does not exceed 5 per cent in any state that is a contracting party to the Agreement on the European Economic Area;
- 2 the exceeding of the thresholds laid down in section 51a (2) and (3) which led to the classification of a group of enterprises as a financial conglomerate is due solely to a substantial change in the structure of the group; such exemption shall not exceed a period of three years, beginning with the next financial year.

## Part V

### Special provisions

#### Section 52 Special supervision

Insofar as institutions are subject to any other government supervision, this shall remain in effect alongside supervision by BaFin.

#### Section 53 Branches of enterprises domiciled outside Germany

(1) <sup>1</sup>If an enterprise domiciled outside Germany maintains a branch in Germany which conducts banking business or provides financial services, that branch shall be deemed to be a credit institution or a financial services institution. <sup>2</sup>If the enterprise maintains several branches in Germany, they shall be deemed to be one institution.

(2) This Act shall apply to the institutions specified in subsection (1) subject to the following provisos.

- 1 The enterprise must appoint at least two natural persons residing in Germany who are authorised to manage the enterprise's business and to represent it in respect of the institution's field of business insofar as the institution conducts banking business or provides financial services and, in providing financial services, is authorised to obtain ownership or possession of funds or securities of customers. These persons shall be deemed to be senior managers. Their names shall be filed for registration in the Commercial Register.
- 2 The institution is obliged to keep separate books and render separate accounts to BaFin and the Deutsche Bundesbank in respect of the business it conducts and the assets of the enterprise used in its business. To this extent, the provisions of the Commercial Code on trading books shall apply *mutatis mutandis*. On the liabilities side of the annual statement of assets and liabilities, the amount of working capital placed at the institution's disposal by the enterprise and the amount of operating surplus retained by the institution to bolster its own funds shall be shown separately. The amount by which the liability items exceed the asset items or by which the asset items exceed the liability items shall be shown separately and in a single sum at the end of the statement of assets and liabilities.
- 3 The statement of assets and liabilities to be drawn up for the end of each financial year pursuant to number 2, together with a statement of income and expenses and notes thereon, shall be deemed to constitute the annual accounts (section 26). Section 340k of the Commercial Code shall apply *mutatis mutandis* to the auditing of the annual accounts subject to the proviso that the auditor is chosen and appointed by the senior managers. The annual accounts of the enterprise for the same financial year shall be submitted along with the annual accounts of the institution.

- 4 The sum total of the amounts shown in the monthly return pursuant to section 25 as working capital placed at the institution's disposal by the enterprise and operating surplus retained by the institution to bolster its own funds, less the amount of a credit balance on inter-branch settlement account, if any, shall be deemed to constitute the institution's own funds. In addition, capital paid up against the granting of participation rights or on account of the incurrance of longer-term subordinated liabilities or short-term subordinated liabilities, and net profit (section 10 (2c) sentence 1 number 1) shall be counted as part of the institution's liable capital or tier 3 capital if the conditions stipulated in section 10 (5), (5a) or (7) relate in each case to the entire enterprise; section 10 (1), (2) sentences 3 and 4, (2c) sentences 2 to 5, (3b), (6), (6a) and (9) shall apply *mutatis mutandis* subject to the proviso that the own funds pursuant to sentence 1 are deemed to be tier 1 capital.
- 5 Authorisation may also be refused if reciprocity on the basis of international agreements is not assured. Authorisation shall be revoked if and insofar as the enterprise's authorisation to conduct banking business or provide financial services has been revoked by the authority responsible for supervising the enterprise outside Germany.
- 6 For the purposes of section 36 (1), the institution shall be deemed to be a legal person.
- 7 The institution shall promptly notify BaFin and the Deutsche Bundesbank of the establishment of new branches and the closure of branches in Germany.

(2a) For the provisions of this Act relating to an institution which is a subsidiary of an enterprise domiciled outside Germany, the branch shall be deemed to be a wholly owned subsidiary of the institution's central office domiciled outside Germany.

(3) For litigation relating to the business undertakings of a branch within the meaning of subsection (1), the place of jurisdiction of the affiliate, pursuant to section 21 of the Code of Civil Procedure, may not be contractually excluded.

(4) Subsections (2) to (3) shall not apply if they conflict with international agreements which have been approved by the legislative bodies in the form of a Federal law.

(5) <sup>1</sup>If a decision has been taken to close a branch, this shall be filed for registration in the Commercial Register of the court relevant for the branch and all legal actions shall bear the note "in liquidation". <sup>2</sup>The authorisation granted shall be returned to BaFin.

(6) <sup>1</sup>The closure of the branch, which must likewise be entered in the Commercial Register, may be carried out only with BaFin's consent. <sup>2</sup>As a rule, such consent shall be refused if it has not been proven that all of the branch's business has been settled.

### **Section 53a Representative offices of institutions domiciled outside Germany**

<sup>1</sup>An institution domiciled outside Germany may establish or operate a representative office in Germany if it is authorised to conduct banking business or provide financial services in its

home state and if it has its head office there. <sup>2</sup>The institution shall promptly notify BaFin and the Deutsche Bundesbank of its intention to establish a representative office, as well as the realisation of that intention. <sup>3</sup>BaFin shall provide the institution with confirmation of the receipt of such notification. <sup>4</sup>The representative office, including its senior managers, may not commence operations until the institution has received confirmation from BaFin. <sup>5</sup>The institution shall promptly notify BaFin and the Deutsche Bundesbank of the relocation or closure of the representative office.

### **Section 53b Enterprises domiciled in another EEA state**

(1) <sup>1</sup>A deposit-taking credit institution or a securities trading firm domiciled in another EEA state may conduct banking business or provide financial services in Germany, either through a branch or by providing cross-border services, without authorisation from BaFin if the enterprise has been granted approval by the competent authorities of the home state, the business it conducts is covered by the approval granted and the enterprise is supervised by the competent authorities in accordance with the directives issued by the European Communities. <sup>2</sup>Sentence 1 shall apply *mutatis mutandis* to e-money institutions. <sup>3</sup>Section 53 shall not apply in this case. <sup>4</sup>This is without prejudice to section 14 of the Industrial Code.

(2) <sup>1</sup>BaFin shall notify an enterprise within the meaning of subsection (1) sentences 1 and 2 intending to establish a branch in Germany – within two months of receiving the documentation relating to the intended establishment of the branch transmitted by the competent authorities of the home state – of the reports to BaFin and the Deutsche Bundesbank prescribed for its operations and shall specify the terms applicable pursuant to subsection (3) sentence 1 to the performance of the branch's planned operations on grounds of public interest. <sup>2</sup>After receipt of the notification from BaFin, but no later than after the end of the period specified in sentence 1, the branch can be established and commence operations. <sup>3</sup>If an enterprise within the meaning of subsection (1) sentence 1 intends to use tied agents, BaFin can ask the competent authorities of the home state for their names.

<sup>4</sup>BaFin may post corresponding information on its website.

(2a) BaFin shall notify an enterprise within the meaning of subsection (1) sentences 1 and 2 intending to engage in operations in Germany by providing cross-border services – within two months of receiving the documentation relating to the intended commencement of the cross-border services transmitted by the competent authorities of the home state – of the terms applicable pursuant to subsection (3) sentence 3 to the performance of the planned operations on grounds of public interest.

(3) <sup>1</sup>The following provisions shall apply *mutatis mutandis* to branches within the meaning of subsection (1) sentences 1 and 2 subject to the proviso that one or more branches of the same enterprise are deemed to be one credit institution, an e-money institution or a financial services institution:

1 sections 3 and 6 (2),

1a section 10 (1) sentences 3 to 8,

- 2 section 11, in the case of a deposit-taking credit institution,  
3 sections 14, 22 and 23,  
4 section 23a, in the case of a deposit-taking credit institution or a financial services  
institution,  
5 section 24 (1) numbers 5 and 7,  
6 sections 24b, 24c, 25 and 25a (1) sentence 6 number 2,  
7 section 25c (2), insofar as the internal organisation requirements for combating  
money laundering and the financing of terrorism are concerned,  
8 sections 25d to 25f, 25h, 37, 39 to 42, 43 (2) and (3), 44 (1) and (6), 44a (1) and (2)  
as well as 44c and 46 to 49, and  
9 section 17 of the Act concerning the Federal Financial Supervisory Authority.

<sup>2</sup>BaFin and the Deutsche Bundesbank shall be notified in writing of any changes in the business plan, especially in the type of business planned and the organisational structure of the branch, the address and the senior managers, as well as in the deposit insurance scheme to which the institution belongs in its home country, no later than one month before such changes enter into force. <sup>3</sup>Section 3, section 23a (in the case of a deposit-taking institution or a financial services institution), sections 37, 44 (1) and sections 44c and 49 as well as section 17 of the Act concerning the Federal Financial Supervisory Authority shall apply *mutatis mutandis* to operations constituting cross-border services pursuant to subsection (1) sentences 1 and 2. <sup>4</sup>Section 23a shall not apply to operators of multilateral trading systems who provide access to such systems in Germany by way of cross-border services.

(4) <sup>1</sup>If BaFin ascertains that an enterprise within the meaning of subsection (1) sentences 1 and 2 is not fulfilling its obligations pursuant to subsection (3) and, in particular, that its liquidity is inadequate, it shall request the enterprise to rectify the shortcoming within a specified period. <sup>2</sup>If the enterprise fails to comply with this request, BaFin shall notify the competent authorities of the home state. <sup>3</sup>If the home state fails to take any measures or if its measures prove to be insufficient, BaFin, after having informed the competent authorities of the home state, may take the necessary measures; if necessary, BaFin may prohibit the enterprise from conducting new business in Germany.

(5) <sup>1</sup>In urgent cases, BaFin may take the necessary measures before initiating the procedure envisaged in subsection (4). <sup>2</sup>It shall promptly notify the Commission of the European Communities and the competent authorities of the home state thereof. <sup>3</sup>BaFin shall modify or set aside the measures if the Commission, after consulting the competent authorities of the home state and BaFin, so decides.

(6) The competent authorities of the home state, after having first notified BaFin, may verify the information needed for the prudential supervision of the branch at the branch concerned, either themselves or through their representative agents.

(7) <sup>1</sup>An enterprise domiciled in another EEA state which conducts banking business within the meaning of section 1 (1) sentence 2 numbers 1 to 3, 5 and 7 to 9, provides financial services within the meaning of section 1 (1a) sentence 2 numbers 7, 9 and 10 or operates as a financial enterprise within the meaning of section 1 (3) may conduct these operations, notwithstanding section 32, without authorisation from BaFin through a branch or by providing cross-border services in Germany if

- 1 the enterprise is a subsidiary of a deposit-taking credit institution or a joint subsidiary of several deposit-taking credit institutions,
- 2 its articles of association or articles of incorporation permit such operations,
- 3 the parent enterprise(s) is (are) authorised to operate as a deposit-taking credit institution in the state in which the enterprise is domiciled,
- 4 the operations performed by the enterprise are likewise conducted in the home state,
- 5 the parent enterprise(s) hold(s) at least 90 per cent of the voting rights in the subsidiary,
- 6 the parent enterprise(s) has (have) submitted convincing evidence of the prudent management of the enterprise to the competent authorities of the enterprise's home state and, with the consent of these competent authorities of the home state, has (have) jointly and severally guaranteed the obligations incurred by the subsidiary, if appropriate, and
- 7 the enterprise is included in the supervision of the parent enterprise on a consolidated basis.

<sup>2</sup>Sentence 1 shall apply *mutatis mutandis* to subsidiaries of enterprises specified in sentence 1 which meet the aforementioned conditions. <sup>3</sup>Subsections (2) to (6) shall apply *mutatis mutandis*.

### **Section 53c Enterprises domiciled in a non-EEA state**

The Federal Ministry of Finance shall be authorised, by way of a statutory order,

- 1 to stipulate that the provisions of this Act concerning foreign enterprises domiciled in another EEA state shall likewise be applied to enterprises domiciled in a non-EEA state insofar as this is necessary in the context of the right of establishment or of service transactions or for supervision on a consolidated basis by virtue of agreements of the European Communities with non-EEA states;
- 2 to order that the provisions of section 53b be applied in full or in part, with full or partial exemption from the provisions of section 53, to enterprises domiciled in a non-EEA state if reciprocity is assured and if
  - (a) the enterprises are supervised in their country of domicile in the areas covered by the exemption in accordance with internationally recognised principles,

- (b) branches of corresponding enterprises domiciled in Germany are afforded comparable exemptions in that state, and
- (c) the competent authorities of the country of domicile are willing to cooperate satisfactorily with BaFin and if this is guaranteed by means of an international agreement.

### **Section 53d Parent enterprises domiciled in a non-EEA state**

(1) If deposit-taking credit institutions, e-money institutions or securities trading firms domiciled in Germany, which are subsidiaries of either an institution or a financial holding company domiciled in a non-EEA state, are not subject to a level of supervision in that non-EEA state which is equivalent to the provisions of this Act relating to supervision on a consolidated basis, BaFin can define the group of enterprises as a group of institutions or a financial holding group and an institution as a superordinated enterprise; the provisions of this Act relating to supervision on a consolidated basis shall apply *mutatis mutandis* in this case.

(2) Subsection (1) shall apply *mutatis mutandis* to regulated financial conglomerate enterprises in the banking and investment services sector domiciled in Germany, which are subsidiaries of either a regulated financial conglomerate enterprise or a mixed financial holding company domiciled in a non-EEA state and are not subject to a level of supervision in that non-EEA state which is equivalent to the provisions of this Act relating to the supervision of financial conglomerates.

(3) <sup>1</sup>Notwithstanding subsections (1) and (2), BaFin, in individual cases, can duly ensure adequate supervision on a consolidated basis or at conglomerate level in other ways. <sup>2</sup>In particular, it can demand that

- 1 in the cases cited in subsection (1), a financial holding company domiciled in Germany or in another EEA state be established, to which the provisions of this Act relating to supervision on a consolidated basis shall apply *mutatis mutandis*;
- 2 in the cases cited in subsection (2), a mixed financial holding company domiciled in Germany or in another EEA state be established, to which the provisions of this Act relating to supplementary supervision at conglomerate level shall apply *mutatis mutandis*.

### **Section 53e Cooperation with the Commission of the European Communities**

(1) <sup>1</sup>BaFin shall report to the Commission of the European Communities

- 1 the granting of authorisation to a deposit-taking credit institution or an e-money institution;

- 2 the granting of authorisation pursuant to section 32 (1) to the subsidiary of an enterprise domiciled in a non-EEA state; the structure of the group shall be outlined in the report;
- 3 (Repealed)
- 4 the number and nature of the cases in which the establishment of a branch in another EEA state has foundered because BaFin has failed to forward the information specified in section 24a (1) sentence 2 to the competent authorities of the host state;
- 5 the number and nature of the cases in which measures have been taken pursuant to section 53b (4) sentence 3 and (5) sentence 1;
- 6 the general difficulties which securities trading firms face in establishing branches, setting up subsidiaries, conducting banking business, providing financial services or in performing the activities specified in section 1 (3) sentence 1 numbers 2 to 8 in a non-EEA state;
- 7 an application for authorisation submitted by the subsidiary of an enterprise domiciled in a non-EEA state.

The reports pursuant to sentence 1 number 7 shall be submitted only at the Commission's request.

(2) <sup>1</sup>BaFin shall report to the Commission of the European Communities

- 1 the notification of the classification of a group of enterprises as a financial conglomerate pursuant to section 51b (1);
- 2 the principles which BaFin applies, in agreement with the other competent EEA authorities, regarding the monitoring of intra-group transactions and risk concentrations;
- 3 the approach chosen in cases described in section 53d (3).

(3) <sup>1</sup>BaFin shall consult the Commission of the European Communities beforehand

- 1 in cases described in section 53d (1) if it would be responsible for consolidated supervision according to the Banking Directive. BaFin will take account of the guidance given by the European Banking Committee in accordance with Article 143 (2) of the Banking Directive;
- 2 in cases described in section 53d (2) if it would act as the coordinator in accordance with Directive 2002/87/EC. BaFin will take account of the guidance given by the Financial Conglomerates Committee in accordance with Article 21 (5) of Directive 2002/87/EC.

## **Part VI**

### **Provisions on penalties and fines**

#### **Section 54 Prohibited business, operating without authorisation**

(1) Anyone who

- 1 conducts business which is prohibited under section 3, also in conjunction with section 53b (3) sentence 1 or 2, or
- 2 conducts banking business or provides financial services without the authorisation required under section 32 (1) sentence 1,

shall be punished by a term of imprisonment of up to three years or by a fine.

(2) If the violator acts with negligence, the punishment shall be imprisonment of up to one year or a fine.

#### **Section 55 Violation of the duty to report insolvency or overindebtedness**

(1) Anyone who fails to give notice or does not do so correctly, in full or in time contrary to section 46b (1) sentence 1, also in conjunction with section 53b (3) sentence 1, shall be punished by a term of imprisonment of up to three years or by a fine.

(2) If the violator acts with negligence, the punishment shall be imprisonment of up to one year or a fine.

#### **Section 55a Unauthorised use of data on loans of 1.5 million euro or more**

(1) Anyone who uses data contrary to section 14 (2) sentence 10 shall be punished by a term of imprisonment of up to two years or by a fine.

(2) The violation shall be investigated only upon application.

#### **Section 55b Unauthorised public disclosure of data on loans of 1.5 million euro or more**

(1) Anyone who publicly discloses data contrary to section 14 (2) sentence 10 shall be punished by a term of imprisonment of up to one year or by a fine.

(2) If the violator acts for monetary consideration or with the intention of enriching himself or a third party or in order to damage a third party, the punishment shall be a term of imprisonment of up to two years or a fine.

(3) The violation shall be investigated only upon application.

## **Section 56 Provisions on administrative fines**

(1) An administrative offence shall be deemed to have been committed by anyone who contravenes an enforceable order pursuant to section 36 (1) or (2) sentence 1.

(2) An administrative offence shall be deemed to have been committed by anyone who intentionally or recklessly

- 1 fails to give notice or does not do so correctly, in full or in time contrary to section 2c (1) sentence 1, 5 or 6, in each case also in conjunction with a statutory order pursuant to section 24 (4) sentence 1,
- 2 contravenes a statutory order pursuant to section 2c (1) sentence 3 insofar as, for a specified offence, it refers to this provision on administrative fines,
- 3 contravenes an enforceable prohibition or order pursuant to
  - (a) section 2c (1b) sentence 1 or (2) sentence 1, or
  - (b) section 12a (2) sentence 1,
- 4 fails to give notice or does not do so correctly, in full or in time contrary to section 2c (3) sentence 1 or 4, section 10 (8) sentence 1 or 3, section 12a (1) sentence 3, section 13 (1) sentence 1, also in conjunction with subsection (4), (2) sentence 5 or 8, in each case also in conjunction with section 13a (2), section 13 (3) sentence 2 or 6, section 13a (1) sentence 1, also in conjunction with subsection (6), (3) sentence 2 or 6, section 14 (1) sentence 1 in conjunction with a statutory order pursuant to section 22 sentence 1 number 13, section 14 (1) sentence 2, in each case also in conjunction with section 53b (3) sentence 1, section 15 (4) sentence 5, section 24 (1) numbers 4 to 10, 12 or 13, number 5 or 7, in each case also in conjunction with section 53b (3) sentence 1, section 24 (1a), section 24 (3) sentence 1 or (3a) sentence 1 number 1 or 2 or sentence 2, in each case also in conjunction with sentence 5, section 24 (3a) sentence 1 number 3, section 24a (1) sentence 1, also in conjunction with subsection (3) sentence 1, or (4) sentence 1, also in conjunction with sentence 2, in each case also in conjunction with a statutory order pursuant to section 24a (5), section 28 (1) sentence 1 or section 53a sentence 2 or 5, in each case also in conjunction with a statutory order pursuant to section 24 (4) sentence 1,
- 5 fails to submit a set of interim accounts, an interim audit report, a monthly return, a set of annual accounts, a management report, an audit report, a set of group accounts or a group management report, or does not do so correctly, in full or in time contrary to section 10 (3) sentence 5 or 6, section 10a (10) sentence 5 or 6, section 25 (1) sentence 1 or (2) sentence 1, in each case in conjunction with a statutory order pursuant to subsection (3) sentence 1, in each case also in conjunction with section 53b (3) sentence 1, or contrary to section 26 (1) sentence 1, 3 or 4 or subsection (3),
- 6 incurs an exposure or fails to ensure that exposures do not exceed the specified limit contrary to section 13 (3) sentence 1 or section 13a (3) sentence 1,

- 7 fails to ensure that large exposures do not exceed the specified limit contrary to section 13 (3) sentence 5 or section 13a (3) sentence 5, or
- 8 commences activities contrary to section 53a sentence 4.

(3) An administrative offence shall be deemed to have been committed by anyone who intentionally or recklessly

- 1 contravenes an enforceable order pursuant to section 6a (1),
- 1a fails to submit a report or does not do so correctly, in full or in time contrary to section 10 (5) sentence 7 or (5a) sentence 7, in each case in conjunction with a statutory order pursuant to section 24 (4) sentence 1,
- 2 holds a qualified participating interest contrary to section 12 (1) sentence 1 or 2,
- 3 fails to ensure that the group does not hold a qualified participating interest contrary to section 12 (2) sentence 1 or 2,
- 4 incurs an exposure contrary to section 18 sentence 1,
- 4a makes payments contrary to section 22i (3) sentence 1, also in conjunction with section 22n (5) sentence 4,
- 5 contravenes an enforceable order pursuant to section 23 (1), also in conjunction with section 53b (3) sentence 1, section 25a (1) sentence 8 or (3) sentence 1, section 26a (3), section 45 (1) or (3) or section 45a (1) sentence 1,
- 6. fails to provide information or does not do so correctly, in full, in the prescribed manner or in time contrary to section 23a (1) sentence 3, also in conjunction with section 53b (3),
- 7 fails to notify a customer, BaFin or the Deutsche Bundesbank or does not do so correctly, in full, in the prescribed manner or in time contrary to section 23a (2), also in conjunction with section 53b (3),
- 7a fails to maintain a data file or does not do so correctly or in full contrary to section 24c (1) sentence 1,
- 7b does not ensure that BaFin has automated access to the data at all times contrary to section 24c (1) sentence 5,
- 7c establishes or maintains a correspondent banking relationship or any other business relationship with a shell bank contrary to section 25h number 1,
- 7d sets up or maintains an account contrary to section 25h number 2,
- 8 contravenes an enforceable condition pursuant to section 32 (2) sentence 1,
- 9 fails to provide information or does not do so correctly, in full or in time, or fails to submit documentation or does not do so correctly, in full or in time contrary to section 44 (1) sentence 1, also in conjunction with section 44b (1) or section 53b (3) sentence 1, section 44 (2) sentence 1 or section 44c (1), also in conjunction with section 53b (3) sentence 1,

- 10 does not acquiesce to a measure contrary to section 44 (1) sentence 4, also in conjunction with section 44b (2) or section 53b (3), (2) sentence 4, (4) sentence 3, (5) sentence 4 or section 44c (5) sentence 1, also in conjunction with section 53b (3),
- 11 fails to take a specified measure or does not do so in time contrary to section 44 (5) sentence 1,
- 12 contravenes an enforceable order pursuant to section 46 (1) sentence 1 or section 46a (1) sentence 1, in each case also in conjunction with section 53b (3) sentence 1, or
- 13 contravenes a statutory order pursuant to section 47 (1) number 2 or 3 or section 48 (1) sentence 1 insofar as, for a specified offence, it refers to this provision on administrative fines.

(4) An administrative offence shall be deemed to have been committed by any person who infringes Regulation (EC) No 1781/2006 of the European Parliament and of the Council of 15 November 2006 on information on the payer accompanying transfers of funds (OJ EU L 345/1) if he/she, when transferring funds, intentionally or recklessly

- 1 fails to ensure that complete information on the payer is transmitted contrary to Article 5 (1),
- 2 fails to verify some of the information on the payer or does not do so in time contrary to Article 5 (2), also in conjunction with (4),
- 3 fails to transmit the information on the payer or does not do so correctly or in full contrary to Article 7 (1),
- 4 fails to have effective procedures in place to detect whether the specified information on the payer is missing contrary to Article 8 sentence 2,
- 5 fails to reject the transfer or does not do so in time or fails to ask for complete information on the payer or does not do so in time contrary to Article 9 (1) sentence 1,
- 6 fails to keep records of any information received on the payer for at least five years contrary to Article 11 or Article 13 (5), or
- 7 fails to ensure that all information received on the payer that accompanies a transfer of funds is kept with the transfer contrary to Article 12.

(5) A breach of administrative regulations may be punished by means of an administrative fine of up to €500,000 in the cases described in subsection (1), subsection (2) number 3 letter (a), numbers 6 and 7 as well as subsection (3) number 12, an administrative fine of up to €150,000 in the cases described in subsection (2) numbers 1, 2 and 3 letter (b) as well as subsection (3) numbers 4 to 10, and by means of an administrative fine of up to €50,000 in all of the other cases described.

### **Sections 57 and 58 (Repealed)**

## **Section 59 Administrative fines imposed on enterprises**

Section 30 of the Act on Breaches of Administrative Regulations shall also apply to enterprises within the meaning of section 53b (1) sentence 1 and (7) sentence 1 operating through a branch or by providing cross-border services in Germany.

## **Section 60 Competent administrative authority**

The administrative authority within the meaning of section 36 (1) number of the Act on Breaches of Administrative Regulations is BaFin.

## **Section 60a Notifications in criminal cases**

(1) <sup>1</sup>In criminal proceedings initiated against the proprietors or senior managers of institutions as well as against holders of qualified participating interests in institutions or their legal representatives or general partners on account of violating their professional duties or committing other criminal acts in carrying out or in connection with carrying out a trade or operating any other kind of business enterprise, as well as in criminal proceedings relating to criminal acts pursuant to section 54, the court, the criminal prosecution authority or the penal enforcement authority shall, if a public action is brought, transmit to BaFin

- 1 the indictment or the petition in lieu of an indictment;
- 2 the application for the issue of a fixed penalty order, and
- 3 the decision concluding the proceedings together with the grounds for the decision;

if an appeal has been lodged against the decision, the decision shall be transmitted together with a reference to the appeal that has been lodged. <sup>2</sup>In proceedings concerning criminal acts committed through recklessness, the information to be transmitted under numbers 1 and 2 shall be transmitted only if the transmitting agency believes that decisions or other measures need to be taken by BaFin promptly.

(1a) In criminal proceedings which concern criminal acts pursuant to section 54, the criminal prosecution authority shall inform BaFin as soon as preliminary investigations are initiated.

(2) <sup>1</sup>If, in criminal proceedings, facts become otherwise known which point to irregularities in an institution's business operations, and if the transmitting agency believes that these need to be made known to BaFin so that it can take measures pursuant to this Act, the court, the criminal prosecution authority or the penal enforcement authority shall likewise transmit these facts, unless it is clear to the transmitting agency that protecting the interests of the party concerned should take precedence. <sup>2</sup>Due consideration should thereby be given to how well substantiated the findings to be transmitted are.

(3) <sup>1</sup>Upon request, BaFin shall be granted access to the files unless it is clear to the party granting access to the files that protecting the interests of the party concerned should take precedence. <sup>2</sup>Subsection (2) sentence 2 shall apply *mutatis mutandis*.

## **Part VII**

### **Transitional and final provisions**

#### **Section 61 Authorisation for existing credit institutions**

If a credit institution was permitted to conduct banking business on the scale specified in section 1 (1) at the time this Act came into force, the authorisation required pursuant to section 32 shall be deemed to have been granted. The period specified in section 35 (1) shall begin with the entry into force of this Act.

#### **Section 62 Transitional provisions**

(1) The legislation already existing in the field of banking and the orders issued by virtue of the existing legislation shall remain in force, except as otherwise provided by this Act. This is without prejudice to legislation prescribing more extensive requirements than those embodied in this Act for the business activities of certain categories of credit institutions.

(2) Functions and powers assigned under Federal legislation to the banking supervisory authority shall devolve upon BaFin.

(3) This is without prejudice to the responsibilities of the German regional governments (*Länder*) for recognition as a relocated financial institution pursuant to the Thirty-fifth Regulation Implementing the Conversion Act (*Fünfunddreissigste Durchführungsverordnung zum Umstellungsgesetz*), for confirmation of the conversion account and the old bank account, and for functions and powers under the Securities Validation Acts (*Wertpapierbereinigungsgesetze*) and the Act on the Validation of German External Bonds (*Bereinigungsgesetz für deutsche Auslandsbonds*).

#### **Section 63 (Repeal of and amendments to legal provisions)**

##### **Section 63a Special provisions relating to the territory specified in Article 3 of the Unification Treaty (*Einigungsvertrag*)**

(1) If a credit institution domiciled in the German Democratic Republic including Berlin (East) was allowed on 1 July 1990 to conduct banking business on the scale specified in section 1 (1), the authorisation pursuant to section 32 shall be deemed to have been granted.

(2) BaFin may exempt certain categories of credit institutions or individual credit institutions domiciled in the territory specified in Article 3 of the Unification Treaty from obligations under this Act if this appears appropriate for special reasons, in particular because the law of the territory specified in Article 3 of the Unification Treaty has not yet been brought into line with the law of the Federal Republic of Germany.

(3) (Repealed)

## **Section 64 Successor enterprises to Deutsche Bundespost**

(1) <sup>1</sup>From 1 January 1995 the authorisation pursuant to section 32 shall be deemed to have been granted to POSTBANK, a successor enterprise to Deutsche Bundespost. <sup>2</sup>For the purpose of consolidation pursuant to section 19 (2) sentence 1, capital shares which are held in the successor enterprises to Deutsche Bundespost by the Bundesanstalt für Post und Telekommunikation Deutsche Bundespost shall be disregarded until 31 December 2002.**Section 64a (Repealed)**

## **Section 64b Capital of existing credit institutions**

(1) <sup>1</sup>Deposit-taking credit institutions which are authorised pursuant to section 32 on 1 January 1993, may have at their disposal an initial capital, notwithstanding section 33 (1) sentence 1 number 1 letter (d), which is lower than the equivalent of 5 million euro. <sup>2</sup>In this case the initial capital may not fall below the level available on 31 December 1990. <sup>3</sup>In the case of deposit-taking credit institutions authorised after 31 December 1990, the initial capital may not fall below the level available at the time authorisation was granted.

(2) If the preconditions of subsection (1) are met, section 35 (2) number 3, in conjunction with section 33 (1) sentence 1 number 1 letter (d), on the revocation of the authorisation shall not apply.

(3) If control over a credit institution which has taken advantage of the preferential treatment specified in subsection (1) changes, section 33 (1) sentence 1 number 1 letter (d) on the amount of the capital shall apply to that credit institution.

(4) <sup>1</sup>In the case of a merger between two or more credit institutions which have taken advantage of the preferential treatment specified in subsection (1), the initial capital of the credit institution resulting from the merger may be below the equivalent of 5 million euro, subject to BaFin's approval, if there is no danger that the credit institution might fail to meet its obligations to its creditors. <sup>2</sup>However, in this case the initial capital of the merged credit institution must at least equal the total initial capital of the merging credit institutions available at the time of the merger.

(5) <sup>1</sup>BaFin may grant the credit institution a grace period within which it must comply with the capital requirements specified in subsection (1) sentence 2 or 3 or subsection (4) sentence 2, or discontinue its activities. <sup>2</sup>If a credit institution lastingly fails to meet these capital requirements, section 35 (2) number 3 on the revocation of the authorisation shall apply *mutatis mutandis*.

## **Section 64c (Repealed)**

## **Section 64d Transitional arrangement for large exposures**

<sup>1</sup>Until 31 December 1998 the reporting threshold for large exposures as specified in section 13 (1) sentence 1 and for the large exposure limit in overall business as specified in section

13a (1) sentence 3 shall be 15 per cent instead of 10 per cent, and the individual large exposure limit as specified in section 13 (3) sentence 1 or 3, the individual large exposure limit on the banking book as specified in section 13a (3) sentence 1 or 3 and the individual large exposure limit in overall business as specified in section 13a (4) sentence 1 or 3 and 4 shall be 40 per cent instead of 25 per cent or 30 per cent instead of 20 per cent, respectively. <sup>2</sup>The exposures shall be reduced to the individual large exposure limits specified in section 13 (3) sentence 1 or 3 and section 13a (4) sentence 1 or 3 by 31 December 2001. <sup>3</sup>Sentence 2 shall not apply to exposures which were incurred before 1 January 1996 and which do not fall due until after 31 December 2001 by virtue of the contractual conditions. <sup>4</sup>In the case of institutions whose liable capital did not exceed 7 million euro on 5 February 1993, the periods specified in sentences 1 and 2 shall be extended by five years in each case; sentence 3 shall apply *mutatis mutandis*. <sup>5</sup>Sentence 4 shall not apply if such an institution was or will be merged with another institution after 5 February 1993 and if the liable capital of the merged credit institutions exceeds 7 million euro.

#### **Section 64e Transitional provisions for the Sixth Act Amending the Banking Act**

(1) For a credit institution which on 1 January 1998 is authorised to conduct business as a deposit-taking credit institution, the authorisation to conduct principal broking services, underwriting business, prepaid card business and network money business and to provide financial services shall be deemed to have been granted as of this date.

(2) <sup>1</sup>Financial services institutions and securities trading banks which were legitimately operating on 1 January 1998 without authorisation from BaFin shall report their activities which require authorisation under this Act and their intention to continue such activities to BaFin and the Deutsche Bundesbank by 1 April 1998. <sup>2</sup>If the report has been submitted by this date, authorisation pursuant to section 32 shall be deemed to have been granted for the scope of activities specified. <sup>3</sup>BaFin shall confirm the specified activities which require authorisation under this Act within three months of receipt of the report. <sup>4</sup>Within three months of receipt of BaFin's confirmation the institution shall submit a supplementary report to BaFin and the Deutsche Bundesbank which satisfies the material requirements under section 32. <sup>5</sup>If the supplementary report is not submitted in time, BaFin may revoke the authorisation granted pursuant to sentence 2; this is without prejudice to section 35.

(3) <sup>1</sup>Section 35 (2) number 3 in conjunction with section 33 (1) sentence 1 number 1 letters (a) to (c) and section 24 (1) number 9 on the initial capital shall apply only as from 1 January 2003 to institutions for which authorisation is deemed to have been granted pursuant to subsection (2). <sup>2</sup>As long as the initial capital of the institutions described in sentence 1 is smaller than the amount required under section 33 (1) sentence 1 number 1, it may not fall below the average level over the preceding six months; the average level shall be calculated every six months and reported to BaFin. <sup>3</sup>If the average level pursuant to sentence 2 is undershot, BaFin may revoke the authorisation. <sup>4</sup>Section 10 (1) to (8) and sections 10a, 11 and 13 to 13b shall apply to institutions described in sentence 1 only as from 1 January 1999, unless they establish a branch or provide cross-border services in other EEA states pursuant to section 24a. <sup>5</sup>Securities trading firms for which authorisation is deemed to have

been granted pursuant to subsection (2) and which do not apply section 10 (1) to (8) and sections 10a, 11 and 13 to 13b shall inform their customers that they may not establish a branch or provide cross-border services in other EEA states pursuant to section 24a. <sup>6</sup>Institutions for which authorisation is deemed to have been granted pursuant to subsection (2) shall notify BaFin and the Deutsche Bundesbank as to whether they apply section 10 (1) to (8) and sections 10a, 11 and 13 to 13b.

(4) (Repealed)

(5) Proven unencumbered personal assets of the proprietor or of the general partners of a credit institution which on 1 January 1998 is authorised pursuant to section 32 may, upon application, be counted as part of the liable capital to an extent to be determined by BaFin.

#### **Section 64f Transitional provisions for the Fourth Financial Market Promotion Act**

(1) For a credit institution which on 1 July 2002 is authorised to conduct business as a deposit-taking credit institution, authorisation to conduct credit card business shall be deemed to have been granted as of this date.

(2) <sup>1</sup>Financial services institutions and securities trading banks which were legitimately operating on 1 July 2002 without authorisation from BaFin pursuant to section 1 (1a) sentence 2 number 8 shall report their activities which require authorisation under this Act and their intention to continue such activities to BaFin and the Deutsche Bundesbank by 1 November 2002. <sup>2</sup>Section 64e (2) sentences 2 to 5 shall apply *mutatis mutandis*.

(3) to (6) (Repealed)

#### **Section 64g Transitional provisions regarding the Act Implementing the Financial Conglomerates Directive**

(1) Until such time as the statutory order pursuant to section 13d (2) has been issued

- 1 all significant risk concentrations that accrue during a calendar year shall be reported to BaFin and the Deutsche Bundesbank before January 16 of the following year. A risk concentration is significant if the counterparty risk, credit risk or investment risk exposure, to be determined pursuant to sections 13 to 13b, 19 and 20 of this Act, in each case in conjunction with the statutory order pursuant to section 22 of this Act, and section 54 of the Insurance Supervision Act, to a counterparty to be determined pursuant to section 19 (2) of this Act on its own or in total equals or exceeds 10 per cent of the capital requirement at conglomerate level;
- 2 the superordinated financial conglomerate enterprise pursuant to section 10b (3) sentences 6 to 8 or (4) shall promptly report to BaFin and the Deutsche Bundesbank risk concentrations resulting from insurance risks and identified as being significant on the basis of the internal risk management system which ensue from major risks and cumulative risks and risks that take a long time to develop and the causal chain of

which is uncertain. To the extent that such risks also have a direct impact on individual counterparties specified under number 1, this shall be included in the report, broken down by individual counterparty. The insurance risk comprises the potential claim, which shall be determined on the basis of the contractual indemnity and taking account of reinsurance, past damages and mathematical models;

- 3 the superordinated financial conglomerate enterprise pursuant to section 10b (3) sentences 6 to 8 or (4) shall promptly notify BaFin and the Deutsche Bundesbank of any risks that ensue from a combination of and interactions between the individual types of risk;
- 4 all significant intra-group transactions carried out within a financial conglomerate during a calendar year shall be reported to BaFin and the Deutsche Bundesbank before January 16 of the following year. Intra-group transactions notably include
  - (a) loans,
  - (b) sureties, guarantees and other off-balance-sheet transactions,
  - (c) transactions relating to own funds components within the meaning of sections 10 and 10a of this Act and sections 53c and 104g of the Insurance Supervision Act,
  - (d) investments,
  - (e) reinsurance transactions;
  - (f) cost-sharing agreements.

An intra-group transaction is significant if the individual transaction equals or exceeds 5 per cent of the capital requirement at conglomerate level. If one or more conglomerate enterprises conduct several transactions with another conglomerate enterprise during any given financial year, these must be aggregated for each counterparty, even if the individual transaction does not equal 5% of the capital requirement at conglomerate level.

(2) Until such time as the statutory order pursuant to section 13c (1) sentence 2 has been issued, subsection (1) number 4 shall apply *mutatis mutandis* to intra-group transactions with mixed-activity holding companies.

(3) Until such time as the statutory order pursuant to section 24 (4) has been supplemented,

- 1 in connection with reports pursuant to section 24 (3a) sentence 1 number 1,
  - (a) the declarations prescribed by section 8 sentence 2 number 2 of the Reports Regulation (*Anzeigenverordnung*) of 29 December 1997 (Federal Law Gazette I, page 3372) as last amended by Article 8 of the Act of 15 August 2003 (Federal Law Gazette I, page 1657) shall be submitted for the purpose of assessing the trustworthiness of persons who are actually to manage the business of a financial holding company or a mixed financial holding company;
  - (b) the documentation specified in section 8 sentence 2 number 1 of the Reports Regulation of 29 December 1997 (Federal Law Gazette I, page 3372) as last

amended by Article 8 of the Act of 15 August 2003 (Federal Law Gazette I, page 1657) shall be appended for the purpose of assessing the professional qualifications of persons who are actually to manage the business of a financial holding company or a mixed financial holding company;

- 2 section 27 of the Reports Regulation of 29 December 1997 (Federal Law Gazette I, page 3372) as last amended by Article 8 of the Act of 15 August 2003 (Federal Law Gazette I, page 1657) shall apply *mutatis mutandis* to reports concerning a mixed financial holding company pursuant to section 12a (1) sentence 3 and section 24 (3a) sentence 5.

(4) <sup>1</sup>The determination and classification of a cross-sector corporate group as a financial conglomerate pursuant to sections 51a to 51c in conjunction with section 1 (20) shall be undertaken for the first time on the basis of the annual accounts for the financial year ending in 2003; BaFin shall take due account of any material changes during the financial year 2004. <sup>2</sup>The provisions of section 10b on the capital required at conglomerate level shall be applied for the first time on the basis of the accounting records for the financial year starting on 1 January 2005 or the financial year ending during 2005. <sup>3</sup>Reports pursuant to subsection (1) numbers 1 and 4 shall be submitted for the first time as of 16 January 2006.

#### **Section 64h Transitional provisions regarding the Act Implementing the recast Banking Directive and the recast Capital Adequacy Directive**

(1) Exposures incurred before 1 January 2007 which, when applying section 10 (1a) sentence 1 in the wording valid as of 31 December 2006, carry a counterparty-related risk weight of zero may continue to attract a zero weighting up to the end of the loan maturity.

(2) <sup>1</sup>Institutions which, pursuant to the transitional provisions in the statutory order pursuant to section 10 (1) sentence 9, apply instead of the CRSA the requirements of Principle I of the Principles Concerning the Own Funds and Liquidity of Credit Institutions (*Grundsätze über die Eigenmittel und die Liquidität der Kreditinstitute*) in the wording of the announcement of 29 October 1997 (Federal Law Gazette, page 13 555), as last amended pursuant to the announcement of 20 July 2000 (Federal Law Gazette, page 17 077) for their CRSA positions until 1 January 2008, may apply until 31 December 2007, consistently for all exposures, sections 13 to 13b, 14, 19, 20, 22 and 64f (3) and (4) in the wording valid until 31 December 2006 and the Regulation governing large exposures and loans of 1.5 million euro or more (*Grosskredit- und Millionenkreditverordnung*) in the wording valid until 31 December 2006.

<sup>2</sup>Institutions which apply sentence 1 shall promptly report this fact to BaFin and the Deutsche Bundesbank.

(3) <sup>1</sup>If at the time of the changeover in the method of determining the consolidated own funds requirement from the procedure pursuant to section 10a (6) to the procedure pursuant to section 10a (7) for participating interests acquired up to this time there is a capitalised aggregation difference within the meaning of section 10a (6) sentence 9, a deduction process initiated pursuant to section 10a (6) sentence 10 may be continued subject to the proviso that up to 31 December 2015 goodwill replaces the capitalised aggregation

difference and the difference is deducted solely from tier 1 capital. <sup>2</sup>The capitalised aggregation difference may continue to be deducted pursuant to section 10a (6) sentence 10 in the case of participating interests acquired up to 31 December 2006.

(4) <sup>1</sup>If a superordinated institution of a group of institutions within the meaning of section 10a (1) or (2) is obliged by the provisions of the Commercial Code to draw up consolidated accounts, it may, notwithstanding the provision of section 10a (7), apply the procedure pursuant to section 10a (6) when determining the own funds adequacy of the group of institutions until 31 December 2015. <sup>2</sup>Sentence 1 shall apply *mutatis mutandis* if the superordinated enterprise, pursuant to Article 4 of Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (OJ EC L 243/1) in the currently valid wording or pursuant to section 315a (2) of the Commercial Code, is obliged when drawing up the consolidated accounts to apply the international accounting standards adopted pursuant to Articles 3 and 6 of the aforementioned Regulation or applies these pursuant to section 315a (3) of the Commercial Code. <sup>3</sup>Sentences 1 and 2 shall apply *mutatis mutandis* to the superordinated enterprise of a financial holding group within the meaning of section 10a (3) if the financial holding company is obliged by the provisions of the Commercial Code to draw up consolidated accounts, pursuant to Article 4 of Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (OJ EC L 243/1) in the currently valid wording or pursuant to section 315a (2) of the Commercial Code is obliged when drawing up the consolidated accounts to apply the international accounting standards adopted pursuant to Articles 3 and 6 of the aforementioned Regulation or applies these pursuant to section 315a (3) of the Commercial Code. <sup>4</sup>If a superordinated enterprise applies the procedure pursuant to section 10a (7) before 31 December 2015, it shall carry on applying this procedure.

(5) Institutions may use personal data which they have collected before 1 January 2007 in accordance with section 10 (1).

(6) Section 20c shall apply no later than until 31 December 2010.

(7) Section 2 (8a) shall apply no later than until 31 December 2010.

#### **Section 64i Transitional provisions regarding the Act Implementing the Markets in Financial Instruments Directive**

(1) <sup>1</sup>In the case of an enterprise which was authorised to conduct one or more kinds of banking business or financial services within the meaning of section 1 (1a) sentence 2 numbers 1 to 4 on 1 November 2007, authorisation to provide investment advice shall be deemed to have been granted as of that date. <sup>2</sup>In the case of a financial services institution which is not covered by sentence 1, authorisation to provide investment advice shall be deemed to have been granted provisionally as of that date until BaFin renders a decision if the institution submitted a complete application for authorisation by 31 January 2008

pursuant to section 32 (1) sentences 1 and 2, also in conjunction with a statutory order pursuant to section 24 (4).

(2) In the case of an enterprise which was authorised to conduct one or more kinds of banking business or financial services within the meaning of section 1 (1a) sentence 2 numbers 1 to 4 on 1 November 2007 and has hitherto traded in financial instruments for its own account, authorisation to conduct proprietary business shall be deemed to have been granted as of that date.

(3) Subsection (1) sentence 2 shall apply *mutatis mutandis* to an enterprise which became a financial services institution or a securities trading bank on 1 November 2007 by virtue of the expansion of the definition of financial instruments in section 1 (11).

(4) <sup>1</sup>In the case of an enterprise which was authorised to engage in investment broking on 1 November 2007, authorisation to operate a multilateral trading system shall be deemed to have been granted as of that date if the institution submitted a complete application for authorisation by 31 January 2008 pursuant to section 32 (1) sentences 1 and 2, also in conjunction with a statutory order pursuant to section 24 (4), and BaFin did not raise an objection thereto within three months of receiving the complete application for authorisation. <sup>2</sup>BaFin may raise an objection if, in the case of an orderly application for authorisation pursuant to section 32, it would have the right to refuse to grant authorisation pursuant to section 33.

(5) In the case of an enterprise which was authorised to engage in contract broking on 1 November 2007, subsection (1) sentence 2 shall apply *mutatis mutandis* to authorisation to engage in placement business.

#### **Section 64j Transitional provisions regarding the Annual Tax Act 2009**

(1) <sup>1</sup>In the case of an enterprise which was authorised to conduct one or more kinds of banking business within the meaning of section 1 (1) or financial services within the meaning of section 1 (1a) sentence 2 numbers 1 to 4 on 25 December 2008, authorisation to engage in factoring and finance leasing shall be deemed to have been granted as of that date.

(2) <sup>1</sup>For financial services institutions that do not come under subsection (1), authorisation to engage in factoring and finance leasing shall be deemed to have been granted as of December 25 if they report their engagement in these activities by 31 January 2009. <sup>2</sup>For enterprises within the meaning of sentence 1 which at the time this Act enters into force do not exceed at least two of the three size criteria stipulated in section 267 (1) of the Commercial Code, a longer period applies until 31 December 2009. <sup>3</sup>The report must contain the information pursuant to section 32 (1) sentence 2 numbers 2 and 6 letters (a) and (b), the annual accounts for the past financial year or – if the latter were not yet to be drawn up pursuant to the periods specified therefor – for the preceding financial year or – if no annual accounts were yet to be drawn up – the opening balance sheet and a quarterly profit and loss account as well as a current excerpt from the commercial register and the trade registration pursuant to section 14 (1) sentence 1 of the Industrial Code.

**Section 64k Transitional provision regarding the Act Implementing the Acquisition Directive**

The provisions of this Act in the wording valid up to 17 March 2009 shall apply to procedures pursuant to section 2c under which a report has been submitted by 17 March 2009.

**Section 64l Transitional provision regarding authorisation to provide asset management services**

<sup>1</sup>For an institution which is authorised to provide principal broking services, proprietary trading services or financial portfolio management services on 25 March 2009, authorisation to provide asset management services shall be deemed to have been granted as of that date. <sup>2</sup>Authorisation to provide asset management services is not required for products for which a sales prospectus was published by 24 September 2008.

**Section 65 Entry into force**

# **Deposit Guarantee and Investor Compensation Act**

## ***(Einlagensicherungs- und Anlegerentschädigungsgesetz, EAEG)***

In the wording of the announcement of  
16 July 1998 (German Federal Gazette I, p 1842)

Last amended by

Article 1 of the Act of 25 June 2009\* (German Federal Gazette I, p 1528).

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\* Articles 1 and 2 of this Act serve to implement Directive 2009/14/EC amending Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on

deposit-guarantee schemes as regards the coverage level and the payout delay (OJ L 68 of 13 March 2009, p 3).

- Unofficial text -

## Section 1 Definitions

(1) Institutions within the meaning of this Act are

1. deposit-taking credit institutions within the meaning of section 1 (3d) sentence 1 of the German Banking Act (*Gesetz über das Kreditwesen*) which have been granted authorisation pursuant to section 1 (1) sentence 2 numbers 1 and 2 of the Banking Act,
2. credit institutions which have been granted authorisation to conduct banking business within the meaning of section 1 (1) sentence 2 number 4 or 10 of the Banking Act or to provide financial services within the meaning of section 1 (1a) sentence 2 numbers 1 to 4 or sentence 3 of the Banking Act,
3. financial services institutions which have been granted authorisation to provide financial services within the meaning of section 1 (1a) sentence 2 numbers 1 to 4 or sentence 3 of the Banking Act, and
4. German asset management companies (*Kapitalanlagegesellschaften*) within the meaning of section 2 (6) of the Investment Act (*Investmentgesetz*) which have been granted authorisation pursuant to section 7 (1) of the Investment Act and which are authorised to provide the services and ancillary services specified in section 7 (2) numbers 1, 3 and 4 of the Investment Act.

(2) Deposits within the meaning of this Act are credit balances which result from funds left in an account or from intermediate positions within the scope of the business operations of an institution within the meaning of subsection (1) number 1 and which are repayable by same under statutory or contractual provisions. Deposits also include claims which the institution has securitised by issuing a certificate, although not bearer or order debt securities, debt instruments which meet the conditions of Article 22 (4) of Regulation 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ EC L 375 p 3), as well as liabilities arising from own bills.

(3) Securities transactions within the meaning of this Act are banking business or financial services within the meaning of section 1 (1) sentence 2 number 4, 5 or 10 or subsection (1a) sentence 2 numbers 1 to 4 of the Banking Act, or services and ancillary services pursuant to section 7 (2) numbers 1, 3 and 4 of the Investment Act.

(4) Liabilities arising from securities transactions within the meaning of this Act are an institution's obligations to repay funds owed or belonging to investors from securities transactions and which are held for their account in connection with securities transactions. These also include investors' claims to the restitution of instruments which they own and which are held or kept in safe custody for their account in connection with securities transactions.

(5) A compensation event within the meaning of this Act occurs if the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, hereinafter referred to as BaFin) determines that an institution, for reasons directly related to its financial circumstances, is unable to repay deposits or meet liabilities arising from securities transactions and there is no prospect of the deposits being repaid or of the liabilities being met at a later date.

## **Section 2**

### **Institutions' obligation to provide cover**

Institutions must cover their deposits and liabilities arising from securities transactions as provided for under this Act through membership of a compensation scheme.

## **Section 3**

### **Claim to compensation**

(1) If a compensation event occurs, the creditor of an institution has a right to compensation as provided in section 4 from the compensation scheme to which the institution has been assigned.

(2) No claim to compensation pursuant to subsection (1) will be granted to

1. institutions within the meaning of section 1 (1) number 1 and financial institutions within the meaning of Article 1 (6) of Directive 89/646/EEC of the Council of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC (OJ EC L 386, p 1) which are domiciled in Germany or abroad, if they are acting in their own name and for their own account,
2. private and public insurance companies domiciled in Germany or abroad,
3. German asset management companies, including the common funds managed by them, or investment stock corporations or collective investment undertakings domiciled abroad,
4. the German Federal Government, a German state government, a legally dependent special fund of the German Federal Government or a German state government, a German local authority, or the national government, a regional government or a local authority of another country,
5. managers, general partners or members of supervisory bodies of the institution, persons holding 5% or more of the institution's capital, auditors within the meaning of section 28 of the Banking Act and creditors with a similar status or function in an enterprise which, together with the institution, constitutes a group as defined in section 18 of the Stock Corporation Act (*Aktiengesetz*), irrespective of its legal form,

6. spouses, registered partners and first and second-degree relatives of the persons referred to in number 5, unless the deposits, funds or financial instruments stem from the spouses' or relatives' own assets,
7. enterprises which, together with the institution, constitute a group within the meaning of section 18 of the Stock Corporation Act, irrespective of its legal form,
8. creditors who were instrumental in initiating or have taken advantage of particular circumstances at the institution, especially if they have received high interest rates or financial advantages by virtue of individually negotiated agreements, which gave rise to the financial difficulties or significantly contributed to the deterioration of the institution's financial situation,
9. enterprises which, pursuant to the provisions of the third book of the Commercial Code (*Handelsgesetzbuch*), are obliged to compile a management report or are exempted from this obligation only because of their inclusion in consolidated financial statements, comparable enterprises domiciled abroad, and
10. creditors whose claims on the institution are connected to transactions as a result of which a criminal conviction has been obtained against certain persons for money laundering within the meaning of Article 1 of Directive 91/308/EEC of the Council of 10 June 1991 on the prevention of the use of the financial system for the purpose of money laundering (OJ EC L 166 p 77).

If the creditor of an institution has acted for the account of a third party, determination of the claim to compensation in accordance with sentence 1 shall relate to the third party insofar as the fiduciary relationship is clearly labelled as such in the account designation.

(3) The claim of the person entitled to compensation (compensatee) on the compensation scheme is statute-barred after five years.

(4) Disputes about the reasons for and the amount of the claim to compensation shall be settled in the civil courts.

## **Section 4**

### **Scope of the claim to compensation**

(1) The claim to compensation of the creditor of the institution is based on the amount and scope of the creditor's deposits or of the liabilities to the creditor arising from securities transactions, taking account of any set-off and retention rights of the institution. There is no claim to compensation if deposits or funds are not denominated in the currency of an EU member state or in euro.

(2) The amount of the claim to compensation is limited to

1. the equivalent of €50,000 of the deposits, and
2. 90 per cent of the liabilities arising from securities transactions and the equivalent of €20,000.

Liabilities arising from securities transactions of an institution within the meaning of section 1 (1) number 1 authorised to conduct banking business or provide financial services within the meaning of section 1 (1) sentence 2 number 4 or 10 or subsection (1a) sentence 2 numbers 1 to 4 of the Banking Act are deemed to be deposits provided that the liabilities refer to the institution's obligation to obtain the possession or ownership of funds for its customers.

(3) The calculation of the amount of the claim to compensation shall be based on the amount of the deposits or monetary amounts and the market value of the financial instruments upon the occurrence of the compensation event. The claim to compensation includes, up to the limits pursuant to subsection (2), claims to interest. Interest accrues starting on the occurrence of the compensation event up to repayment of the liabilities, and at the latest up to the initiation of insolvency proceedings. The claim to compensation is reduced insofar as the asset loss sustained by the creditor as a result of the compensation event is offset by payments by third parties.

(4) The limit pursuant to subsection (2) refers to the creditor's aggregate claim on the institution, irrespective of the number of accounts, the currency or the location at which the accounts are maintained or the financial instruments are held. The compensation may be paid in euro.

(5) In the case of joint accounts, the limit pursuant to subsection (2) is based on each account holder's relative share. In the absence of special provisions, the deposits, monetary amounts or financial instruments will be attributed to the account holders in equal parts.

(6) If the creditor has acted for the account of a third party, the limit pursuant to subsection (2) shall apply to the third party.

## **Section 5**

### **Compensation procedure**

(1) BaFin shall determine that a compensation event has occurred promptly, but no later than five working days after it has come to its notice that an institution is unable to repay deposits and no later than 21 days after it has come to its notice that an institution is unable to meet obligations arising from securities transactions. It shall also determine that a compensation event has occurred if measures pursuant to section 46a (1) numbers 1 to 3 of the Banking Act have been ordered and they continue for more than six weeks. Objections to and appeals against the determination of a compensation event do not have suspensory effect. BaFin will publicise compensation events which have been determined pursuant to sentences 1 and 2 in the Federal Gazette (*Bundesanzeiger*). BaFin will promptly notify the compensation scheme to which the institution has been assigned of the determination of a compensation event.

(2) The compensation scheme shall promptly notify the institution's creditors of the occurrence of a compensation event and of the deadline pursuant to subsection (3) sentence 1; it will take appropriate measures to compensate the creditors within the period specified in subsection (4). To this end, the institution shall make the documents necessary for the creditors' compensation available to the compensation scheme promptly, and at the latest within one week.

(3) The claim to compensation shall be submitted to the compensation scheme in writing within one year from the date of notification that a compensation event has occurred. The right to compensation is barred after expiry of this period unless the compensatee is not responsible for failing to meet the deadline.

(4) The compensation scheme shall examine the submitted claims promptly. The compensation scheme shall meet duly examined claims which are intended to provide compensation for deposits no later than 20 working days after BaFin has determined that a compensation event has occurred. The compensation scheme shall meet claims which are submitted later than two weeks after the occurrence of a compensation event has been determined no later than 20 working days after receiving the claim. Section 4 (2) sentence 2 shall apply *mutatis mutandis*. In special cases, subject to BaFin's approval, the deadline pursuant to sentences 2 and 3 may be extended up to 30 working days. The compensation scheme shall meet claims which are intended to provide compensation for the institution's liabilities arising from securities transactions no later than three months after it has established eligibility and the amount of the claims. In special cases, subject to BaFin's approval, this period may be extended by up to three months.

(5) Insofar as the compensation scheme meets a compensatee's claim to compensation, the latter's claims on the institution are transferred to the compensation scheme.

(6) If the creditor's claim is connected to business as a result of which persons are under investigation in criminal proceedings in relation to money laundering within the meaning of Article 1 of Directive 2005/60/EC, the compensation scheme may suspend payment of compensation until the proceedings have been terminated.

## **Section 6**

### **Compensation schemes**

(1) Compensation schemes will be set up at the KfW banking group (*Kreditanstalt für Wiederaufbau*) as special Federal funds having no legal personality for each of the categories of institutions referred to in sentence 2.

The categories of institutions are

1. private institutions within the meaning of section 1 (1) number 1,
2. public institutions within the meaning of section 1 (1) number 1, and
3. other institutions.

The compensation schemes may act, sue or be sued in legal actions.

(2) BaFin may, upon request, assign an institution to another compensation scheme if

1. the institution is able to demonstrate a justified interest in the assignment requested,

this does not jeopardise the performance of the function pursuant to subsection (3) of the compensation scheme to which the institution belongs, and

2. the other compensation scheme agrees to the assignment requested.

BaFin may also assign institutions to other compensation schemes if all institutions belonging to one compensation scheme have requested to be assigned to other compensation schemes and these compensation schemes agree to the assignment requested. Contributions and payments which an institution has paid within its previous compensation scheme are not transferred to the new compensation scheme; this also applies if there is a change of compensation scheme by law because the authorisation remit has changed. Details of the liquidation and winding-up of the compensation scheme to which the institutions were hitherto assigned will be regulated by the Federal Ministry of Finance by way of a statutory order.

(3) The compensation schemes are responsible for collecting contributions from the institutions assigned to them, for investing the funds pursuant to section 8 (1) and, if a compensation event occurs, for compensating the creditors of an institution assigned to them for deposits not repaid or for unfulfilled liabilities arising from securities transactions.

(4) The KfW banking group manages the compensation schemes. To that extent it is subject to supervision by BaFin. Section 7 (3) sentences 2 to 4 shall apply *mutatis mutandis*. It receives reasonable remuneration from the special funds for managing the schemes.

(5) BaFin decides on objections to administrative acts by the compensation scheme.

(6) The compensation schemes shall regularly review the functional viability of their systems. They shall inform BaFin of the results of such reviews.

(7) If BaFin becomes aware of circumstances at an institution which threaten to give rise to the occurrence of a compensation event, it shall duly inform the compensation scheme to which the institution has been assigned.

## **Section 7**

### **Entrusted compensation schemes**

(1) The Federal Ministry of Finance shall be authorised to assign, by way of a statutory order, functions and powers of a compensation scheme to a legal person under private law if the latter is prepared to take over the functions of the compensation scheme and offers reasonable assurance that the claims of compensatees will be met (entrusted compensation scheme). A legal person offers adequate assurance if

1. the persons responsible according to law or the articles of association or incorporation for managing and representing the legal person are trustworthy and have the necessary professional qualifications,
2. it has the facilities and organisation necessary to perform its functions, in particular to collect contributions, manage the funds and pay compensation claims, and for this purpose has resources of its own equivalent to one million euro or more.

The Federal Ministry of Finance may, by way of the statutory order pursuant to sentence 1, reserve the right to approve the legal person's articles of association or incorporation and changes thereto.

(2) If entrusted with responsibility for the compensation scheme in accordance with subsection (1), the legal person under private law succeeds to the rights and obligations of the compensation scheme concerned in accordance with section 6. The provisions of section 6 (1) and (2) on the assignment of the institutions and of section 6 (5) to (7) shall apply *mutatis mutandis*.

(3) Entrusted compensation schemes are subject to supervision by BaFin. BaFin shall counteract irregularities which may impair the proper handling of the compensation or jeopardise the assets accumulated for paying compensation. BaFin may issue orders that are appropriate and necessary to remedy or prevent such irregularities. BaFin has the right to receive information from and audit the compensation schemes in accordance with section 44 (1) of the Banking Act.

## **Section 8**

### **Financial resources of compensation schemes**

(1) The funds for paying compensation are raised by collecting contributions from the institutions. The institutions are required to pay contributions to the compensation scheme to which they have been assigned. The contributions paid by the institutions must cover the claims on the compensation scheme as well as the administrative and other costs incurred in connection with the compensation scheme's activities. The funds accumulated for compensation purposes shall be invested with a view to diversifying the risk in a way that ensures the greatest possible safety and adequate liquidity of the invested assets paired with a reasonable return.

(2) The institutions are required to pay annual contributions at the end of each accounting year. The accounting year extends from 1 October of one year to 30 September of the following year. An upper limit for the collection of annual contributions shall be specified in the statutory order pursuant to subsection (8) sentence 1. Institutions assigned to a compensation scheme after 1 August 1998 have to make a one-off payment in addition to the annual contribution. Subject to BaFin's approval, the compensation scheme may lower or suspend compulsory contributions if the funds available for paying compensation are sufficient.

(3) After being informed by BaFin of a compensation event pursuant to section 5 (1) sentence 5, the compensation scheme shall promptly determine the amount of funds required and thereafter promptly collect special contributions subject to subsection (4) if this is necessary in order to carry out the compensation procedure. The compensation scheme is entitled to cover the funds needed for a compensation event by way of special contributions, which are to be collected in partial amounts, insofar as the obligation pursuant to section 5 (4) can be met in this way taking into account the duration, size and circumstances of the compensation event. If partial amounts are collected, the compensation scheme shall inform the institutions concerned about the procedure it intends to follow.

(3a) Special contributions are advance payments to cover the funds needed if a compensation event occurs. The funds needed are the aggregate compensation payable in a compensation event plus the administrative and other costs incurred in

handling the compensation event less the funds available to the compensation scheme at the time the compensation event was determined. The compensation scheme shall determine the aggregate compensation on the basis of the documents to be provided by the institutions pursuant to section 5 (2) sentence 2. If the aggregate compensation cannot be determined with an adequate degree of precision on the basis of the documents provided, the compensation scheme shall estimate the amount on the basis, in particular, of the data at its disposal concerning the compensation event, the average compensation payment and the costs incurred in previous compensation events at the institutions assigned to it. If the compensation scheme ascertains that the funds actually needed for the aggregate compensation exceed the amount determined in accordance with sentence 3 or 4, the compensation scheme shall be required to collect further special contributions promptly after establishing this fact in order to cover the need for funds. Special contributions fall due as soon as notification concerning the special contributions is given.

(4) If the funds needed by the compensation scheme cannot be covered in good time to meet its obligations pursuant to section 5 (4) by collecting special contributions, it must take out a loan. If it is expected that the compensation scheme will be unable to service the loan from the available assets, it must collect special payments to cover capital repayments, interest payments and charges. Special payments fall due six weeks prior to maturity of the loan repayments in each case, although no sooner than two weeks after notification concerning the special payments is given. Instead of collecting contributions in accordance with subsection (3) sentence 1, the compensation scheme may take out a loan if it can be expected to repay this loan completely, including interest and charges, within the current and the subsequent accounting year out of the available assets without having to collect special payments.

(5) The obligation to pay special contributions and special payments applies to all enterprises which were allocated to the compensation scheme at the beginning of the accounting year in which a special contribution or special payment is collected. This does not apply to institutions which left the compensation scheme before the occurrence of a compensation event was determined.

(6) The amount of each special contribution and special payment is measured by the ratio of the last full annual contribution payable by each individual institution to the total amount of the annual contributions, one-off payments and, in the cases covered by sentence 3, notional annual contributions by all institutions subject to contribution or payment requirements pursuant to subsection (5). In the case of institutions which have not yet had to pay an annual contribution, the last payable annual contribution shall be replaced by the one-off payment pursuant to subsection (2) sentence 4. In cases covered by sentence 2, the statutory order pursuant to subsection (8) sentence 1 may provide that, at an institution's request and after presentation of plausible budgeted figures, the compensation schemes calculate a notional annual contribution to replace the last payable annual contribution if this results in a considerable deviation from the institution's one-off payment. The compensation scheme is entitled to collect several special contributions and special payments in one accounting year. The special contributions and special payments collected in one accounting year may not, in total, exceed five times the last annual contribution payable by an institution or, in the case of institutions which have not yet had to pay an annual contribution, five times the one-off payment or five times the notional annual contribution. If an

institution has paid special contributions or special payments over a period of three consecutive accounting years, special contributions and special payments collected in immediately subsequent years may not exceed, in total, twice the last annual contribution payable by an institution or, in the case of institutions which have not yet had to pay an annual contribution, twice the one-off payment or twice the notional annual contribution in each accounting year. Subject to BaFin's approval, the compensation scheme may wholly or partly exempt an institution from the obligation to pay a special contribution or a special payment if the fulfilment of that institution's obligations towards its creditors would be jeopardised as a result of the total sum of payments to be made to the compensation scheme.

(7) Upon conclusion of a compensation procedure the compensation scheme shall report to the institutions on the use of the special contributions and special payments. It shall refund special contributions and special payments to the institutions after conclusion of the compensation procedure inasmuch as the special contributions were not used to deal with the compensation event or the special payments were not used to service a loan pursuant to subsection (4) sentences 1 and 2.

(8) Details of the annual contributions, the one-off payments, the special contributions and the special payments are regulated by the Federal Ministry of Finance by way of a statutory order and without requiring approval by the Bundesrat (Upper House of Parliament), after consulting the compensation schemes; the computation of the annual contributions, special contributions and special payments must take due account of the type and scale of the insured transactions, the business volume, and the number, size and business structure of the institutions assigned to the compensation scheme as well as their risk of bringing about a compensation event. The statutory order may also contain provisions on collecting interest on arrears for contributions that are paid late, on raising loans and on investing the funds. The Federal Ministry of Finance may delegate this authority to BaFin by way of a statutory order.

(9) Enforcement on the basis of the contribution notices issued by the compensation scheme will take place in accordance with the provisions of the Administration Enforcement Act (*Verwaltungs-Vollstreckungsgesetz*). The copy of the enforceable decision is issued by the compensation scheme. Objections to and appeals against the contribution notices do not have suspensory effect.

(10) The compensation scheme is liable for meeting the obligations pursuant to section 3 (1) solely with the assets available as a result of the contributions paid after deduction of the costs pursuant to subsection (1) sentence 3. An entrusted compensation scheme shall hold and manage these assets separately from its other assets.

## **Section 9**

### **Audit of the institutions**

(1) The compensation scheme shall perform regular and *ad hoc* audits of the institutions assigned to it in order to assess the risk of a compensation event occurring. It shall gear the intensity and frequency of audits pursuant to sentence 1 to the probability of an institution being faced with compensation event and to the total amount of the compensation likely in such an event. Objections to and appeals against audits pursuant to sentences 1 and 2 do not have suspensory effect.

(2) The institutions are required to promptly submit to the compensation scheme to which they have been assigned their approved annual accounts together with the relevant audit report and, if requested, to provide all the information and present all the documents which the compensation scheme needs to perform its functions under this Act. The staff employed or engaged by the compensation scheme shall be permitted to enter the institution's premises and offices during normal working hours insofar as this is necessary for the compensation scheme to perform its functions under this Act. A person obliged to furnish information may refuse to do so in respect of any questions, the answers to which would place him/her or one of his/her relatives referred to in section 383 (1) numbers 1 to 3 of the Code of Civil Procedure (*Zivilprozessordnung*) at risk of criminal prosecution or proceedings under the Act on Breaches of Administrative Regulations (*Gesetz über Ordnungswidrigkeiten*). The person obliged to furnish information shall be informed about his/her right to refuse to do so.

(3) In the case of an enterprise which has submitted to BaFin an application for authorisation in accordance with section 32 (1) sentence 2 of the Banking Act, the compensation scheme to which the institution will be assigned if authorisation is granted may perform audits in order to assess the risk of a compensation event occurring if authorisation is granted.

(4) For the compensation schemes at the KfW banking group, the audits pursuant to subsections (1) and (3) are performed by the Deutsche Bundesbank. On the suggestion of the compensation schemes, BaFin instructs the Deutsche Bundesbank to perform the audits. Entrusted compensation schemes pursuant to section 7 shall have the audits pursuant to subsections (1) and (3) performed by their own expert auditors or commission suitable third parties to perform the audits. Suitable third parties are external auditors, certified public accountants, auditing and public accounting firms as well as other third parties with the requisite skills and experience, unless there are any circumstances which give grounds for suspecting possible conflicts of interest for these persons with regard to the institutions to be audited. The entrusted compensation scheme shall require the persons commissioned with the tasks pursuant to sentence 3 to notify it promptly if such circumstances are found to exist. The audits may not be performed by the auditor of the institution's accounts or the auditor of the institution's disclosure obligations and code of corporate governance. The audited enterprises shall reimburse the costs of the audits to the respective compensation scheme. The compensation schemes shall reimburse staff and other operating expenditure to the Deutsche Bundesbank or, in the cases specified in sentence 3, to the suitable third parties.

(5) The compensation scheme specifies the details of the audits in audit guidelines which require the approval of BaFin.

(6) The staff employed by the compensation scheme as well as persons whose services it uses may enter an institution's business premises during normal office and business hours if BaFin has ordered measures pursuant to section 46a of the Banking Act to be carried out against this institution. All documents which they require to prepare a compensation procedure pursuant to section 5 (1) sentences 1 and 2 are to be placed at their disposal. If parts of the institution have been outsourced to another enterprise, sentences 1 and 2 shall apply *mutatis mutandis* to this enterprise.

(7) The institution shall reimburse the compensation scheme's expenses incurred in executing or preparing a compensation procedure within the meaning of section 5.

(8) If the compensation scheme, while performing an audit pursuant to section 1 or in another way, obtains knowledge of circumstances which substantiate the risk of the occurrence of a compensation event at an institution, it shall notify BaFin promptly.

## **Section 10**

### **Audit of the compensation schemes**

(1) At the end of each calendar year, the compensation schemes shall draw up an annual report and commission an independent external auditor or an independent accounting firm to audit the completeness of the annual report and the correctness of the information given. The compensation schemes shall notify BaFin of the auditor they have appointed promptly after making the appointment. Within one month of receiving of such notification, BaFin may request the appointment of a different auditor if this appears necessary to achieve the object of the audit; objections to and appeals against such requests do not have suspensory effect. The annual report must contain information on the compensation scheme's activities and financial situation, in particular the amount and investment of the funds, the use of the funds to pay compensation claims, the level of the contributions and the administrative costs.

(2) The compensation schemes shall submit the approved annual report to BaFin and the Deutsche Bundesbank by 31 May of each year. The auditor shall submit the report on the audit of the annual report to BaFin and the Deutsche Bundesbank promptly upon completing the audit. BaFin and the Deutsche Bundesbank shall also, at their request, be provided with the information prescribed in subsection (1) sentence 4. Section 9 of the Banking Act shall apply *mutatis mutandis*.

## **Section 11**

### **Exclusion from the compensation scheme**

(1) If an institution fails to meet the contribution or cooperation requirements pursuant to section 8 or section 9, or does not comply with them correctly, in full or in time, the compensation scheme concerned shall notify BaFin and the Deutsche Bundesbank. If the institution also fails to meet its obligations within one month of being called upon by BaFin to do so, the compensation scheme may notify the institution of its exclusion from the compensation scheme after a period of 12 months. Upon expiry of this period the compensation scheme, subject to BaFin's approval, may exclude the institution from the compensation scheme if the institution continues to fail to meet the obligations. Following exclusion, the compensation scheme is liable only for the institution's obligations which originated before expiry of this period.

(2) If the authorisation to conduct deposit business in accordance with section 1 (1) sentence 2 number 1 of the Banking Act or to conduct investment business in accordance with section 1 (3) is rescinded, the compensation scheme is liable only for the institution's obligations which originated before the rescission of the authorisation.

## **Section 12**

### **Schemes safeguarding the viability of institutions**

(1) Institutions within the meaning of section 1 (1) number 1 which are members of the guarantee schemes operated by the regional savings bank and giro associations or the guarantee scheme of the Federal Association of German People's Banks and Raiffeisen Banks (*Bundesverband der Deutschen Volksbanken und Raiffeisenbanken*) are not assigned to any compensation scheme as long as these guarantee schemes, by virtue of their statutes, protect the member institutions themselves, in particular safeguard their liquidity and solvency, and have at their disposal the requisite funds (schemes safeguarding the viability of institutions).

(2) Without prejudice to supervision by other government bodies, schemes safeguarding the viability of institutions are subject to supervision and audit by BaFin with regard to the requirements of subsection (1); section 7 (3) sentence 4 and section 10 shall apply *mutatis mutandis*. The schemes safeguarding the viability of institutions are required to notify BaFin of any changes to their statutes. BaFin informs the Federal Ministry of Finance if facts justify the assumption that a scheme safeguarding the viability of institutions does not meet the requirements of subsection (1). After consulting the relevant scheme safeguarding the viability of institutions, the Federal Ministry of Finance may rule that the requirements of subsection (1) are not met.

## **Section 13**

### **Branches of enterprises domiciled in another state of the European Economic Area**

(1) Branches of an enterprise within the meaning of section 53b of the Banking Act have the right to join a compensation scheme on the conditions applying to domestic institutions, insofar as the amount or scope of compensation under this Act exceeds the cover in the enterprise's home state. Admission is conditional on the enterprise having been granted authorisation in its home state to conduct the business of a deposit-taking credit institution or a securities trading firm within the meaning of section 1 (3d) of the Banking Act.

(2) The amount and scope of cover as defined in subsection (1) is limited to that part of the cover which exceeds the cover provided in the home state. No cover is provided for banking business or financial services involving foreign exchange or units of account.

(3) If a branch which has joined a compensation scheme in accordance with subsection (1) fails to meet its obligations towards the compensation scheme, the compensation scheme shall notify BaFin and the Deutsche Bundesbank. BaFin will call on the branch to meet its obligations within a period to be determined by BaFin. If the branch fails to comply with this request, BaFin will notify the competent authorities of the home state which granted the authorisation referred to in subsection (1) sentence 2. BaFin and the competent authorities of the home state, in cooperation with the compensation scheme, will take all the measures necessary to ensure that the branch meets its obligations under this Act.

(4) If the competent authorities of the home state do not take any measures or if the measures provided for in subsection (3) prove to be inadequate, the compensation scheme, with the approval of the competent authorities of the home state, may exclude the branch from the compensation scheme subject to a period of notice of 12 months. Following exclusion, the compensation scheme will be liable only for the branch's obligations which originated before expiry of this period.

(5) The compensation schemes will cooperate, in consultation with BaFin, with the compensation schemes of the home state in the cases described in subsections (1) to (4).

## **Section 14**

(Repealed)

## **Section 15**

### **Confidentiality requirement**

Persons employed or engaged by the compensation scheme may not disclose or use third-party secrets, in particular, business and trade secrets, without being authorised to do so. Under the Act on the Formal Obligation of Persons without Civil Servant Status (*Gesetz über die förmliche Verpflichtung nichtbeamteter Personen*) of 2 March 1974 (Federal Law Gazette I pp 469, 547), they shall be required by BaFin to perform their duties conscientiously. In particular, such disclosure or use without being authorised to do so within the meaning of sentence 1 shall not be deemed to be given if facts are passed on to BaFin or the Deutsche Bundesbank.

## **Section 16**

### **Non-application of the Insurance Supervision Act**

The provisions of the Insurance Supervision Act (*Versicherungsaufsichtsgesetz*) do not apply to compensation schemes within the meaning of sections 6 and 7 and schemes safeguarding the viability of institutions within the meaning of section 12.

## **Section 17**

### **Provisions on administrative fines**

(1) An administrative offence shall be deemed to have been committed by any person who

1. wilfully or recklessly, in violation of section 9 (2) sentence 1, does not submit the annual accounts with the relevant audit report or does not do so correctly, in full or in time, or
2. wilfully or recklessly, in violation of section 9 (2) sentence 1,
  1. does not provide information or does not do so correctly, in full or in time, or
  2. does not submit documentation or does not do so correctly, in full or in time.

(2) A breach of administrative regulations is punishable by a fine not exceeding €50,000.

(3) The competent administrative authority within the meaning of section 36 (1) number 1 of the Act on Breaches of Administrative Regulations is BaFin.

## **Section 17a**

### **Administrative sanctions**

(1) The compensation scheme can enforce compliance with the orders which it issues within its statutory powers by means of administrative sanctions pursuant to the provisions of the Administration Enforcement Act.

(2) In the case of measures pursuant to section 8 (1) and (2) sentence 1, section 9 (2) sentence 1, (3) and (5) sentences 1 and 2, the maximum amount of the sanction is €50,000; in the case of measures pursuant to section 9 (1) sentence 1, the maximum amount is €100,000.

## **Section 18**

### **Timing of applications**

(1) In the case of a compensation event due to non-fulfilment of obligations arising from investment business, a claim to compensation under this Act only exists if the compensation event in question occurred after 25 September 1998.

(2) Claims to compensation under this Act may be filed for the first time from 1 November 1998. If creditors were notified in accordance with section 5 (2) at an earlier date, the period for filing claims in accordance with section 5 (3) does not begin until 1 November 1998.

## **Section 19**

### **Application and transitional provisions**

(1) The compensation schemes and institutions may, until 31 December 2010, continue to apply section 5 in the version valid until 29 June 2009.

(2) Institutions which left a compensation scheme before 30 June 2009 can no longer be called upon in connection with the settlement of compensation cases with that compensation scheme.

(3) With regard to compensation events which were determined before 30 June 2009 and in the case of which the compensation procedure has not yet been completed, section 8 (3) to (10) in the version valid as from 30 June 2009 shall apply subject to the following provisos:

1. "After being informed by BaFin" pursuant to section 8 (3) sentence 1 shall be replaced by "after 30 June 2009".
2. If the compensation scheme took out a loan before 30 June 2009 to cover its need for funds, the obligation to collect special contributions pursuant to section 8 (3) sentence 1 does not apply insofar as the need for funds is met by the loan.

(4) German asset management companies which, on 29 June 2009, are authorised to provide individual asset management services pursuant to section 7 (2) number 1 of the Investment Act and have not made use of this authorisation for more than one year shall not be deemed to be institutions within the meaning of section 1 (1) number 4 up to 29 September 2009.

Diese Übersetzung hat keinen offiziellen Charakter. Der authentische Text ist der im Bundesgesetzblatt veröffentlichte. Weder der Verlag noch die Autoren können für Fehler oder Auslassungen haftbar gemacht werden.

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## Depotgesetz (DepotG)

in der Fassung der Bekanntmachung vom  
11. Januar 1995 (BGBl. I S. 34), das zuletzt durch  
Artikel 5 des Gesetzes vom 31. Juli 2009 (BGBl. I  
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## Safe Custody Act (DepotG)

in the version promulgated on 11 January 1995  
(BGBl. I p. 34), last amended by Article 5 of the  
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### § 1 Allgemeine Vorschriften

(1) Wertpapiere im Sinne dieses Gesetzes sind Aktien, Kuxe, Zwischenscheine, Zins-, Gewinnanteil- und Erneuerungsscheine, auf den Inhaber lautende oder durch Indossament übertragbare Schuldverschreibungen, ferner andere Wertpapiere, wenn diese vertretbar sind, mit Ausnahme von Banknoten und Papiergeld. Wertpapiere im Sinne dieses Gesetzes sind auch Namensschuldverschreibungen, soweit sie auf den Namen einer Wertpapiersammelbank ausgestellt wurden.

(2) Verwahrer im Sinne dieses Gesetzes ist, wem im Betrieb seines Gewerbes Wertpapiere unverschlossen zur Verwahrung anvertraut werden.

(3) Wertpapiersammelbanken sind Kreditinstitute, die von der nach Landesrecht zuständigen Stelle des Landes, in dessen

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### § 1 General provisions

(1) Securities within the meaning of this Act shall be shares, mining shares, interim certificates, interest, dividend and renewal coupons, bearer debentures or bonds transferable by endorsement and furthermore, other securities, provided that they are fungible, except for bank notes and paper money. Securities within the meaning of this Act shall also be registered bonds provided they were issued to the name of a securities clearing and deposit bank.

(2) A custodian within the meaning of this Act shall be anyone to whom securities are entrusted openly for safe custody within the scope of his business activities.

(3) Securities clearing and deposit banks shall be banks which are recognised under state law as such by the competent au-

Gebiet das Kreditinstitut seinen Sitz hat, als solche anerkannt sind. Die Anerkennung des Kreditinstituts als Wertpapiersammelbank kann, auch nachträglich, im Interesse des Anlegerschutzes von der Erfüllung von Auflagen abhängig gemacht werden. Die Anerkennung und deren Aufhebung sowie Auflagen sind öffentlich bekanntzugeben.

### 1. Abschnitt Verwahrung

#### § 2 Sonderverwahrung

Der Verwahrer ist verpflichtet, die Wertpapiere unter äußerlich erkennbarer Bezeichnung jedes Hinterlegers gesondert von seinen eigenen Beständen und von denen Dritter aufzubewahren, wenn es sich um Wertpapiere handelt, die nicht zur Sammelverwahrung durch eine Wertpapiersammelbank zugelassen sind, oder wenn der Hinterleger die gesonderte Aufbewahrung verlangt. Erwaige Rechte und Pflichten des Verwahrers, für den Hinterleger Verfügungen oder Verwaltungshandlungen vorzunehmen, werden dadurch nicht berührt.

#### § 3 Drittverwahrung

(1) Der Verwahrer ist berechtigt, die Wertpapiere unter seinem Namen einem anderen Verwahrer zur Verwahrung anzuvertrauen. Zweigstellen eines Verwahrers gelten sowohl untereinander als auch in ihrem Verhältnis zur Hauptstelle als verschiedene Verwahrer im Sinne dieser Vorschrift.

(2) Der Verwahrer, der Wertpapiere von einem anderen Verwahrer verwahren läßt (Zwischenverwahrer), haftet für ein Verschulden des Drittverwahrers wie für eigenes Verschulden. Für die Beobachtung der erforderlichen Sorgfalt bei der Auswahl des Drittverwahrers bleibt er auch dann verantwortlich, wenn ihm die Haftung für ein Verschulden des Drittverwahrers durch Vertrag erlassen worden ist, es sei denn, daß die Papiere auf ausdrückliche Weisung des Hinterlegers bei einem be-

thorities of the state on whose territory the bank has its registered office. The recognition of the bank as a securities clearing and deposit bank may also be made dependent subsequently, in the interest of investor protection, dependent on the fulfilment of conditions imposed by such public authorities. The recognition and its revocation as well as the conditions imposed by public authorities must be publicly announced.

### Part 1 Safe custody

#### § 2 Individual safe custody

The custodian shall be obliged to keep the securities with an outwardly identifiable designation of each depositor separately from its own securities and those of third parties if they are securities which are not admitted to collective safe custody by a securities clearing and deposit bank or if the depositor requests separate safe custody. Any rights and obligations of the custodian to dispose of or administer the deposits shall not be affected hereby.

#### § 3 Third party safe custody

(1) The custodian shall be entitled to entrust the securities under its own name to another custodian for safe custody. Branches of a custodian shall be deemed to be different depositaries within the meaning of this clause both amongst themselves and also in relation to the main branch.

(2) The custodian which has securities held in safe custody with another custodian (intermediate custodian) shall be liable for any fault on the part of the third party custodian in the same way as for its own fault. It shall remain responsible for exercising due care in the selection of the third party custodian even if it has been released from liability for a fault on the part of the third party custodian by contract, unless the securities are held in safe custody pursuant to express instructions

stimmten Drittverwahrer verwahrt werden.

#### § 4 Beschränkte Geltendmachung von Pfand- und Zurückbehaltungsrechten

(1) Vertraut der Verwahrer die Wertpapiere einem Dritten an, so gilt als dem Dritten bekannt, daß die Wertpapiere dem Verwahrer nicht gehören. Der Dritte kann an den Wertpapieren ein Pfandrecht oder ein Zurückbehaltungsrecht nur wegen solcher Forderungen geltend machen, die mit Bezug auf diese Wertpapiere entstanden sind oder für die diese Wertpapiere nach dem einzelnen über sie zwischen dem Verwahrer und dem Dritten vorgenommenen Geschäft haften sollen.

(2) Absatz 1 gilt nicht, wenn der Verwahrer dem Dritten für das einzelne Geschäft ausdrücklich und schriftlich mitteilt, daß er Eigentümer der Wertpapiere sei.

(3) Vertraut ein Verwahrer, der nicht Bankgeschäfte betreibt, Wertpapiere einem Dritten an, so gilt Absatz 1 nicht. Ist er nicht Eigentümer der Wertpapiere, so hat er dies dem Dritten mitzuteilen; in diesem Falle gilt Absatz 1 Satz 2.

#### § 5 Sammelverwahrung

(1) Der Verwahrer darf vertretbare Wertpapiere, die zur Sammelverwahrung durch eine Wertpapiersammelbank zugelassen sind, dieser zur Sammelverwahrung anvertrauen, es sei denn, der Hinterleger hat nach § 2 Satz 1 die gesonderte Aufbewahrung der Wertpapiere verlangt. Anstelle der Sammelverwahrung durch eine Wertpapiersammelbank darf der Verwahrer die Wertpapiere ungetrennt von seinen Beständen derselben Art oder von solchen Dritter selbst aufbewahren oder einem Dritten zur Sammelverwahrung anvertrauen, wenn der Hinterleger ihn dazu ausdrücklich und schriftlich ermächtigt hat. Die Ermächtigung darf weder in Geschäftsbedingungen des Verwahrers enthalten sein noch auf andere Urkunden verweisen; sie muß für jedes Verwahrungsgeschäft besonders erteilt werden.

by the depositor with a specific third party custodian.

#### § 4 Restricted assertion of liens and rights of retention

(1) If the custodian entrusts the securities to a third party, it shall be assumed that the third party is aware that the securities do not belong to the custodian. The third party may only assert a lien or a right of retention in respect of the securities for claims which have arisen in respect of these securities or for which the securities are to be liable under the individual transaction carried out in their respect between the custodian and the third party.

(2) Paragraph 1 shall not apply if the custodian informs the third party expressly and in writing for each single transaction that it is the owner of the securities.

(3) If a custodian that does not carry on banking business entrusts securities to a third party, paragraph 1 shall not apply. If it is not the owner of the securities, it must inform the third party accordingly; in this case paragraph 1 sentence 2 shall apply.

#### § 5 Collective safe custody

(1) The custodian may entrust securities, which are admitted to collective safe custody by a securities clearing and deposit bank, to the latter for collective safe custody, unless the depositor has requested separate safe custody of the securities in accordance with § 2 sentence 1. In lieu of collective safe custody by a securities clearing and deposit bank, the custodian may hold the securities in safe custody itself without separating them from its own holdings of the same category or those of third parties or entrust them to a third party for collective safe custody, if the depositor has authorised this expressly and in writing. The authorisation may neither be included in standard terms and conditions of the custodian nor refer to other documents; it must be given separately for each safe custody transaction.

(2) Der Verwahrer kann, anstatt das eingelieferte Stück in Sammelverwahrung zu nehmen, dem Hinterleger einen entsprechenden Sammelbestandteil übertragen.

(3) Auf die Sammelverwahrung bei einem Dritten ist § 3 anzuwenden.

(4) Wertpapiersammelbanken dürfen einem ausländischen Verwahrer im Rahmen einer gegenseitigen Kontoverbindung, die zur Aufnahme eines grenzüberschreitenden Effektengiroverkehrs vereinbart wird, Wertpapiere zur Sammelverwahrung anvertrauen, sofern

1. der ausländische Verwahrer in seinem Sitzstaat die Aufgaben einer Wertpapiersammelbank wahrnimmt und einer öffentlichen Aufsicht oder einer anderen für den Anlegerschutz gleichwertigen Aufsicht unterliegt,
2. dem Hinterleger hinsichtlich des Sammelbestands dieses Verwahrers eine Rechtsstellung eingeräumt wird, die derjenigen nach diesem Gesetz gleichwertig ist,
3. dem Anspruch der Wertpapiersammelbank gegen den ausländischen Verwahrer auf Auslieferung der Wertpapiere keine Verbote des Sitzstaats dieses Verwahrers entgegenstehen und

4. die Wertpapiere vertretbar und zur Sammelverwahrung durch die Wertpapiersammelbank und den ausländischen Verwahrer im Rahmen ihrer gegenseitigen Kontoverbindung zugelassen sind.

Die Haftung der Wertpapiersammelbanken nach § 3 Abs. 2 Satz 1 für ein Verschulden des ausländischen Verwahrers kann durch Vereinbarung nicht beschränkt werden.

#### § 6 Miteigentum am Sammelbestand, Verwaltungsbefugnis des Verwahrers bei der Sammelverwahrung

(1) Werden Wertpapiere in Sammelverwahrung genommen, so entsteht mit dem Zeitpunkt des Eingangs beim Sammelverwahrer für die bisherigen Eigentümer Miteigentum nach Bruchteilen an den zum Sammelbestand des Verwahrers gehörenden Wertpapieren derselben Art. Für die

(2) Instead of taking the securities into collective safe custody, the custodian may transfer a corresponding share of collective holdings to the depositor.

(3) § 3 shall apply to collective safe custody with a third party.

(4) Securities clearing and deposit banks may entrust securities for collective safe custody to a foreign custodian within the framework of a mutual account relationship which has been agreed upon in view of cross-border securities clearing transactions, provided that

1. the foreign custodian acts as a securities clearing and deposit bank in the country in which it has its registered office and is subject to public supervision or another equivalent supervision in terms of investor protection;
2. the depositor is granted a legal status in respect of the collective holdings of such custodian which is equivalent to the status under this Act;

3. the claim of the securities clearing and deposit bank against a foreign custodian to delivery of the securities is not subject to prohibitions of the country in which such custodian has its registered office; and

4. the securities are fungible and admitted to collective safe custody by the securities clearing and deposit bank and the foreign custodian within the framework of their mutual account relationship.

The liability of the securities clearing and deposit banks under § 3 para. 2 sentence 1 for fault by the foreign custodian may not be restricted by agreement.

#### § 6 Co-ownership of collective holdings, administrative powers of the custodian for collective safe custody

(1) If securities are taken into collective safe custody, fractional co-ownership in the securities of the same category belonging to the collective holdings of the custodian shall arise for the existing owners upon receipt by the collective custodian. The determination of the fraction shall be

Bestimmung des Bruchteils ist der Wertpapiernennbetrag maßgebend, bei Wertpapieren ohne Nennbetrag die Stückzahl.

(2) Der Sammelverwahrer kann aus dem Sammelbestand einem jeden der Hinterleger die diesem gebührende Menge ausliefern oder die ihm selbst gebührende Menge entnehmen, ohne daß er hierzu der Zustimmung der übrigen Beteiligten bedarf. In anderer Weise darf der Sammelverwahrer den Sammelbestand nicht verringern. Diese Vorschriften sind im Falle der Drittverwahrung auf Zwischenverwahrer sinngemäß anzuwenden.

#### § 7 Auslieferungsansprüche des Hinterlegers bei der Sammelverwahrung

(1) Der Hinterleger kann im Falle der Sammelverwahrung verlangen, daß ihm aus dem Sammelbestand Wertpapiere in Höhe des Nennbetrags, bei Wertpapieren ohne Nennbetrag in Höhe der Stückzahl der für ihn in Verwahrung genommenen Wertpapiere ausgeliefert werden; die von ihm eingelieferten Stücke kann er nicht zurückfordern.

(2) Der Sammelverwahrer kann die Auslieferung insoweit verweigern, als sich infolge eines Verlustes am Sammelbestand die dem Hinterleger nach § 6 gebührende Menge verringert hat. Er haftet dem Hinterleger für den Ausfall, es sei denn, daß der Verlust am Sammelbestand auf Umständen beruht, die er nicht zu vertreten hat.

#### § 8 Ansprüche der Miteigentümer und sonstiger dinglich Berechtigter bei der Sammelverwahrung

Die für Ansprüche des Hinterlegers geltenden Vorschriften der § 6 Abs. 2 Satz 1, § 7 sind sinngemäß auf Ansprüche eines jeden Miteigentümers oder sonst dinglich Berechtigten anzuwenden.

#### § 9 Beschränkte Geltendmachung von Pfand- und Zurückbehaltungsrechten bei der Sammelverwahrung

§ 4 gilt sinngemäß auch für die Geltendmachung von Pfandrechten und Zurückbehaltungsrechten an Sammelbestandanteilen.

governed by the nominal value of the securities and, in the case of securities without nominal value, by the number of securities.

(2) The collective custodian may deliver from the collective holdings an amount to which each depositor is entitled or withdraw the amount to which it is itself entitled without this requiring the approval of the other parties involved. The collective custodian may not reduce the collective holdings in any other way. These provisions must be applied *mutatis mutandis* to intermediate custodians in the event of third party safe custody.

#### § 7 Depositors' claim to delivery in case of collective safe custody

(1) In the case of collective safe custody, the depositor may demand that securities in the amount of the nominal value or in the case of securities without nominal value the number of securities held in safe custody for it be delivered to it from the collective holdings; it may not claim back the securities delivered by it.

(2) The collective custodian may refuse delivery to the extent that due to a loss in respect of the collective holdings the amount to which the depositor is entitled pursuant to § 6 has been reduced. It shall be liable to the depositor for such loss unless the loss in respect of the collective holdings is attributable to circumstances for which it is not responsible.

#### § 8 Claims of the co-owners and other parties entitled in rem in respect of collective safe custody

The provisions of § 6 para. 2 sentence 1 and of § 7 applying to the claims of depositors shall apply *mutatis mutandis* to claims of each co-owner or other party entitled in rem.

#### § 9 Restricted assertion of liens and rights to retention in the event of collective safe custody

§ 4 shall apply *mutatis mutandis* to the assertion of liens and rights to retention in respect of collective holdings.

#### § 9a Sammelurkunde

(1) Der Verwahrer hat ein Wertpapier, das mehrere Rechte verbrieft, die jedes für sich in vertretbaren Wertpapieren einer und derselben Art verbrieft sein könnten (Sammelurkunde), einer Wertpapiersammelbank zur Verwahrung zu übergeben, es sei denn, der Hinterleger hat nach § 2 Satz 1 die gesonderte Aufbewahrung der Sammelurkunde verlangt. Der Aussteller kann jederzeit und ohne Zustimmung der übrigen Beteiligten

1. eine von der Wertpapiersammelbank in Verwahrung genommene Sammelurkunde ganz oder teilweise durch einzelne in Sammelverwahrung zu nehmende Wertpapiere oder
2. einzelne Wertpapiere eines Sammelbestands einer Wertpapiersammelbank durch eine Sammelurkunde ersetzen.

(2) Verwahrt eine Wertpapiersammelbank eine Sammelurkunde allein oder zusammen mit einzelnen Wertpapieren, die über Rechte der in der Sammelurkunde verbrieften Art ausgestellt sind, gelten die §§ 6 bis 9 sowie die sonstigen Vorschriften dieses Gesetzes über Sammelverwahrung und Sammelbestandanteile sinngemäß, soweit nicht in Absatz 3 etwas anderes bestimmt ist.

(3) Wird auf Grund der §§ 7 und 8 die Auslieferung von einzelnen Wertpapieren verlangt, so hat der Aussteller die Sammelurkunde insoweit durch einzelne Wertpapiere zu ersetzen, als dies für die Auslieferung erforderlich ist; während des zur Herstellung der einzelnen Wertpapiere erforderlichen Zeitraums darf die Wertpapiersammelbank die Auslieferung verweigern. Ist der Aussteller nach dem zugrunde liegenden Rechtsverhältnis nicht verpflichtet, an die Inhaber der in der Sammelurkunde verbrieften Rechte einzelne Wertpapiere auszugeben, kann auch von der Wertpapiersammelbank die Auslieferung von einzelnen Wertpapieren nicht verlangt werden.

#### § 10 Tauschverwahrung

(1) Eine Erklärung, durch die der Hinterleger den Verwahrer ermächtigt, an

#### § 9a Global certificate

(1) The custodian shall deliver a security which certifies several rights which could each be certificated in fungible securities in one and the same way (global certificate) to a securities clearing and deposit bank for safe custody, unless the depositor has requested separate safe custody of the global certificate in accordance with § 2 sentence 1. The issuer may at any time and without the approval of the other parties involved

1. replace a global certificate taken in safe custody by the securities clearing and deposit bank as a whole or in part by individual securities to be taken in collective safe custody or
2. replace individual securities of a collective holding of a securities clearing and deposit bank by a global certificate.

(2) If a securities clearing and deposit bank holds a global certificate in safe custody alone or together with other securities which are issued in respect of rights of the kind certificated in the global certificate, §§ 6 to 9 as well as the other provisions of this Act on collective safe custody and shares in collective holdings shall apply *mutatis mutandis*, unless otherwise provided for in paragraph 3.

(3) If delivery of individual securities under §§ 7 and 8 is requested, the issuer shall replace the global certificate by individual securities insofar as necessary for the purpose of delivery; during the period necessary for the production of the individual securities, the securities clearing and deposit bank may refuse delivery. If the issuer is not obliged under the underlying legal relationship to deliver individual securities to the owners of the rights certified by the global certificate, the delivery of individual securities may not be requested from the securities clearing and deposit bank.

#### § 10 Exchangeable safe custody

(1) A declaration by which the depositor empowers the custodian to redeliver

Stelle ihm zur Verwahrung anvertrauter Wertpapiere Wertpapiere derselben Art zurückzugewähren, muß für das einzelne Verwahrungsgeschäft ausdrücklich und schriftlich abgegeben werden. Sie darf weder in Geschäftsbedingungen des Verwahrers enthalten sein noch auf andere Urkunden verweisen.

(2) Derselben Form bedarf eine Erklärung, durch die der Hinterleger den Verwahrer ermächtigt, hinterlegte Wertpapiere durch Wertpapiere derselben Art zu ersetzen.

(3) (gegenstandslos)

#### § 11 Umfang der Ermächtigung zur Tauschverwahrung

Eine Erklärung, durch die der Hinterleger den Verwahrer ermächtigt, an Stelle ihm zur Verwahrung anvertrauter Wertpapiere Wertpapiere derselben Art zurückzugewähren, umfaßt, wenn dies nicht in der Erklärung ausdrücklich ausgeschlossen ist, die Ermächtigung, die Wertpapiere schon vor der Rückgewähr durch Wertpapiere derselben Art zu ersetzen. Sie umfaßt nicht die Ermächtigung zu Maßnahmen anderer Art und bedeutet nicht, daß schon durch ihre Entgegennahme das Eigentum an den Wertpapieren auf den Verwahrer übergehen soll.

#### § 12 Ermächtigungen zur Verpfändung

(1) Der Verwahrer darf die Wertpapiere oder Sammelbestandteile nur auf Grund einer Ermächtigung und nur im Zusammenhang mit einer Krediteinräumung für den Hinterleger und nur an einen Verwahrer verpfänden. Die Ermächtigung muß für das einzelne Verwahrungsgeschäft ausdrücklich und schriftlich erteilt werden; sie darf weder in Geschäftsbedingungen des Verwahrers enthalten sein noch auf andere Urkunden verweisen.

(2) Der Verwahrer darf auf die Wertpapiere oder Sammelbestandteile Rückkredit nur bis zur Gesamtsumme der Kredite nehmen, die er für die Hinterleger eingeräumt hat. Die Wertpapiere oder Sammelbestandteile dürfen nur mit Pfandrechten zur Sicherung dieses Rück-

securities of the same category in lieu of the securities entrusted for safe custody to it, must be made expressly and in writing for each single safe custody transaction. It may neither be contained in standard terms and conditions of the custodian nor refer to any other documents.

(2) A declaration by which the depositor empowers the custodian to replace securities held in safe custody by securities of the same category shall require the same form.

(3) (no longer applicable)

#### § 11 Scope of empowerment for exchangeable safe custody

A declaration by which the depositor empowers the custodian to redeliver securities of the same category to it in lieu of the securities entrusted for safe custody, shall be deemed to include, unless expressly excluded in the declaration, the empowerment to replace securities already prior to the redelivery by securities of the same category. It shall not include the empowerment to take any other measures and shall not mean that already through the acceptance ownership in respect of the securities is to pass to the custodian.

#### § 12 Empowerments to pledge

(1) The custodian may only pledge the securities or shares in collective holdings by virtue of an empowerment and only in connection with the granting of a loan for the depositor, and may only pledge to a custodian. The empowerment must be granted expressly and in writing for each individual safe custody transaction; it may not be included in standard terms and conditions of the custodian and may not refer to any other documents.

(2) The custodian may only take out a counter-loan in respect of the securities or shares in collective holdings up to the total amount of the loans granted to the depositors. The securities or shares in collective holdings may only be charged with liens to secure this counter-loan. The

kredits belastet werden. Der Wert der verpfänderten Wertpapiere oder Sammelbestandteile soll die Höhe des für den Hinterleger eingeräumten Kredits mindestens erreichen, soll diese jedoch nicht unangemessen übersteigen.

(3) Ermächtigt der Hinterleger den Verwahrer nur, die Wertpapiere oder Sammelbestandteile bis zur Höhe des Kredits zu verpfänden, den der Verwahrer für diesen Hinterleger eingeräumt hat (beschränkte Verpfändung), so bedarf die Ermächtigung nicht der Form des Absatzes 1 Satz 2. Absatz 2 Satz 3 bleibt unberührt.

(4) Ermächtigt der Hinterleger den Verwahrer, die Wertpapiere oder Sammelbestandteile für alle Verbindlichkeiten des Verwahrers und ohne Rücksicht auf die Höhe des für den Hinterleger eingeräumten Kredits zu verpfänden (unbeschränkte Verpfändung), so muß in der Ermächtigung zum Ausdruck kommen, daß der Verwahrer das Pfandrecht unbeschränkt, also für alle seine Verbindlichkeiten und ohne Rücksicht auf die Höhe des für den Hinterleger eingeräumten Kredits bestellen kann. Dies gilt sinngemäß, wenn der Hinterleger den Verwahrer von der Innehaltung einzelner Beschränkungen des Absatzes 2 befreit.

(5) Der Verwahrer, der zur Verpfändung von Wertpapieren oder Sammelbestandteilen ermächtigt ist, darf die Ermächtigung so, wie sie ihm gegeben ist, weitergeben.

#### § 12 a Verpfändung als Sicherheit für Verbindlichkeiten aus Börsengeschäften

(1) Abweichend von § 12 darf der Verwahrer die Wertpapiere oder Sammelbestandteile auf Grund einer ausdrücklichen und schriftlichen Ermächtigung als Sicherheit für seine Verbindlichkeiten aus Geschäften an einer Börse, die einer gesetzlichen Aufsicht untersteht, an diese Börse, deren Träger oder eine von ihr mit der Abwicklung der Geschäfte unter ihrer Aufsicht beauftragte rechtsfähige Stelle, deren Geschäftsbetrieb auf diese Tätigkeit

value of the pledged securities or shares in collective holdings shall at least reach the amount of the loan granted to the depositor but should not exceed it in an inappropriate manner.

(3) If the depositor empowers the custodian only to pledge the securities or shares in collective holdings up to the amount of the loan granted by the custodian to this depositor (restricted pledging), the empowerment shall not require the form of paragraph 1 sentence 2. Paragraph 2 sentence 3 shall not be affected.

(4) If the depositor empowers the custodian to pledge the securities or shares in collective holdings in respect of all liabilities of the custodian and without taking into account the loan granted to the depositor (unrestricted pledging), it must be expressed in the empowerment that the custodian may create the lien without restriction, i.e. for all its liabilities and without taking into account the loan granted to the depositor. This shall apply *mutatis mutandis* if the depositor releases the custodian from compliance with individual restrictions under paragraph 2.

(5) The custodian who is empowered to pledge securities or shares in collective holdings may pass on the empowerment in the way it is issued to it.

#### § 12 a Pledging as collateral for liabilities from stock exchange transactions

(1) Notwithstanding the provisions in § 12, the custodian may pledge the securities or shares in collective holdings by virtue of an express and written empowerment as collateral for its liabilities from transactions at a stock exchange, which is subject to statutory supervision, to such stock exchange, its sponsoring entity or any entity with a legal capacity to which it has entrusted the settlement of transactions under its supervision whose business

beschränkt ist, verpfänden, sofern aus einem inhaltsgleichen Geschäft des Hinterlegers mit dem Verwahrer Verbindlichkeiten des Hinterlegers bestehen. Der Wert der verpfändeten Wertpapiere oder Sammelbestandteile soll die Höhe der Verbindlichkeiten des Hinterlegers gegenüber dem Verwahrer aus diesem Geschäft nicht unangemessen übersteigen. Die Ermächtigung des Hinterlegers nach Satz 1 kann im voraus für eine unbestimmte Zahl derartige Verpfändungen erteilt werden.

(2) Der Verwahrer muß gegenüber dem Pfandgläubiger sicherstellen, daß die verpfändeten Wertpapiere oder Sammelbestandteile für seine in Absatz 1 genannten Verbindlichkeiten nur insoweit in Anspruch genommen werden dürfen, als Verbindlichkeiten des Hinterlegers gegenüber dem Verwahrer nach Absatz 1 bestehen. Der Verwahrer haftet für ein Verschulden des Pfandgläubigers wie für eigenes Verschulden; diese Haftung kann durch Vereinbarung nicht beschränkt werden.

### § 13 Ermächtigung zur Verfügung über das Eigentum

(1) Eine Erklärung, durch die der Verwahrer ermächtigt wird, sich die anvertrauten Wertpapiere anzueignen oder das Eigentum an ihnen auf einen Dritten zu übertragen, und alsdann nur verpflichtet sein soll, Wertpapiere derselben Art zurückzugewähren, muß für das einzelne Verwahrungsgeschäft ausdrücklich und schriftlich abgegeben werden. In der Erklärung muß zum Ausdruck kommen, daß mit der Ausübung der Ermächtigung das Eigentum auf den Verwahrer oder einen Dritten übergehen soll und mithin für den Hinterleger nur ein schuldrechtlicher Anspruch auf Lieferung nach Art und Zahl bestimmter Wertpapiere entsteht. Die Erklärung darf weder auf andere Urkunden verweisen noch mit anderen Erklärungen des Hinterlegers verbunden sein.

(2) Eignet sich der Verwahrer die Wertpapiere an oder überträgt er das Eigentum an ihnen auf einen Dritten, so sind von diesem Zeitpunkt an die Vorschriften die-

operations are limited to this activity, provided liabilities of the custodian exist under a transaction of the depositor with the custodian with the same content. The value of the pledged securities or shares and collective holdings shall not inappropriately exceed the amount of liabilities of the depositor vis-a-vis the custodian under this transaction. The empowerment of the depositor in accordance with sentence 1 may be granted in advance for an indefinite number of such pledgings.

(2) The custodian must ensure vis-a-vis the pledgee that the pledged securities or shares in collective holdings may only be used for the liabilities referred to in paragraph 1 insofar as liabilities of the depositor exist vis-a-vis the custodian under paragraph 1. The custodian shall be liable for any fault of the pledgee in the same way as for its own fault; such liability may not be restricted by agreement.

### § 13 Empowerment to dispose of the ownership

(1) A declaration in which the custodian is empowered to appropriate the entrusted securities or to transfer ownership in their respect to a third party and then to be only obliged to redeliver securities of the same category must be made expressly and in writing for each individual safe custody transaction. In the declaration it must be stated that when exercising the empowerment ownership is to pass to the custodian or a third party and that for the depositor there is only a contractual claim to delivery of a certain category and number of securities. The declaration may neither refer to other documents nor be linked to other declarations by the depositor.

(2) If the custodian appropriates the securities for itself or if it transfers ownership of them to a third party, the provisions of this section shall no longer be

ses Abschnitts auf ein solches Verwahrungsgeschäft nicht mehr anzuwenden.

### § 14 Verwahrungsbuch

(1) Der Verwahrer ist verpflichtet, ein Handelsbuch zu führen, in das jeder Hinterleger und Art, Nennbetrag oder Stückzahl, Nummern oder sonstige Bezeichnungsmerkmale der für ihn verwahrten Wertpapiere einzutragen sind. Wenn sich die Nummern oder sonstigen Bezeichnungsmerkmale aus Verzeichnissen ergeben, die neben dem Verwahrungsbuch geführt werden, genügt insoweit die Bezugnahme auf diese Verzeichnisse.

(2) Die Eintragung eines Wertpapiers kann unterbleiben, wenn seine Verwahrung beendet ist, bevor die Eintragung bei ordnungsmäßigem Geschäftsgang erfolgen konnte.

(3) Die Vorschriften über die Führung eines Verwahrungsbuchs gelten sinngemäß auch für die Sammelverwahrung.

(4) Vertraut der Verwahrer die Wertpapiere einem Dritten an, so hat er den Ort der Niederlassung des Dritten im Verwahrungsbuch anzugeben. Ergibt sich der Name des Dritten nicht aus der sonstigen Buchführung, aus Verzeichnissen, die neben dem Verwahrungsbuch geführt werden, oder aus dem Schriftwechsel, so ist auch der Name des Dritten im Verwahrungsbuch anzugeben. Ist der Verwahrer zur Sammelverwahrung nach § 5 Abs. 1 Satz 2, zur Tauschverwahrung, zur Verpfändung oder zur Verfügung über das Eigentum ermächtigt, so hat er auch dies in dem Verwahrungsbuch ersichtlich zu machen.

(5) Teilt ein Verwahrer dem Drittverwahrer mit, daß er nicht Eigentümer der von ihm dem Drittverwahrer anvertrauten Wertpapiere ist (§ 4 Abs. 3), so hat der Drittverwahrer dies bei der Eintragung im Verwahrungsbuch kenntlich zu machen.

### § 15 Unregelmäßige Verwahrung, Wertpapierdarlehen

(1) Wird die Verwahrung von Wertpapieren in der Art vereinbart, daß das Eigentum sofort auf den Verwahrer oder ei-

applicable to a safe custody transaction of this nature.

### § 14 Custody ledger

(1) The custodian shall be obliged to keep a trading book in which each depositor and the category of securities, the nominal amount or number of securities, identification numbers or other descriptive features of the securities held in safe custody shall be entered. If the identification numbers or other descriptive features result from lists which are kept in addition to the custody ledger, a reference to such lists shall suffice.

(2) There is no need to enter a security if its safe custody ends before the entry could be made in the ordinary course of business.

(3) The provisions governing the keeping of a custody ledger shall apply mutatis mutandis to collective safe custody as well.

(4) If the custodian entrusts the securities to a third party it shall specify the place of the establishment of the third party in the custody ledger. If the name of the third party is not clear from the further accounting, lists which are kept in addition to the custody ledger or from correspondence, the name of the third party must likewise be stated in the custody ledger. If the custodian is empowered to collective safe custody under § 5 para. 1 sentence 2, exchange safe custody, pledging or to dispose of ownership, this shall likewise be evidenced in the custody ledger.

(5) If a custodian informs the third party custodian that it is not the owner of the securities entrusted by it to the third party custodian (§ 4 para. 3), the third party custodian must evidence this when making the entry in the custody ledger.

### § 15 Irregular safe custody, securities lending

(1) If the safe custody of securities is agreed in such a way that the ownership passes immediately to the custodian or a

nen Dritten übergeht und der Verwahrer nur verpflichtet ist, Wertpapiere derselben Art zurückzugewähren, so sind die Vorschriften dieses Abschnitts auf ein solches Verwahrungsgeschäft nicht anzuwenden.

(2) Eine Vereinbarung der in Absatz 1 bezeichneten Art ist nur gültig, wenn die Erklärung des Hinterlegers für das einzelne Geschäft ausdrücklich und schriftlich abgegeben wird. In der Erklärung muß zum Ausdruck kommen, daß das Eigentum sofort auf den Verwahrer oder einen Dritten übergehen soll und daß mithin für den Hinterleger nur ein schuldrechtlicher Anspruch auf Lieferung nach Art und Zahl bestimmter Wertpapiere entsteht. Die Erklärung darf weder auf andere Urkunden verweisen noch mit anderen Erklärungen des Hinterlegers verbunden sein.

(3) Diese Vorschriften gelten sinngemäß, wenn Wertpapiere jemandem im Betrieb seines Gewerbes als Darlehen gewährt werden.

#### § 16 Befreiung von Formvorschriften

Die Formvorschriften des § 4 Abs. 2, des § 5 Abs. 1 Satz 2 und 3 und der §§ 10, 12, 13 und 15 Abs. 2 und 3 sind nicht anzuwenden, wenn der Verwahrer einer gesetzlichen Aufsicht untersteht und der Hinterleger ein Kaufmann ist, der

1. in das Handelsregister oder Genossenschaftsregister eingetragen ist oder
2. im Falle einer juristischen Person des öffentlichen Rechts nach der für sie maßgebenden gesetzlichen Regelung, nicht eingetragen zu werden braucht oder
3. nicht eingetragen wird, weil er seinen Sitz oder seine Hauptniederlassung im Ausland hat.

#### § 17 Pfandverwahrung

Werden jemandem im Betrieb seines Gewerbes Wertpapiere unverschlossen als Pfand anvertraut, so hat der Pfandgläubiger die Pflichten und Befugnisse eines Verwahrers.

third party and the custodian is only obliged to redeliver securities of the same category, the provisions of this section shall not be applicable to a safe custody transaction of this kind.

(2) An agreement of the kind referred to in paragraph 1 shall not be valid unless the declaration by the depositor is made expressly and in writing for each single transaction. The declaration must state that ownership is to pass immediately to the custodian or a third party and that the depositor therefore only has a contractual claim to delivery in terms of category and number of certain securities. The declaration may neither refer to other documents nor be linked to other declarations of the depositor.

(3) These provisions shall apply *mutatis mutandis* if securities are granted as a loan to somebody carrying on a business activity.

#### § 16 Exemption from requirements as to form

The requirements as to form in § 4 para. 2, § 5 para. 1 sentences 2 and 3 and in §§ 10, 12, 13 and 15 paras. 2 and 3 shall not be applicable if the custodian is subject to statutory supervision or if the custodian is a merchant who

1. is entered in the commercial register or the register of co-operative societies or
2. is a legal entity under public law which does not have to be registered by virtue of the applicable statutory provisions or
3. is not registered because it has its registered office or main branch outside Germany.

#### § 17 Safe custody of liens

If somebody is entrusted openly with securities as a pledge within the framework of the exercise of its business, the pledgee shall have the obligations and powers of a custodian.

#### § 17a Verfügungen über Wertpapiere

Verfügungen über Wertpapiere oder Sammelbestandanteile, die mit rechtsbegründender Wirkung in ein Register eingetragen oder auf einem Konto verbucht werden, unterliegen dem Recht des Staates, unter dessen Aufsicht das Register geführt wird, in dem unmittelbar zugunsten des Verfügungsempfängers die rechtsbegründende Eintragung vorgenommen wird, oder in dem sich die konroführende Haupt- oder Zweigstelle des Verwahrers befindet, die dem Verfügungsempfänger die rechtsbegründende Gutschrift erteilt.

### 2. Abschnitt Einkaufskommission

#### § 18 Stückverzeichnis

(1) Führt ein Kommissionär (§§ 383, 406 des Handelsgesetzbuchs) einen Auftrag zum Einkauf von Wertpapieren aus, so hat er dem Kommittenten unverzüglich, spätestens binnen einer Woche ein Verzeichnis der gekauften Stücke zu übersenden. In dem Stückverzeichnis sind die Wertpapiere nach Gattung, Nennbetrag, Nummern oder sonstigen Bezeichnungsmarkmalen zu bezeichnen.

(2) Die Frist zur Übersendung des Stückverzeichnisses beginnt, falls der Kommissionär bei der Anzeige über die Ausführung des Auftrags einen Dritten als Verkäufer namhaft gemacht hat, mit dem Erwerb der Stücke, andernfalls beginnt sie mit dem Ablauf des Zeitraums, innerhalb dessen der Kommissionär nach der Erstattung der Ausführungsanzeige die Stücke bei ordnungsmäßigem Geschäftsgang ohne schuldhaftes Verzögerung beziehen oder das Stückverzeichnis von einer zur Verwahrung der Stücke bestimmten dritten Stelle erhalten konnte.

(3) Mit der Absendung des Stückverzeichnisses geht das Eigentum an den darin bezeichneten Wertpapieren, soweit der Kommissionär über sie zu verfügen berechtigt ist, auf den Kommittenten über, wenn es nicht nach den Bestimmungen des bürgerlichen Rechts schon früher auf ihn übergegangen ist.

#### § 17a Disposal of securities

Disposals of securities or shares in collective holdings which are entered into a register or booked in an account with constitutive legal effect shall be governed by the law of the country under whose supervision the register is kept in which such entry for the direct benefit of the transferee is made or in which the account-keeping main or branch office of the custodian is located who makes the account entry with constitutive legal effect for the benefit of the transferee.

### Part 2 Buying commission

#### § 18 List of securities

(1) If a commission agent (§§ 383, 406 of the Commercial Code) executes an order to buy securities, it must send the principal immediately, but no later than within one week, a list of the purchased securities. The list of securities must specify the securities by category, nominal amount, identification numbers and other descriptive features.

(2) The period for sending the list of securities shall commence, if on notification of the execution of the order the commission agent has named a third party as seller, upon the acquisition of the securities; otherwise it shall commence with the expiration of the period within which the commission agent was able to acquire the securities after notification of execution during the ordinary course of business without any culpable delay or could have obtained the list of securities from a third party designated to hold the securities in safe custody.

(3) With the sending of the list of securities the ownership of the securities specified therein shall pass to the principal insofar as the commission agent is entitled to dispose of them, unless it has already passed at an earlier stage to it under the provisions of civil law.

## § 19 Aussetzung der Übersendung des Stückeverzeichnis

(1) Der Kommissionär darf die Übersendung des Stückeverzeichnis aussetzen, wenn er wegen der Forderungen, die ihm aus der Ausführung des Auftrags zustehen, nicht befriedigt ist und auch nicht Stundung bewilligt hat. Als Stundung gilt nicht die Einstellung des Kaufpreises ins Kontokorrent.

(2) Der Kommissionär kann von der Befugnis des Absatzes 1 nur Gebrauch machen, wenn er dem Kommittenten erklärt, daß er die Übersendung des Stückeverzeichnis und damit die Übertragung des Eigentums an den Papieren bis zur Befriedigung wegen seiner Forderungen aus der Ausführung des Auftrags aussetzen werde. Die Erklärung muß, für das einzelne Geschäft gesondert, ausdrücklich und schriftlich abgegeben und binnen einer Woche nach Erstattung der Ausführungsanzeige abgesandt werden, sie darf nicht auf andere Urkunden verweisen.

(3) Macht der Kommissionär von der Befugnis des Absatzes 1 Gebrauch, so beginnt die Frist zur Übersendung des Stückeverzeichnis frühestens mit dem Zeitpunkt, in dem der Kommissionär wegen seiner Forderungen aus der Ausführung des Auftrags befriedigt wird.

(4) Stehen die Parteien miteinander im Kontokorrentverkehr (§ 355 des Handelsgesetzbuchs), so gilt der Kommissionär wegen der ihm aus der Ausführung des Auftrags zustehenden Forderungen als befriedigt, sobald die Summe der Habenposten die der Sollposten zum erstenmal erreicht oder übersteigt. Hierbei sind alle Posten zu berücksichtigen, die mit Wertstellung auf denselben Tag zu buchen waren. Führt der Kommissionär für den Kommittenten mehrere Konten, so ist das Konto, auf dem das Kommissionärgeschäft zu buchen war, allein maßgebend.

(5) Ist der Kommissionär teilweise befriedigt, so darf er die Übersendung des Stückeverzeichnis nicht aussetzen, wenn die Aussetzung nach den Umständen, ins-

## § 19 Suspension of the sending of the list of securities

(1) The commission agent may suspend the sending of the list of securities if it is not satisfied in respect of the claims to which it is entitled pursuant to the execution of the order and if it has not granted any deferral. The entering of the purchase price into a current account shall not qualify as a deferral.

(2) The commission agent may only make use of the empowerment set forth in paragraph 1 if it declares vis-a-vis the principal that it will suspend the sending of the list of securities and hence the transfer of ownership in respect of the securities pending satisfaction of its claims under the execution of the contract. The declaration must be made separately, expressly and in writing for each individual transaction and must be sent within one week of notification of execution; it may not refer to other documents.

(3) If the commission agent makes use of its empowerment under paragraph 1, the period for the sending of the list of securities shall commence at the earliest when the commission agent is satisfied in respect of its claims under the execution of the order.

(4) If the parties have a current account relationship (§ 355 of the Commercial Code), the commission agent shall be deemed to be satisfied in respect of the claims to which it is entitled under the execution of the contract as soon as the amount of the credit positions reaches or exceeds for the first time the amount of the debit positions. In this context, all entries shall be taken into account which were to be posted with the same value date. If the commission agent keeps several accounts for the principal, the account into which the commission transaction was to be posted shall be solely authoritative.

(5) If the commission agent is partly satisfied, it may not suspend the sending of the list of securities if, under the given circumstances, the suspension infringes

besondere wegen verhältnismäßiger Geringfügigkeit des rückständigen Teils, gegen Treu und Glauben verstoßen würde.

## § 20 Übersendung des Stückeverzeichnis auf Verlangen

(1) Wenn der Kommissionär einem Kommittenten, mit dem er im Kontokorrentverkehr (§ 355 des Handelsgesetzbuchs) steht, für die Dauer der Geschäftsverbindung oder für begrenzte Zeit zugesagt, daß er in bestimmtem Umfang oder ohne besondere Begrenzung für ihn Aufträge zur Anschaffung von Wertpapieren auch ohne alsbaldige Berichtigung des Kaufpreises ausführen werde, so kann er sich dabei vorbehalten, Stückeverzeichnis erst auf Verlangen des Kommittenten zu übersenden.

(2) Der Kommissionär kann von dem Vorbehalt des Absatzes 1 nur Gebrauch machen, wenn er dem Kommittenten bei der Erstattung der Ausführungsanzeige schriftlich mitteilt, daß er die Übersendung des Stückeverzeichnis und damit die Übertragung des Eigentums an den Papieren erst auf Verlangen des Kommittenten ausführen werde.

(3) Erklärt der Kommittent, daß er die Übersendung des Stückeverzeichnis verlange, so beginnt die Frist zur Übersendung des Stückeverzeichnis frühestens mit dem Zeitpunkt, in dem die Erklärung dem Kommissionär zugeht. Die Aufforderung muß schriftlich erfolgen und die Wertpapiere, die in das Stückeverzeichnis aufgenommen werden sollen, genau bezeichnen.

## § 21 Befugnis zur Aussetzung und Befugnis zur Übersendung auf Verlangen

Will der Kommissionär die Übersendung des Stückeverzeichnis sowohl deshalb aussetzen, weil er wegen seiner Forderungen nicht befriedigt ist (§ 19), als auch deshalb, weil er sich die Aussetzung mit Rücksicht auf die Besonderheit des Kontokorrentverkehrs mit dem Kommittenten vorbehalten hat (§ 20), so hat er dem Kommittenten bei Erstattung der Ausführungsanzeige schriftlich mitzutei-

the principles of good faith, in particular because of the relative insignificance of the amount in arrears.

## § 20 Sending of the list of securities on request

(1) If the commission agent undertakes vis-a-vis a principal with which it has a current account relationship (§ 355 of the Commercial Code) for the duration of the business relationship or for a limited period of time that it will execute on a certain scale and without a particular restriction orders for it to acquire securities also without immediate adjustment of the purchase price, it may reserve the right to send lists of securities only at the request of the principal.

(2) The commission agent may only exercise the reservation under paragraph 1 if it informs the principal on notification of execution in writing that it will send the list of securities and hence execute the transfer of ownership in respect of the securities only at the request of the principal.

(3) If the principal declares that it requests the sending of the list of securities, the period for the sending of the list of securities shall not commence before the date on which the commission agent receives the declaration. The request must be made in writing and the securities that are to be entered in the list of securities must be specified in detail.

## § 21 Empowerment to suspend and empowerment to send on request

If the commission agent wishes to suspend the sending of the list of securities because it is either not satisfied in respect of its claims (§ 19) or also because it did reserve the right to suspend the transaction taking into account the particularities of the current account relationship with the principal (§ 20), it must inform the principal in writing on notification of execution that it shall only send the list of se-

len, daß er die Übersendung des Stücke-  
verzeichnisses und damit die Übertragung  
des Eigentums an den Papieren erst auf  
Verlangen des Kommitenten, frühestens  
jedoch nach Befriedigung wegen seiner  
Forderungen aus der Ausführung des Auf-  
trags ausführen werde.

#### § 22 Stückeverzeichnis beim Auslandsgeschäft

(1) Wenn die Wertpapiere vereinba-  
rungsgemäß im Ausland angeschafft und  
aufbewahrt werden, braucht der Kommi-  
sionär das Stückeverzeichnis erst auf Ver-  
langen des Kommitenten zu übersenden.  
Der Kommitent kann die Übersendung  
jederzeit verlangen, es sei denn, daß aus-  
ländisches Recht der Übertragung des Ei-  
gentums an den Wertpapieren durch Ab-  
sendung des Stückeverzeichnisses entge-  
gensteht oder daß der Kommissionär nach  
§ 19 Abs. 1 berechtigt ist, die Übersen-  
dung auszusetzen.

(2) Erklärt der Kommitent, daß er die  
Übersendung des Stückeverzeichnisses ver-  
lange, so beginnt die Frist zur Übersen-  
dung des Stückeverzeichnisses frühestens  
mit dem Zeitpunkt, in dem die Erklärung  
dem Kommissionär zugeht. Die Aufforde-  
rung muß schriftlich erfolgen und die  
Wertpapiere, die in das Stückeverzeichnis  
aufgenommen werden sollen, genau be-  
zeichnen.

#### § 23 Befreiung von der Übersendung des Stückeverzeichnisses

Die Übersendung des Stückeverzeich-  
nisses kann unterbleiben, soweit innerhalb  
der dafür bestimmten Frist (§§ 18 bis 22)  
die Wertpapiere dem Kommitenten aus-  
geliefert sind oder ein Auftrag des Kom-  
mitenten zur Wiederveräußerung ausge-  
führt ist.

#### § 24 Erfüllung durch Übertragung von Miteigentum am Sammelbestand

(1) Der Kommissionär kann sich von  
seiner Verpflichtung, dem Kommitenten  
Eigentum an bestimmten Stücken zu ver-

curities and hence transfer ownership of  
the securities at the request of the princi-  
pal but not before satisfaction in respect  
of its claims under the execution of the  
contract.

#### § 22 List of securities in international transactions

(1) If securities are acquired and held in  
safe custody outside Germany in accord-  
ance with a corresponding agreement, the  
commission agent shall only send the list  
of securities at the request of the princi-  
pal. The principal may request the sending  
at any time unless foreign law opposes the  
transfer of ownership in respect of the se-  
curities by sending the list of securities, or  
if the commission agent is entitled to sus-  
pend the sending pursuant to § 19 para. 1.

(2) If the principal declares that it re-  
quests the sending of the list of securities,  
the period for the sending of the list of se-  
curities shall not commence before the  
date on which the commission agent re-  
ceives the declaration. The request must  
be made in writing and the securities  
which are to be entered in the list of securi-  
ties must be specified in detail.

#### § 23 Exemption from the sending of the list of securities

There is no need to send the list of se-  
curities if, within the specified period (§§ 18  
to 22), the securities are delivered to the  
principal or an order of the principal con-  
cerning reselling has been executed.

#### § 24 Performance by transfer of co-ownership in the collective hold- ing

(1) The commission agent may exempt  
itself from its obligation to procure own-  
ership of certain securities for the princi-

schaffen, dadurch befreien, daß er ihm  
Miteigentum an den zum Sammelbestand  
einer Wertpapiersammelbank gehörenden  
Wertpapieren verschafft; durch Verschaf-  
fung von Miteigentum an den zum Sam-  
melbestand eines anderen Verwahrers ge-  
hörenden Wertpapieren kann er sich nur  
befreien, wenn der Kommitent im einzel-  
nen Falle ausdrücklich und schriftlich zu-  
stimmt.

(2) Mit der Eintragung des Übertra-  
gungsvermerks im Verwahrungsbuch des  
Kommissionärs geht, soweit der Kommi-  
sionär Verfügungsberechtigt ist, das Mitei-  
gentum auf den Kommitenten über, wenn  
es nicht nach den Bestimmungen des bür-  
gerlichen Rechts schon früher auf ihn  
übergegangen ist. Der Kommissionär hat  
dem Kommitenten die Verschaffung des  
Miteigentums unverzüglich mitzuteilen.

(3) Kreditinstitute und Kapitalanlagege-  
sellschaften brauchen die Verschaffung des  
Miteigentums an einem Wertpapiersam-  
melbestand und die Ausführung der Ge-  
schäftsbesorgung abweichend von Ab-  
satz 2 Satz 2 sowie von den §§ 675 und 666  
des Bürgerlichen Gesetzbuchs und von  
§ 384 Abs. 2 des Handelsgesetzbuchs den  
Kunden erst innerhalb von dreizehn Mo-  
naten mitzuteilen, sofern das Miteigentum  
jeweils auf Grund einer vertraglich ver-  
einbarten gleichbleibenden monatlichen,  
zweimonatlichen oder vierteljährlichen  
Zahlung erworben wird und diese Zahlun-  
gen jährlich das Dreifache des höchsten Be-  
trags nicht übersteigen, bis zu dem nach  
dem Vierten Vermögensbildungsgesetz in  
der jeweils geltenden Fassung vermögens-  
wirksame Leistungen gefördert werden  
können.

#### § 25 Rechte des Kommitenten bei Nichtübersendung des Stückeverzeichnisses

(1) Unterläßt der Kommissionär, ohne  
hierzu nach den §§ 19 bis 24 befugt zu  
sein, die Übersendung des Stückeverzei-  
chnisses und holt er das Versäumte auf eine  
nach Ablauf der Frist zur Übersendung des  
Stückeverzeichnisses an ihn ergangene  
Aufforderung des Kommitenten nicht

pal, by procuring it co-ownership in the  
securities belonging to the collective hold-  
ing of a securities clearing and deposit  
bank; by procuring co-ownership of securi-  
ties belonging to the collective holdings  
of another custodian, it may only be ex-  
empted if the principal agrees expressly  
and in writing in each individual case.

(2) Upon the entry of the transfer notice  
in the custody ledger of the commission  
agent, co-ownership shall pass to the  
principal, in as far as the commission  
agent is entitled to dispose of the securi-  
ties, unless it has already passed at an ear-  
lier stage to it under the provisions of civil  
law. The commission agent shall inform  
the principal without delay of the pro-  
curement of co-ownership.

(3) Notwithstanding paragraph 2 sen-  
tence 2 as well as §§ 675 and 666 of the  
Civil Code and § 384 para. 2 of the  
Commercial Code, banks and investment  
management companies shall only have to  
notify customers within 13 months of the  
procurement of the co-ownership in col-  
lective holdings of securities and the exe-  
cution of the agency services, provided  
that the co-ownership is acquired in each  
case by virtue of a contractually agreed  
invariable monthly, bi-monthly or quar-  
terly payment and these payments do not  
exceed the triple of the maximum amount  
on an annual basis up to which payments  
towards a savings scheme can be subsid-  
ised pursuant to the Fourth Capital  
Formation Act as amended.

#### § 25 Rights of the principal in the event of failure to send the list of securities

(1) If the commission agent fails to send  
the list of securities without being entitled  
to do so pursuant to §§ 19 to 24 and if it  
does not remedy within three days such  
default, pursuant to a request by the princi-  
pal after the expiration of the period for  
sending the list of securities, the principal

binnen drei Tagen nach, so ist der Kommittent berechtigt, das Geschäft als nicht für seine Rechnung abgeschlossen zurückzuweisen und Schadensersatz wegen Nichterfüllung zu beanspruchen. Dies gilt nicht, wenn die Unterlassung auf einem Umstand beruht, den der Kommissionär nicht zu vertreten hat.

(2) Die Aufforderung des Kommittenten verliert ihre Wirkung, wenn er dem Kommissionär nicht binnen drei Tagen nach dem Ablauf der Nachholungsfrist erklärt, daß er von dem in Absatz 1 bezeichneten Recht Gebrauch machen wolle.

#### § 26 Stückeverzeichnis beim Auftrag zum Umtausch und zur Geltendmachung eines Bezugsrechts

Der Kommissionär, der einen Auftrag zum Umtausch von Wertpapieren oder von Sammelbestandteilen gegen Wertpapiere oder einen Auftrag zur Geltendmachung eines Bezugsrechts auf Wertpapiere ausführt, hat binnen zwei Wochen nach dem Empfang der neuen Stücke dem Kommittenten ein Verzeichnis der Stücke zu übersenden, soweit er ihm die Stücke nicht innerhalb dieser Frist aushändigt. In dem Stückeverzeichnis sind die Wertpapiere nach Gattung, Nennbetrag, Nummern oder sonstigen Bezeichnungsmerkmalen zu bezeichnen. Im übrigen finden die §§ 18 bis 24 Anwendung; § 25 ist insoweit anzuwenden, als der Kommittent nur Schadensersatz wegen Nichterfüllung verlangen kann.

#### § 27 Verlust des Provisionsanspruchs

Der Kommissionär, der den in § 26 ihm auferlegten Pflichten nicht genügt, verliert das Recht, für die Ausführung des Auftrags Provision zu fordern (§ 396 Abs. 1 des Handelsgesetzbuchs).

#### § 28 Unabdingbarkeit der Verpflichtungen des Kommissionärs

Die sich aus den §§ 18 bis 27 ergebenden Verpflichtungen des Kommissionärs können durch Rechtsgeschäft weder ausgeschlossen noch beschränkt werden, es sei denn, daß der Kommittent gewerbsmäßig Bankgeschäfte betreibt.

shall be entitled to reject the transaction as not made for its account and claim damages for non-performance. This shall not apply if the failure to send is attributable to circumstances for which the commission agent is not responsible.

(2) The request by the principal shall be ineffective if it fails to declare to the commission agent within three days of the expiration of the remedying period that it intends to exercise the right referred to in paragraph 1.

#### § 26 List of securities in the event of an order for exchange or the assertion of a subscription right

The commission agent who executes an order for the exchange of securities or shares in collective holdings for securities or executes an order to assert a subscription right in respect of securities shall send a list of securities to the principal within two weeks of receipt of the new securities if it does not deliver the securities within that period. In the list of securities the securities must be specified and broken down by type, nominal amount, identification numbers or other descriptive features. As for the rest, §§ 18 to 24 shall apply; § 25 shall apply insofar as the principal may only claim damages for non-performance.

#### § 27 Loss of the commission claim

The commission agent who fails to satisfy its obligations under § 26 shall lose its right to claim commission upon execution of the order (§ 396 para. 1 of the Commercial Code).

#### § 28 Mandatory nature of the obligations of the commission agent

The obligations of the commission agent resulting from §§ 18 to 27 may not be excluded or restricted by legal arrangements, unless the principal commercially engages in banking business.

#### § 29 Verwahrung durch den Kommissionär

Der Kommissionär hat bezüglich der in seinem Besitz befindlichen, in das Eigentum oder das Miteigentum des Kommittenten übergebenen Wertpapiere die Pflichten und Befugnisse eines Verwahrers.

#### § 30 Beschränkte Geltendmachung von Pfand- und Zurückbehaltungsrechten bei dem Kommissionsgeschäft

(1) Gibt der Kommissionär einen ihm erteilten Auftrag zur Anschaffung von Wertpapieren an einen Dritten weiter, so gilt als dem Dritten bekannt, daß die Anschaffung für fremde Rechnung geschieht.

(2) § 4 gilt sinngemäß.

#### § 31 Eigenhändler, Selbsteintritt

Die §§ 18 bis 30 gelten sinngemäß, wenn jemand im Betrieb seines Gewerbes Wertpapiere als Eigenhändler verkauft oder umtauscht oder einen Auftrag zum Einkauf oder zum Umtausch von Wertpapieren im Wege des Selbsteintritts ausführt.

### 3. Abschnitt

#### Vorrang im Insolvenzverfahren

#### § 32 Vorrangige Gläubiger

(1) Im Insolvenzverfahren über das Vermögen eines der in den §§ 1, 17 und 18 bezeichneten Verwahrer, Pfandgläubiger und Kommissionäre haben Vorrang nach den Absätzen 3 und 4:

1. Kommittenten, die bei Eröffnung des Insolvenzverfahrens das Eigentum oder Miteigentum an Wertpapieren noch nicht erlangt, aber ihre Verpflichtungen aus dem Geschäft über diese Wertpapiere dem Kommissionär gegenüber vollständig erfüllt haben; dies gilt auch dann, wenn im Zeitpunkt der Eröffnung des Insolvenzverfahrens der Kommissionär die Wertpapiere noch nicht angeschafft hat;

#### § 29 Safe custody by the commission agent

With respect to the securities in its possession in regard of which ownership of co-ownership has been passed to the principal, the commission agent shall have the obligations and rights of a custodian.

#### § 30 Limited assertion of liens and rights to retention in the case of commission business

(1) If a commission agent passes on a contract placed with it for the acquisition of securities to a third party, it shall be assumed that the third party is aware that the procurement is for another party's account.

(2) § 4 shall apply *mutatis mutandis*.

#### 31 Own account trader, contracting in one's own name

§§ 18 to 30 shall apply *mutatis mutandis* if somebody, as part of its business, sells or exchanges securities as an own account trader or performs a contract for the acquisition or exchange of securities by way of contracting in its own name.

### Part 3

#### Priority in insolvency proceedings

#### § 32 Prior-ranking creditors

(1) In insolvency proceedings against the assets of one of the custodians, pledgees and commission agents pursuant to §§ 1, 17 and 18, the following shall have priority in accordance with paragraphs 3 and 4:

1. Principals that upon commencement of insolvency proceedings have not yet obtained ownership or co-ownership regarding securities but have fully satisfied their obligations under the transaction in respect of these securities *vis-à-vis* the commission agent; this shall apply even if at the time of commencement of the insolvency proceedings the commission agent has not yet procured the securities;

2. Hinterleger, Verpfänder und Kommitenten, deren Eigentum oder Miteigentum an Wertpapieren durch eine rechtswidrige Verfügung des Verwahrers, Pfandgläubigers oder Kommissionärs oder ihrer Leute verletzt worden ist, wenn sie bei Eröffnung des Insolvenzverfahrens ihre Verpflichtungen aus dem Geschäft über diese Wertpapiere dem Schuldner gegenüber vollständig erfüllt haben;
3. die Gläubiger der Nummern 1 und 2, wenn der nichterfüllte Teil ihrer dort bezeichneten Verpflichtungen bei Eröffnung des Insolvenzverfahrens zehn vom Hundert des Wertes ihres Wertpapierlieferungsanspruchs nicht überschreitet und wenn sie binnen einer Woche nach Aufforderung des Insolvenzverwalters diese Verpflichtungen vollständig erfüllt haben.
- (2) Entsprechendes gilt im Insolvenzverfahren über das Vermögen eines Eigenhändlers, bei dem jemand Wertpapiere gekauft oder erworben hat, und im Insolvenzverfahren über das Vermögen eines Kommissionärs, der den Auftrag zum Einkauf oder zum Umtausch von Wertpapieren im Wege des Selbsteintritts ausgeführt hat (§ 31).
- (3) Die nach den Absätzen 1 und 2 vorrangigen Forderungen werden vor den Forderungen aller anderen Insolvenzgläubiger aus einer Sondermasse beglichen; diese wird gebildet aus den in der Masse vorhandenen Wertpapieren derselben Art und aus den Ansprüchen auf Lieferung solcher Wertpapiere. Die vorrangigen Forderungen werden durch Lieferung der vorhandenen Wertpapiere beglichen, soweit diese nach dem Verhältnis der Forderungsbeträge an alle vorrangigen Gläubiger verteilt werden können. Soweit eine solche Verteilung nicht möglich ist, wird der volle Erlös der nichtverteilten Wertpapiere unter die vorrangigen Gläubiger im Verhältnis ihrer Forderungsbeträge verteilt.
- (4) Die Gläubiger der Absätze 1 und 2 haben den beanspruchten Vorrang bei der Anmeldung der Forderung nach § 174 der

2. depositors, pledgees and principals whose ownership or co-ownership of the securities has been infringed by an unlawful disposal of the custodian, pledgee or commission agent or their employees if upon commencement of insolvency proceedings they have fully satisfied their obligations under the transaction concerning these securities vis-a-vis the debtor;
3. the creditors under numbers 1 and 2 if the non-performed part of the obligations specified therein does not exceed 10 per cent of the value of their securities delivery claim upon commencement of the insolvency proceedings and if they have fully satisfied these obligations within one week of the corresponding request by the insolvency administrator.
- (2) This shall apply *mutatis mutandis* in insolvency proceedings against the assets of an own account trader from whom someone has bought or acquired securities, and in the insolvency proceeding over the assets of a commission agent who has carried out the order to purchase or exchange securities by way of contracting in its own name (§ 31).
- (3) The claims with priority ranking in accordance with paragraphs 1 and 2 shall be settled from separate insolvency assets prior to the claims of all other insolvency creditors; they (i.e. the separated insolvency assets) shall be formed from the existing securities of the same type and the claims to delivery of such securities. The prior-ranking claims shall be settled by delivery of the existing securities to the extent that they can be distributed to all prior-ranking creditors in the proportion of their claims. Insofar as such distribution is not possible, the proceeds from the non-distributed securities shall be distributed among the prior-ranking creditors in the proportion of their claims.
- (4) The creditors in accordance with paragraphs 1 and 2 must state the claimed priority when filing the claim pursuant to

Insolvenzordnung anzugeben. Sie können aus dem sonstigen Vermögen des Schuldners nur unter entsprechender Anwendung der für die Absonderungsberechtigten geltenden Vorschriften der §§ 52, 190 und 192 der Insolvenzordnung Befriedigung erlangen. Im übrigen bewendet es für sie bei den Vorschriften der Insolvenzordnung über Insolvenzgläubiger.

(5) Das Insolvenzgericht hat, wenn es nach Lage des Falles erforderlich ist, den vorrangigen Gläubigern zur Wahrung der ihnen zustehenden Rechte einen Pfleger zu bestellen. Für die Pflegschaft tritt an die Stelle des Betreuungsgerichts das Insolvenzgericht. § 78 Abs. 2 bis 5 des Versicherungsaufsichtsgesetzes ist sinngemäß anzuwenden.

### § 33 Ausgleichsverfahren bei Verpfändung

(1) Im Insolvenzverfahren über das Vermögen eines Verwahrers, dessen Pfandgläubiger die ihm nach § 12 Abs. 2 verpfändeten Wertpapiere oder Sammelbestandteile ganz oder zum Teil zu seiner Befriedigung verwertet hat, findet unter den Hinterlegern, die die dem Pfandgläubiger verpfändeten Wertpapiere oder Sammelbestandteile dem Verwahrer anvertraut haben, ein Ausgleichsverfahren mit dem Ziel der gleichmäßigen Befriedigung statt.

(2) Die am Ausgleichsverfahren beteiligten Hinterleger werden aus einer Sondermasse befriedigt. In diese Sondermasse sind aufzunehmen:

1. die Wertpapiere oder Sammelbestandteile, die dem Pfandgläubiger nach § 12 Abs. 2 verpfändet waren, von diesem aber nicht zu seiner Befriedigung verwertet worden sind;
2. der Erlös aus den Wertpapieren oder Sammelbestandteilen, die der Pfandgläubiger verwertet hat, soweit er ihm zu seiner Befriedigung nicht gebührt;
3. die Forderungen gegen einen am Ausgleichsverfahren beteiligten Hinterleger aus dem ihm eingeräumten Kredit so-

§ 174 of the German Insolvency Code. They can only obtain satisfaction from the other assets of the debtor by analogous application of the provisions of §§ 52, 190 and 192 of the Insolvency Code applicable to the secured creditors. As for the rest, the provisions of the Insolvency Code concerning insolvency creditors shall apply to them.

(5) The insolvency court shall appoint a curator if this is necessary according to the facts of the case in order to secure the rights to which the priority creditors are entitled. For the curatorship the court of custody shall be replaced by the insolvency court. § 78 paras. 2 to 5 of the Insurance Supervision Act shall apply *mutatis mutandis*.

### § 33 Settlement procedures for pledgings

(1) In insolvency proceedings over the assets of a custodian whose pledgee has fully or partly realised the securities or shares in collective holdings pledged to it pursuant to § 12 para. 2 for its satisfaction, there shall be a compensation procedure amongst the depositors who entrusted to the custodian the securities or shares in collective holdings pledged to the pledgee, for the purposes of equal satisfaction.

(2) The depositors involved in the compensation procedure shall be satisfied from the separated insolvency assets. The following shall be included in such separated insolvency assets:

1. The securities or shares in collective holdings pledged to the pledgee pursuant to § 12 para. 2 but that were not realised by the latter for its satisfaction;
2. the proceeds from the securities or shares in collective holdings which the pledgee has realised to the extent that it is not entitled to it for its satisfaction;
3. the claims against one of the depositors involved in the compensation procedure under a loan extended to it as well

wie Leistungen zur Abwendung einer drohenden Pfandverwertung.

(3) Die Sondermasse ist unter den am Ausgleichsverfahren beteiligten Hinterlegern nach dem Verhältnis des Wertes der von ihnen dem Verwahrer anvertrauten Wertpapiere oder Sammelbestandteile zu verteilen. Maßgebend ist der Wert am Tag der Eröffnung des Insolvenzverfahrens, es sei denn, daß die Wertpapiere oder Sammelbestandteile erst später verwertet worden sind. In diesem Falle ist der erzielte Erlös maßgebend. Ein nach Befriedigung aller am Ausgleichsverfahren beteiligter Hinterleger in der Sondermasse verbleibender Betrag ist an die Insolvenzmasse abzuführen.

(4) Jeder am Ausgleichsverfahren Beteiligte ist berechtigt und verpflichtet, die von ihm dem Verwahrer anvertrauten und in der Sondermasse vorhandenen Wertpapiere oder Sammelbestandteile zu dem Schätzwert des Tages der Eröffnung des Insolvenzverfahrens zu übernehmen. Übersteigt dieser Wert den ihm aus der Sondermasse gebührenden Betrag, so hat er den Unterschied zur Sondermasse einzuzahlen. Die Wertpapiere oder Sammelbestandteile haften als Pfand für diese Forderung.

(5) Jeder Hinterleger kann seine Forderungen, soweit er mit ihnen bei der Befriedigung aus der Sondermasse ausgefallen ist, zur Insolvenzmasse geltend machen.

(6) § 32 Abs. 4 und 5 ist sinngemäß anzuwenden.

#### 4. Abschnitt Strafbestimmungen

##### § 34 Depotunterschlagung

(1) Wer, abgesehen von den Fällen der §§ 246 und 266 des Strafgesetzbuchs, eigenen oder fremden Vorteils wegen

as payments made to ward off an imminent realisation of the pledge.

(3) The separated insolvency assets must be distributed amongst the depositors involved in the compensation procedure in the proportion of the value of the securities or shares in collective holdings entrusted by them to the custodian. The authoritative value shall be the value on the day of the commencement of the insolvency proceedings unless the securities or shares in collective holdings have only been realised later. In this case the proceeds obtained shall be authoritative. Any amount remaining in the separated insolvency assets after the satisfaction of all depositors involved in the compensation proceedings shall be transferred to the insolvency assets.

(4) Every person involved in compensation proceedings shall be entitled and obliged to take over the securities or shares in collective holdings entrusted to the custodian and which are part of the separated insolvency assets subject to the estimated value on the day of the commencement of the insolvency proceedings. If this value exceeds the amount to which it is entitled in respect of the separated insolvency assets, it shall pay the difference into the separated insolvency assets. The securities or shares in collective holdings shall be liable as a lien for this claim.

(5) Each depositor may assert its claims in respect of the insolvency assets insofar as it has not been satisfied from the separated insolvency assets.

(6) § 32 paras. 4 and 5 shall apply *mutatis mutandis*.

#### Part 4 Penal provisions

##### § 34 Misappropriation of deposits

(1) Anyone who, except for the cases pursuant to §§ 246 and 266 of the Penal Code, for its own or a third party advantage

1. über ein Wertpapier der in § 1 Abs. 1 bezeichneten Art, das ihm als Verwahrer oder Pfandgläubiger anvertraut worden ist oder das er als Kommissionär für den Kommittenten im Besitz hat oder das er im Falle des § 31 für den Kunden im Besitz hat, rechtswidrig verfügt,

2. einen Sammelbestand solcher Wertpapiere oder den Anteil an einem solchen Bestand dem § 6 Abs. 2 zuwider verringert oder darüber rechtswidrig verfügt, wird mit Freiheitsstrafe bis zu fünf Jahren oder mit Geldstrafe bestraft.

(2) (weggefallen)

##### § 35 Unwahre Angaben über das Eigentum

Wer eigenen oder fremden Vorteils wegen eine Erklärung nach § 4 Abs. 2 wahrheitswidrig abgibt oder eine ihm nach § 4 Abs. 3 obliegende Mitteilung unterläßt, wird, wenn die Tat nicht nach anderen Vorschriften mit schwererer Strafe bedroht ist, mit Freiheitsstrafe bis zu einem Jahr oder mit Geldstrafe bestraft.

##### § 36 Strafantrag

Ist in den Fällen der §§ 34 und 35 durch die Tat ein Angehöriger (§ 11 Abs. 1 Nr. 1 des Strafgesetzbuchs) verletzt, so wird sie nur auf Antrag verfolgt.

##### § 37 Strafbarkeit im Falle der Zahlungseinstellung oder des Insolvenzverfahrens

Wer einer Vorschrift der §§ 2 und 14 oder einer sich aus den §§ 18 bis 24, 26 ergebenden Pflicht zuwiderhandelt, wird mit Freiheitsstrafe bis zu zwei Jahren oder mit Geldstrafe bestraft, wenn er seine Zahlungen eingestellt hat oder über sein Vermögen das Insolvenzverfahren eröffnet worden ist und wenn durch die Zuwiderhandlung ein Anspruch des Berechtigten auf Aussonderung der Wertpapiere vereitelt oder die Durchführung eines solchen Anspruchs erschwert wird.

§§ 38 bis 40 (weggefallen)

1. unlawfully disposes of a security of the kind referred to in § 1 para. 1 entrusted to it as custodian or pledgee or which it possesses as commission agent for the principal or which it possesses in the case of § 31 for the customer,

2. reduces collective holdings of such securities or a share in such securities contrary to § 6 para. 2 and disposes unlawfully of them,

shall be liable to a term of imprisonment not exceeding five years or to a fine.

(2) (no longer applicable)

##### § 35 Untrue information concerning ownership

Anyone who makes for its own or third party advantage a statement pursuant to § 4 para. 2 which is untrue, or fails to make a notification to which it is obliged under § 4 para. 3, shall be liable to a term of imprisonment not exceeding one year or to a fine unless this act runs the risk of more severe punishment under other provisions.

##### § 36 Initiation of criminal prosecution

If, in the cases of §§ 34 and 35, an act injures a family member (§ 11 para. 1 number 1 of the Penal Code) such act shall only be prosecuted following a formal application.

##### § 37 Criminal liability in the event of cessation of payments or of insolvency proceedings

Any person who infringes a provision under §§ 2 and 14 or an obligation resulting from §§ 18 to 24, 26 shall be liable to a term of imprisonment not exceeding two years or to a fine if such person ceases its payments or insolvency proceedings have been initiated against its assets or if, as a result of the infringement, a claim of the beneficiary to separation of the securities from the insolvency assets is prevented or the enforcement of such claim is rendered more difficult.

§§ 38 to 40 (no longer applicable)

### 5. Abschnitt Schlußbestimmungen

§ 41 (weggefallen)

§ 42 Anwendung auf Treuhänder, Erlass weiterer Bestimmungen

Das Bundesministerium der Justiz kann im Einvernehmen mit dem Bundesministerium der Finanzen und dem Bundesministerium für Wirtschaft und Technologie durch Rechtsverordnung, die nicht der Zustimmung des Bundesrates bedarf, die Anwendung von Vorschriften dieses Gesetzes für Fälle vorschreiben, in denen Kaufleute als Treuhänder für Dritte Wertpapiere besitzen oder erwerben oder Beteiligungen oder Gläubigerrechte ausüben oder erwerben oder in öffentliche Schuldbücher oder sonstige Register eingetragen sind.

§ 43 (Inkrafttreten, Außerkrafttreten anderer Vorschriften, Überleitungsvorschrift)

### Part 5 Final provisions

§ 41 (no longer applicable)

§ 42 Applicability to trustees, enactment of further provisions

The Federal Ministry of Justice may prescribe, following consultation with the Federal Ministry of Finance and the Federal Ministry for Economic Affairs and Technology, by way of a regulation which does not require the consent of the Bundesrat, the application of provisions of this Act in cases in which merchants possess or acquire securities as trustees for third parties or exercise or acquire shares or creditor rights or are entered into public debt registers or other registers.

§ 43 (Entry into force, repeal of other provisions, transitional provisions)

*This translation is furnished for information purposes only. The original German text is binding in all respects.*

## **Securities Trading Act (Wertpapierhandelsgesetz – WpHG)**

**- unofficial text -**

**as published in the announcement of 9 September 1998 (Federal Law Gazette I, p. 2708)**

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**Section 1**  
**Scope of application**

(1) This Act shall apply to the provision of investment services and ancillary services, to on and off-exchange trading in financial instruments, to the conclusion of financial futures and forward transactions, to financial analyses and to changes in the percentage of voting rights held by shareholders of listed companies.

(2) The provisions in parts 3 and 4, as well as sections 30h, 30i, 34b and 34c are also applicable to actions and omissions performed outside of Germany, to the extent that they relate to financial instruments traded on a German stock exchange.

(3) The provisions of parts 3 and 4, as well as sections 34b and 34c shall not apply to transactions carried out for monetary policy purposes or within the framework of public debt management by the European Central Bank, the German Federal Government or one of its funds, a Federal State, the *Deutsche Bundesbank*, a foreign country or its central bank or another body commissioned to conduct such transactions or any person acting for their account.

**Section 2**  
**Definitions**

(1) Securities within the meaning of this Act, whether or not represented by a certificate, are all categories of transferable securities with the exception of instruments of payment which are by their nature negotiable on the financial markets, in particular

1. shares in companies;
2. other investments equivalent to shares in German or foreign legal persons, partnerships and other enterprises as well as certificates representing shares; and
3. debt securities;
  - a) in particular profit-participation certificates and bearer bonds and order bonds as well as certificates representing debt securities;
  - b) other securities giving the right to acquire or sell securities specified in nos. 1 and 2 or giving rise to a cash settlement determined by reference to securities, currencies, interest rates or other yields, commodities, indices or measures.

Units in investment funds (*Investmentvermögen*) issued by an asset management company (*Kapitalanlagegesellschaft*) or a foreign investment company (*Investmentgesellschaft*) are also deemed to be securities.

(1a) Money market instruments within the meaning of this Act are any categories of receivables which do not come under the provisions of subsection (1) and are usually traded on the money market with the exception of instruments of payment.

(2) Derivatives within the meaning of this Act are

1. firm contracts or option contracts in the form of acquisitions, swaps or in other forms which are to be settled at a future date and whose values are derived directly or indirectly from the price or value measure of an underlying instrument (futures and forward transactions) relating to the following underlying instruments:
  - a. securities or money market instruments;
  - b. foreign exchange or units of account;
  - c. interest rates or other yields;
  - d. indices of the underlying instruments specified in (a), (b) or (c), other financial indices or financial measures; or
  - e. derivatives;
2. futures and forward transactions relating to commodities, freight rates, emission allowances, climatic or other physical variables, inflation rates or other economic variables or other assets, indices or measures as underlying instruments, provided
  - a. they are cash-settled or grant the party to a contract the right to demand cash settlement without this right being contingent on default or another termination event;
  - b. they are concluded on an organised market or a multilateral trading facility; or
  - c. in accordance with Article 38 (1) of Commission Regulation (EC) No. 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive (OJ EU no. L 241 p. 1), they have the characteristics of other derivatives and are not for commercial purposes and if the conditions set out in Article 38 (4) of this Regulation are not satisfied;

and if they are not spot contracts within the meaning of Article 38 (2) of Regulation (EC) No. 1287/2006;

3. financial contracts for differences;
4. firm contracts or option contracts in the form of acquisitions, swaps or in other forms which are to be settled at a future date and are intended for the transfer of credit risk (credit derivatives);

5. futures and forward transactions relating to the underlying instruments set out in Article 39 of Regulation (EC) No. 1287/2006 if they satisfy the conditions of no. 2.

(2a) (Repealed)

(2b) Financial instruments within the meaning of this Act are securities within the meaning of subsection (1), money market instruments within the meaning of subsection (1a), derivatives within the meaning of subsection (2) and securities subscription rights.

(2c) Commodities within the meaning of this Act are economic goods of a fungible nature that are capable of being delivered; this includes metals, ores and alloys, agricultural products and energy such as electricity.

(3) Investment services within the meaning of this Act are

1. the purchase or sale of financial instruments in one's own name for the account of others (principal broking services);
2. the continuous offer to buy or sell financial instruments on an organised market or in a multilateral trading facility at prices defined by the offerors themselves, the dealing on own account outside an organised market or a multilateral trading facility on a frequent, organised and systematic basis by providing a system accessible to third parties in order to engage in dealings with them, or the purchase or sale of financial instruments for own account as a service for third parties (proprietary trading);
3. the purchase or sale of financial instruments in the name of a third party for the account of others (contract broking);
4. the brokering of transactions involving the purchase and sale of financial instruments (investment broking);
5. the underwriting of financial instruments at one's own risk for placement in the market or the assumption of equivalent guarantees (underwriting business);
6. the placing of financial instruments without a firm commitment basis (placing business);
7. the administration of individual or several portfolios invested in financial instruments for others on a discretionary basis (portfolio management);
8. the operation of a multilateral system which, in the system and in accordance with pre-determined provisions, brings together multiple third-party buying and selling interests in financial instruments in a way that results in a contract for the acquisition of these financial instruments (operation of a multilateral trading facility);
9. the provision of personal recommendations relating to transactions in certain financial instruments to clients or their representatives insofar as the recommendation is based on an evaluation of the investor's personal circumstances or is presented as being suitable for the investor and is not provided exclusively via distribution channels or for the general public (investment advice).

The purchase or sale of financial instruments for own account which does not constitute a service for third parties within the meaning of sentence 1 no. 2 shall also be deemed investment services (proprietary business). Investment management requiring authorisation pursuant to section 1 (1a) sentence 2 no. 11 of the Banking Act (*Kreditwesengesetz*) shall be deemed equivalent to portfolio management in respect of sections 9, 31 to 34 and 34b to 36b of this Act and to Articles 7 and 8 of Commission Regulation (EC) No. 1287/2006.

(3a) Ancillary investment services within the meaning of this Act are

1. the safe custody and administration of financial instruments for the account of others and services connected thereto (safe custody business);
2. the granting of credits or loans to others for the carrying out of investment services provided the enterprise granting the credits or loans is involved in these transactions;
3. the provision of advice to companies with respect to the capital structure and the industrial strategy as well as the provision of advice and services relating to the acquisition and mergers of undertakings;
4. foreign exchange transactions which are connected to investment services;
5. the production, distribution or communication of financial analyses or other information concerning financial instruments or their issuers which directly or indirectly contain a recommendation relating to a specific investment decision;
6. services which are connected to underwriting business;
7. services relating to an underlying instrument within the meaning of subsection (2) no. 2 or no. 5 and which are connected to investment services or ancillary services.

(4) Investment services enterprises within the meaning of this Act are credit institutions, financial services institutions and enterprises operating under section 53 (1) sentence 1 of the Banking Act which provide investment services alone or in connection with ancillary services on a commercial basis or on a scale which requires commercially organised business operations.

(5) An organised market within the meaning of this Act is a multilateral system operated or managed in Germany, another member state of the European Union or another signatory to the Agreement on the European Economic Area, authorised, regulated and supervised by public bodies, which, in the system and in accordance with pre-determined provisions, brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments admitted to trading on such a system in a way that results in a contract for the acquisition of these financial instruments.

(6) Issuers whose home country is the Federal Republic of Germany are

1. issuers of debt securities the denomination per unit of which is less than 1,000 euros or the value of such denomination per unit in another currency as at the date of issue, or of shares,
  - a. who are domiciled in Germany and whose securities are admitted to trading on an organised market in Germany or in another member state of the European Union or another signatory to the Agreement on the European

Economic Area; or

- b. who are domiciled in a country which is neither a member state of the European Union nor a signatory to the Agreement on the European Economic Area (third country) and whose securities are admitted to trading on an organised market in Germany or in another member state of the European Union or another signatory to the Agreement on the European Economic Area, if the annual document within the meaning of section 10 of the Securities Prospectus Act (*Wertpapierprospektgesetz*) is to be filed with the Supervisory Authority;
2. issuers who do not issue financial instruments within the meaning of no. 1, if they are domiciled in Germany or a third country and their financial instruments are admitted to trading on an organised market in Germany but not in another member state of the European Union or another signatory to the Agreement on the European Economic Area;
  3. issuers who do not issue financial instruments within the meaning of no. 1 and who do not fall within the scope of no. 2
    - a. if they are domiciled in Germany and their financial instruments are admitted to trading on an organised market also, or exclusively, in one or several other member states of the European Union or in one or several other signatories to the Agreement on the European Economic Area; or
    - b. if they are domiciled in another member state of the European Union or in another signatory to the Agreement on the European Economic Area and their financial instruments are admitted to trading on an organised market also, or exclusively, in Germany; or
    - c. if they are domiciled in a third country and their financial instruments are admitted to trading on an organised market in Germany and in one or several other member states of the European Union or one or several other signatories to the Agreement on the European Economic Area,

and if they have chosen the Federal Republic of Germany as their home country pursuant to section 2b. The Federal Republic of Germany shall be deemed the home country for issuers who fall within the scope of (a) but have not made a choice; the same applies to issuers who fall within the scope of (c) but have not chosen a home country, if the annual document within the meaning of section 10 of the Securities Prospectus Act is to be filed with the Supervisory Authority.

(7) Domestic issuers are

1. issuers whose home country is the Federal Republic of Germany, with the exception of those issuers whose securities are not admitted in Germany but only in another member state of the European Union or another signatory to the Agreement on the European Economic Area, to the extent that they are subject to the disclosure and notification requirements pursuant to Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (*regulierter Markt*) and amending Directive 2001/34/EC (OJ EU no. L 390 p. 38); and

2. issuers whose home country is not the Federal Republic of Germany but another member state of the European Union or another signatory to the Agreement on the European Economic Area and whose securities are only admitted to trading on an organised market in Germany.

(8) Home member state within the meaning of this Act is

1. in the case of an investment services enterprise, the member state in which its head office is located;
2. in the case of an organised market, the member state in which the organised market is registered or authorised or, if under the law of that member state it has no registered office, the member state in which the head office of the organised market is situated.

(9) Host member state within the meaning of this Act is

1. in the case of an investment services enterprise, the member state in which it has a branch or in which it conducts its operations under the freedom to provide cross-border services;
2. in the case of an organised market, the member state in which the organised market provides appropriate arrangements so as to facilitate access to trading on its system by market participants established in that same member state.

(10) A systematic internaliser within the meaning of this Act is a company which, in accordance with Article 21 of Commission Regulation (EC) No. 1287/2006, engages in proprietary trading outside organised markets and multilateral trading facilities on a frequent, organised and systematic basis.

## **Section 2a Exceptions**

(1) The following are not deemed to be investment services enterprises:

1. enterprises which provide investment services within the meaning of section 2 (3) sentence 1 solely for their parent enterprise or their subsidiaries or sister enterprises within the meaning of section 1 (6) and (7) of the Banking Act (*Kreditwesengesetz*);
2. enterprises which provide investment services for others that only involve the administration of an employee participation scheme of their own or of affiliated enterprises;
3. enterprises which provide investment services only within the meaning of both nos. 1 and 2;
4. insurance undertakings under public or private law;
5. the public debt management of the Federal Government or one of its funds, of a Federal State, of another member state of the European Union or another signatory to the Agreement on the European Economic Area, the *Deutsche Bundesbank* and other members of the European System of Central Banks or the central banks of the

other signatories;

6. members of independent professions who provide investment services as self-employed persons on behalf of clients only occasionally, and who are members of a professional organisation in the form of a corporate body under public law the professional rules and regulations of which do not exclude the provision of investment services;
7. enterprises which provide others with investment services consisting solely of investment advice and investment broking between clients and
  - a. institutions within the meaning of the Banking Act;
  - b. institutions or financial enterprises domiciled in another state of the European Economic Area which fulfil the requirements specified in section 53b (1) sentence 1 or subsection (7) of the Banking Act;
  - c. enterprises which by virtue of a Regulation pursuant to section 53c of the Banking Act are subjected to or exempted from the provisions of that Act; or
  - d. asset management companies (*Kapitalanlagegesellschaften*), investment stock corporations (*Investmentaktiengesellschaften*) or foreign investment companies (*Investmentgesellschaften*)

to the extent that these investment services are limited to units in investment funds (*Investmentvermögen*) which are issued by a German investment management company or asset management companies, investment stock corporations or foreign investment companies within the meaning of sections 96 to 111a of the Investment Act (*Investmentgesetz*), or limited to foreign investment units which may be sold to the public pursuant to the Investment Act, and to the extent that the companies are not authorised to obtain ownership or possession of monies or shares from clients in the course of providing these investment services, unless the company has filed for and obtained a corresponding authorisation pursuant to section 32 (1) of the Banking Act; units in funds (*Sondervermögen*) with additional risks pursuant to section 112 of the Investment Act are not deemed units in investment funds (*Investmentvermögen*) within the meaning of this provision;

8. enterprises whose investment service consists exclusively in providing one or several of the following services:
  - a. proprietary business on a German stock exchange or on multilateral trading facilities in Germany where derivatives are traded (derivatives markets), and on cash markets for the sole purpose of hedging these positions;
  - b. proprietary trading, principal broking services or contract broking on derivatives markets exclusively on behalf of other members of those markets;
  - c. quotation of prices as market maker within the meaning of section 23 (4) while engaging in proprietary trading on behalf of other members of those derivatives markets;

to the extent that responsibility for ensuring the performance of contracts entered into by these enterprises on such markets or multilateral trading facilities is assumed by clearing members of the same markets or trading facilities;

9. enterprises conducting proprietary business in financial instruments or providing investment services in derivatives within the meaning of section 2 (2) nos. 2 and 5 provided that
  - a. they are not part of a group whose main business is the provision of investment services or banking services within the meaning of section 1 (1) sentence 2 no. 1, 2, 8 or 11 of the Banking Act;
  - b. these investment services are ancillary activities to their main business when considered on a group basis; and
  - c. the investment services in derivatives within the meaning of section 2 (2) nos. 2 and 5 are provided exclusively to the clients of their main business in connection with transactions conducted in their main business;
10. enterprises which do not provide any investment services other than proprietary business provided they do not
  - a. offer on a continuous basis to buy or sell financial instruments on an organised market or in a multilateral trading facility by way of proprietary trading at prices defined by them; or
  - b. engage in proprietary trading outside an organised market or a multilateral trading facility on an organised, frequent and systematic basis by providing a system accessible to third parties in order to engage in dealings with them;
11. enterprises which, in the course of providing another professional activity, provide investment services consisting solely of investment advice which is not specifically remunerated;
12. enterprises whose main business is to conduct proprietary business and proprietary trading in commodities or derivatives within the meaning of section 2 (1) no. 2 relating to commodities, provided that they are not part of a group whose main business is the provision of investment services or banking services within the meaning of section 1 (1) sentence 2 no. 1, 2, 8 or 11 of the Banking Act; and
13. stock exchange operators or operators of organised markets which do not provide any other investment services within the meaning of section 2 (3) sentence 1 beside the operation of a multilateral trading facility.
14. (repealed)

(2) An enterprise which, as a tied agent within the meaning of section 2 (10) sentence 1 of the Banking Act, provides investment services consisting solely of contract broking, investment broking, placing of financial instruments without a firm commitment basis or investment advice is not deemed to be an investment services enterprise. Its business activities are attributed to the institution or enterprise for the account and under the liability of which it provides its services.

(3) (Repealed)

## **Section 2b**

### **Choice of home country**

(1) An issuer within the meaning of section 2 (6) no. 3 (a) to (c) may choose the Federal Republic of Germany as his home country if he has not chosen another country as his home country within the past three years. The choice shall be valid for a minimum period of three years unless the issuer's financial instruments are no longer admitted to trading on an organised market in a member state of the European Union or in another signatory to the Agreement on the European Economic Area. The choice must be published and transmitted to the company register within the meaning of section 8b of the Commercial Code (*Handelsgesetzbuch*) to be stored there. The choice shall become effective with its publication.

(2) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning the publication of the choice of home country.

## **Part 2**

### **Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*)**

#### **Section 3**

(Repealed)

#### **Section 4**

##### **Functions and powers**

(1) The Federal Financial Supervisory Authority (Supervisory Authority) shall exercise supervision in accordance with the provisions of this Act. Within the framework of the functions assigned to it, the Supervisory Authority shall counteract undesirable developments which may adversely affect the orderly conduct of trading with financial instruments or the provision of investment services or ancillary services or which may result in serious disadvantages for the financial market. It may issue orders that are appropriate and necessary to eliminate or prevent such undesirable developments.

(2) The Supervisory Authority monitors compliance with the prohibitions and requirements of this Act, and may issue orders appropriate and necessary for its enforcement. It may temporarily suspend trading with individual or several financial instruments or order suspension of individual or several financial instruments from trading in markets on which financial instruments are traded, to the extent that this is necessary for the enforcement of the prohibitions and requirements of this Act or for the elimination or prevention of undesirable developments in accordance with subsection (1).

(3) The Supervisory Authority may require the provision of information, submission of documentation and surrender of copies from anyone, as well as summon and question persons, to the extent that these measures are necessary based on evidence for monitoring compliance with the prohibitions and requirements of this Act. In particular, it may require details concerning changes in holdings of financial instruments as well as information about

the identities of other persons, especially the principal and the persons acquiring rights or incurring liabilities from transactions. Statutory rights to provide or refuse to provide information as well as statutory obligations of confidentiality remain unaffected.

(4) During normal business hours, employees of the Supervisory Authority and the persons commissioned by it shall be permitted to enter the property and business premises of persons required to provide information pursuant to subsection (3) insofar as this is necessary for the performance of their functions. Outside of normal business hours or if the business premises are located in residential property, entry without permission shall be allowed and must be tolerated only to the extent that this is necessary to prevent imminent danger to public safety and order and if there is evidence indicating contravention of a prohibition or requirement of this Act by the person required to provide information. The basic right granted by Article 13 of the Basic Law (*Grundgesetz*) is, to this extent, restricted.

(5) The Supervisory Authority must without undue delay report facts giving rise to suspicion of a criminal offence pursuant to section 38 to the competent public prosecutor's office. It may communicate to the public prosecutor's office the personal data of any persons suspected of the offence or persons who may be required to act as witnesses, to the extent that this is necessary for criminal prosecution. The public prosecutor's office shall decide on the necessary investigatory measures to be pursued, especially with regard to searches, in accordance with the provisions of the Code of Criminal Procedure (*Strafprozessordnung*). The powers of the Supervisory Authority pursuant to subsections (2) to (4) shall remain unaffected, to the extent that this is necessary for the implementation of administrative measures or the fulfilment of requests by foreign agencies in accordance with section 7 (2), subsection (2b) sentence 1 or subsection (7) and to the extent that this does not present a threat to the purpose of investigations by prosecuting authorities or the courts responsible for criminal cases.

(6) The Supervisory Authority may make publications or notifications in accordance with the provisions of this Act at the expense of the entity subject to the publication or notification requirement if it fails to comply with the requirement or complies with it incorrectly, incompletely or not in the prescribed form.

(7) Objections and actions to annul measures in accordance with subsections (1), (4) and (6) shall have no suspensive effect.

(8) Addressees of measures pursuant to subsections (2) to (4) which are taken by the Supervisory Authority in reaction to a possible contravention of a prohibition pursuant to section 14 or section 20a are prohibited from informing persons other than state agencies and such persons who, based on their profession, are subject to a statutory obligation of confidentiality, of the measures or of any preliminary proceedings initiated against them.

(9) A person obliged to furnish information may refuse to do so in respect of any questions, the answers to which would place himself or one of his relatives as designated in section 383 (1) nos. 1 to 3 of the Code of Civil Procedure (*Zivilprozessordnung*) at risk of criminal prosecution or proceedings under the Act on Breaches of Administrative Regulations (*Gesetz über Ordnungswidrigkeiten*). Persons obliged to furnish information shall be informed of the right to refuse and instructed that, in accordance with the Act, they are at all times free, including prior to questioning, to consult with a defence counsel of their choosing.

(10) The Supervisory Authority may only store, edit and use the personal data submitted to it for the purposes of fulfilling its supervisory functions and for international cooperation purposes in accordance with section 7.

(11) The Supervisory Authority may allow auditors or experts to carry out investigations or verifications to perform its functions.

#### **Section 4 a** **Powers to safeguard the financial system**

(1) The Supervisory Authority may, in consultation with the Deutsche Bundesbank, issue orders that are appropriate and necessary to eliminate or prevent undesirable developments that may be detrimental to the stability of financial markets or undermine confidence in the proper functioning of financial markets. In particular, the Supervisory Authority may temporarily

1. prohibit trading in individual or several financial instruments, in particular
  - a. order a ban on transactions in derivatives whose value is derived directly or indirectly from the price of shares or debt securities issued by central governments, regional governments or local authorities of member states of the European Union whose legal currency is the euro, provided such derivatives are admitted to trading on the regulated market of a German stock exchange, are equivalent, based on an economic view, to a short-selling transaction in such shares or debt securities in terms of structure and effect and do not result in a reduction in an existing market risk or in a market risk assumed in direct temporal connection with a derivative transaction; in this respect section 37 of the Exchange Act (*Börsengesetz*) shall not apply; or
  - b. order a ban on the acquisition of rights attached to currency derivatives within the meaning of section 2 (2) no. 1 (b), (d) or (e) where the value of the derivatives is derived directly or indirectly from the exchange rate of the euro, unless it is to be expected that the market value of such rights decreases when the euro exchange rate appreciates, and the acquisition of such rights is used to hedge existing or expected own currency risks; such ban may also extend to legal obligations to enter into such transactions; or
2. order the suspension of trading in individual or several financial instruments on markets on which financial instruments are traded.

(2) The Supervisory Authority may order that persons who enter into transactions in financial instruments must publish their positions in such financial instruments and at the same time notify these to the Supervisory Authority. The Supervisory Authority may publish notifications pursuant to sentence 1 on its website.

(3) The provisions of section 4 (3), (4), (6), (9) and (10) shall apply *mutatis mutandis*.

(4) Measures pursuant to subsections (1) to (3) shall be limited to a maximum of 12 months. An extension of this period by up to 12 months shall be permitted. In this case, the Federal Ministry of Finance shall submit a report to the *Bundestag* within one month of the beginning of the extension. Objections and actions to annul measures in accordance with subsections (1) to (3) shall have no suspensive effect.

#### **Section 5** **Securities Council**

(1) A Securities Council is established at the Supervisory Authority. It comprises representatives of the Federal States. Membership shall not be held in a personal capacity. Each Federal State shall appoint one representative. Representatives of the Federal Ministries of Finance, of Justice and of Economics and Technology, as well as the *Deutsche Bundesbank* shall be entitled to attend the meetings of the Securities Council. The Securities Council may consult experts, particularly from the stock exchanges, from amongst market participants, from business and from academics. The Securities Council shall draw up standing orders.

(2) The Securities Council shall assist with supervision. It shall advise the Supervisory Authority, in particular

1. on issuing Regulations and establishing guidelines for the supervisory activity of the Supervisory Authority;
2. concerning the effects of supervisory issues on stock exchange and market structures and on competition in trading with financial instruments and
3. on the demarcation of responsibilities between the Supervisory Authority and the stock exchange supervisory authorities as well as on issues of cooperation.

The Securities Council may submit proposals to the Supervisory Authority concerning the general development of supervisory practice. The Supervisory Authority shall report to the Securities Council at least once per year on its supervisory activities, on the development of supervisory practice and on international cooperation.

(3) The Securities Council shall be convened at least once each year by the President of the Supervisory Authority. It shall also be convened at the request of one third of its members. Any member shall be entitled to put forward proposals for consultation.

## **Section 6 Cooperation with other domestic authorities**

(1) The stock exchange supervisory authorities shall act on behalf of the Supervisory Authority in implementing urgent measures as part of monitoring compliance with the prohibition of insider dealing pursuant to section 14 and the prohibition of market manipulation pursuant to section 20a on the stock exchanges subject to their supervision. The details shall be regulated in an administrative agreement between the Federal Government and the Federal States conducting stock exchange supervision.

(2) The Supervisory Authority, the *Deutsche Bundesbank* (in the course of its activities pursuant to the Banking Act (*Kreditwesengesetz*)), the *Bundeskartellamt* (Federal Cartel Office), the stock exchange supervisory authorities, the trading surveillance units, the Federal Network Agency (*Bundesnetzagentur*) in the course of its activities pursuant to the Energy Industry Act (*Energiewirtschaftsgesetz*) and the competent bodies responsible for the supervision of insurance intermediaries and brokers of units in investment funds (*Investmentvermögen*) shall communicate to each other any observations and findings, including personal data, which may be necessary for the performance of their functions.

(3) For the performance of its functions, the Supervisory Authority may, in an automated procedure, retrieve data stored with the *Deutsche Bundesbank* pursuant to sections 2 (10), 2c, 24 (1) nos. 1, 2, 5, 7 and 10 and subsection (3), section 25a (2), section 32 (1)

sentences 1 and 2 nos. 2, 6 (a) and (b) of the Banking Act. For purposes of monitoring data protection compliance, the *Deutsche Bundesbank* shall log the time, the details which enable the retrieved data records to be identified, and the person responsible for the retrieval. The recorded data may only be used for the purpose of data protection compliance, data security or for ensuring the proper functioning of the data processing equipment. The records shall be deleted at the end of the calendar year following the year in which they were stored.

(4) Public agencies are to ensure suitable and transparent procedures with regard to the publication of statistics which have the potential to significantly impact on financial markets. In particular, it must be guaranteed that no third parties receive informational advantages from the publications.

## **Section 7**

### **Cooperation with competent authorities in other countries**

(1) The Supervisory Authority is responsible for cooperation with the competent authorities responsible for the supervision of conduct of business and organisational requirements of companies providing investment services, of financial instruments and of markets on which financial instruments or commodities are traded in other member states of the European Union and the other signatories to the Agreement on the European Economic Area. Within the framework of its cooperation, for purposes of monitoring compliance with the prohibitions and requirements of this Act and of the countries specified in sentence 1 which are equivalent to those prohibitions and requirements of this Act or the Exchange Act (*Börsengesetz*), the Supervisory Authority may make use of all powers available to it by law, to the extent that this is suitable and necessary to honour the requests of the authorities specified in sentence 1. The Supervisory Authority may, upon request of the authorities specified in sentence 1, order the prohibition or suspension of trading on a domestic market pursuant to section 4 (2) sentence 2 only if this does not seriously jeopardise investors' interests or the orderly conduct of trading on the market concerned. This shall be without prejudice to the provisions of the Exchange Act relating to cooperation between the trading surveillance units and similar bodies or the boards of management of the exchanges in other countries.

(2) Upon request by the competent authorities named in subsection (1) sentence 1, the Supervisory Authority conducts investigations pursuant to Article 15 of Commission Regulation (EC) No. 1287/2006 and transmits all information without undue delay, to the extent that this is necessary for the supervision of organised markets or other markets for financial instruments, of credit institutions, financial services institutions, investment companies, financial enterprises or insurance undertakings or administrative or judicial proceedings related thereto. When transmitting information, the Supervisory Authority is obliged to instruct the recipient that, without prejudice to his prosecutorial obligations, the transmitted information, including personal data, is to be used only to fulfil supervisory duties in accordance with sentence 1 and in the context of administrative and judicial proceedings related thereto.

(2a) The Supervisory Authority takes reasonable steps to ensure effective cooperation, in particular with respect to those member states where the operations of a domestic stock exchange are of substantial importance for the functioning of the financial markets and the protection of investors pursuant to Article 16 of Commission Regulation (EC) No. 1287/2006, or whose organised markets are of substantial importance in Germany.

(2b) The Supervisory Authority may, upon request, allow representatives of competent authorities of other countries to participate in investigations conducted by the Supervisory

Authority. The competent authorities within the meaning of subsection (1) sentence 1 or entities commissioned by them may, after notifying the Supervisory Authority, examine directly at the branch the information required for monitoring whether the branch within the meaning of section 53b (1) sentence 1 of the Banking Act (*Kreditwesengesetz*) complies with the reporting requirements laid down in section 9, the conduct of business, organisational and transparency obligations specified in sections 31 to 34 or in the relevant foreign provisions.

(3) The Supervisory Authority may refuse an investigation, the transmission of information or the participation of representatives of foreign authorities within the meaning of subsection (1) sentence 1 if

1. this might adversely affect the sovereignty, security or public order of the Federal Republic of Germany or
2. judicial proceedings have already been initiated in respect of the same facts against the persons in question or if a final judgement has been passed.

In the event that the Supervisory Authority fails to comply with a request or exercises its right pursuant to sentence 1, it shall without undue delay notify the requesting authority and provide the grounds; in the case of a refusal pursuant to sentence 1 no. 2, exact information concerning the judicial proceedings or final judgement shall be communicated.

(4) In accordance with Article 15 of Commission Regulation (EC) No. 1287/2006, the Supervisory Authority requests the competent authorities named in subsection (1) to conduct investigations and transmit information suitable and necessary to perform its functions in accordance with the provisions of this Act. It may request that representatives of the Supervisory Authority be permitted to take part in investigations conducted by the competent authorities. The Supervisory Authority may, with the consent of the competent authority, conduct investigations abroad and commission auditors or experts to do so; where the Supervisory Authority conducts investigations of branches of domestic investment services enterprises in host member states, prior information of the competent authority abroad is sufficient. If the Supervisory Authority issues orders vis-à-vis companies domiciled abroad which are members of organised markets in Germany, it informs the authorities competent for the supervision of those companies. Without prejudice to its obligations in prosecutorial matters concerned with contraventions of prohibitions pursuant to the provisions of this Act, the Supervisory Authority may utilise information received from an authority of another country only for the purpose of performing its supervisory functions in accordance with subsection (2) sentence 1 and in the context of administrative and judicial proceedings related thereto. The Supervisory Authority may, in compliance with the purpose intended by the authority transmitting the information, transmit the information to the authorities specified in section 6 (2) if this is necessary for the performance of its functions. Any other use of the information is only permitted with the consent of the authority transmitting the information. With the exception of information related to insider trading and market manipulation, such consent may be waived in exceptional and duly justified cases if the authority transmitting the information is informed thereof without undue delay and the grounds for such waiver are indicated. In the event that a request by the Supervisory Authority pursuant to sentences 1 to 3 is not honoured within an appropriate period of time, or if the request is refused without adequate grounds, the Supervisory Authority may notify the Committee of European Securities Regulators of this fact.

(5) If the Supervisory Authority has sufficient evidence of a contravention of prohibitions or requirements of this Act or equivalent regulations of a foreign country mentioned in subsection (1) sentence 1, it shall notify the competent authorities of the country pursuant to subsection (1) sentence 1 on whose territory the unlawful action is being or was performed or on whose territory the financial instruments in question are traded on an organised market, or which is responsible for prosecuting such contravention under European Union law. If the Supervisory Authority receives such notification from competent foreign authorities, it shall inform them of the results of investigations commenced in response thereto. The Supervisory Authority informs the competent authorities of orders concerning the suspension, prohibition or removal of a financial instrument from trading pursuant to section 4 (2) sentence 2 of this Act and section 3 (5) no. 1 and section 25 (1) of the Exchange Act and, within one month following receipt of a notification pursuant to section 19 (10) of the Exchange Act, of the intention of the board of management of a stock exchange to grant market participants from such countries direct access to their trading systems.

(6) The above shall be without prejudice to provisions on international assistance in criminal matters.

(7) The Supervisory Authority may work in cooperation with the competent authorities of countries other than those mentioned in subsection (1) in accordance with subsections (1) to (6) and conclude agreements on the exchange of information. Subsection (4) sentences 5 and 6 shall apply subject to the proviso that information transmitted by these authorities may only be utilised in compliance with the purpose intended by the authority transmitting the information and may only be communicated to the *Deutsche Bundesbank* or the *Bundeskartellamt* (Federal Cartel Office) with the express consent of the authority transmitting the information if this is necessary for the performance of their functions. Subsection (4) sentence 8 shall not apply. Section 4b of the Federal Data Protection Act (*Bundesdatenschutzgesetz*) shall apply to the communication of personal data.

(8) The Federal Ministry of Finance may issue more detailed provisions for the purposes stated in subsections (2), (2a) and (4) by means of a Regulation not requiring the consent of the *Bundesrat*, concerning the transmission of information to foreign authorities, the conducting of investigations at the request of foreign authorities as well as requests to foreign authorities by the Supervisory Authority. The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Federal Financial Supervisory Authority.

## **Section 8**

### **Obligation of confidentiality**

(1) Persons employed with the Supervisory Authority and persons commissioned in accordance with section 4 (3) of the Act Establishing the Federal Financial Supervisory Authority (*Finanzdienstleistungsaufsichtsgesetz*) may not without authorisation disclose or utilise facts which have come to their knowledge in the course of their activities, the secrecy of which is in the interests of an entity subject to this Act or a third party, especially business and trade secrets as well as personal data, even if the above persons have ceased employment or their activities have ended. The same shall apply with respect to other persons who may obtain knowledge of the information referred to in sentence 1 through official reporting. Disclosure or utilisation shall specifically not be deemed made without authorisation as defined in sentence 1 of this subsection, if facts are communicated to

1. public prosecutors' offices or courts having jurisdiction in criminal cases and administrative offence cases;
2. bodies, and persons commissioned by such bodies, entrusted by law or by order of public authorities with the supervision of stock exchanges or other markets on which financial instruments are traded, of trading in financial instruments or currencies, of credit institutions, financial services institutions, investment companies, financial enterprises, insurance undertakings, insurance intermediaries, investment advisers or brokers of units in investment funds (*Investmentvermögen*) within the meaning of section 2a (1) no. 7;
3. central banks, the European System of Central Banks or the European Central Bank in their capacity as monetary authorities and other state authorities entrusted with the supervision of payment systems;
4. bodies involved in the liquidation or the insolvency proceedings over the assets of an investment services enterprise, an organised market or the operator of an organised market

provided that these bodies require the information for the performance of their functions. The obligation of confidentiality as specified in sentence 1 shall apply *mutatis mutandis* to persons employed by such bodies. If the body is located in another country, the facts may be communicated only if that body and the persons commissioned by it are subject to an obligation of confidentiality equivalent to that specified in sentence 1.

(2) The provisions of sections 93, 97 and 105 (1), 111 (5) in conjunction with section 105 (1) and section 116 (1) of the Fiscal Code (*Abgabenordnung*) shall not apply to the persons referred to in subsection (1) sentence 1 or 2, to the extent that they are acting in a capacity to implement this Act. The requirements do apply, if the tax authorities require the information obtained for a proceeding arising from a criminal tax offence and a tax proceeding related thereto, if there is a compelling public interest in prosecuting the offence and provided such information does not include information which has been communicated to the persons referred to in subsection (1) sentence 1 or 2 by an authority of another country within the meaning of subsection (1) sentence 3 no. 2 or by persons commissioned by such an authority.

## **Section 9**

### **Reporting requirements**

(1) Investment services enterprises and branches within the meaning of section 53b of the Banking Act (*Kreditwesengesetz*) shall be required to report to the Supervisory Authority not later than the next working day (excluding Saturdays) after conclusion of the transaction, pursuant to subsection (2), any transaction in financial instruments which are admitted to trading on an organised market or are included in the regulated market (*regulierter Markt*) or the regulated unofficial market (*Freiverkehr*) of a German stock exchange. The requirement pursuant to sentence 1 shall also apply to the purchase or sale of securities subscription rights, if these securities are to be traded on an organised market or on the regulated unofficial market, and to transactions in shares and warrants in respect of which an application for admission to trading on an organised market or on the regulated unofficial market or for inclusion in the regulated market or the regulated unofficial market has been made or publicly announced. The requirements pursuant to sentences 1 and 2 shall also apply to domestic central counterparties within the meaning of section 1 (31) of the Banking Act with respect to transactions concluded by them. The requirements pursuant to sentences 1 and 2 shall also apply to undertakings domiciled in a country which is not a member state

of the European Union or a signatory to the Agreement on the European Economic Area and authorised to trade on a German stock exchange with respect to transactions in financial instruments concluded by them on that German stock exchange. The requirement pursuant to sentences 1 and 2 shall also apply to undertakings domiciled in another member state of the European Union or a signatory to the Agreement on the European Economic Area and authorised to trade on a German stock exchange, but only with respect to transactions in financial instruments concluded by them on that German stock exchange where these financial instruments are neither admitted to trading on an organised market nor included in the regulated market of a German stock exchange.

(1a) Exempt from the requirement pursuant to subsection (1) are building societies (*Bausparkassen*) within the meaning of section 1 (1) of the Building and Loan Associations Act (*Gesetz über Bausparkassen*) and enterprises within the meaning of section 2 (4) and (5) of the Banking Act, if they are not admitted to trading on a German stock exchange, as well as housing cooperatives with a savings scheme (*Wohnungsgenossenschaften mit Spareinrichtung*). The requirement pursuant to subsection (1) shall also not apply to transactions in units in investment funds (*Investmentvermögen*) issued by asset management companies (*Kapitalanlagegesellschaften*) or foreign investment companies (*Investmentgesellschaften*) which include a redemption obligation.

(2) The report must be transmitted to the Supervisory Authority by way of remote electronic data transfer unless the requirements of Article 12 of Commission Regulation (EC) No. 1287/2006 are satisfied according to which the report may be stored on a data medium. The report must contain, for each transaction, at least the information specified in Article 13 (1) in conjunction with Table 1 of Annex I to Commission Regulation (EC) No. 1287/2006 to the extent that the Supervisory Authority has made a declaration with respect to this information pursuant to Article 13 (1) of Commission Regulation (EC) No. 1287/2006. In addition, the report must contain:

1. an identifier for the securities account holder or the securities account, unless the securities account holder himself is obliged to submit a report in accordance with subsection (1);
2. an identifier for the principal, unless identical with the securities account holder

(3) The Supervisory Authority is the competent authority for the purposes of Articles 9 to 15 of Commission Regulation (EC) No. 1287/2006. It transmits the report pursuant to subsection (1), within the time limits specified in Article 14 (3) of Commission Regulation (EC) No. 1287/2006, to the competent authority of another member state of the European Union or of another signatory to the Agreement on the European Economic Area, if the most relevant market in terms of liquidity for the reported financial instrument within the meaning of Articles 9 and 10 of Commission Regulation (EC) No. 1287/2006 is situated in that state or if a request from a competent authority pursuant to Article 14 (1) (c) of Commission Regulation (EC) No. 1287/2006 has been submitted. Sentence 2 shall *apply mutatis mutandis* to notifications submitted to the Supervisory Authority by branches within the meaning of section 53b (1) sentence 1 of the Banking Act, unless the competent authority in the home country has waived the transmission. Transmission pursuant to sentence 2, also in conjunction with sentence 3, shall also be deemed made to the competent authority in the home country, if it is made to another body in agreement with that authority. Article 14 (2) and (3) of Commission Regulation (EC) No. 1287/2006 shall apply to the content, form and time limit for the transmission pursuant to sentences 2 to 4. Article 15 of Commission Regulation (EC) No. 1287/2006 shall apply to non-automated cooperation between the Supervisory Authority and the competent authority of another member state of the

European Union or another signatory to the Agreement on the European Economic Area in the field of reporting in accordance with this provision or comparable foreign provisions. In order to satisfy the obligations set forth in sentence 2, the Supervisory Authority shall establish a list of financial instruments pursuant to Article 11 of Commission Regulation (EC) No. 1287/2006 and may request reference data from domestic exchanges under the conditions specified in Article 11 of Commission Regulation (EC) No. 1287/2006. This is without prejudice to section 7.

(4) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*,

1. issue more detailed provisions on the content, nature, scope and form of the report and on permitted data media and means of transmission;
2. prescribe additional information in addition to the information pursuant to subsection (2) to the extent that this is justified in the light of the special characteristics of the financial instrument which is the subject of the report, or of the special conditions prevailing in the trading venue, and to the extent that such additional information is necessary for the performance of the supervisory functions of the Supervisory Authority;
3. permit reports by those subject to these requirements to be made at their own expense by the stock exchange or by a suitable third party, and set forth the relevant details;
4. for transactions relating to bonds, permit the information specified in subsection (2) to be reported in summary form;
5. in the case of savings banks or credit cooperatives conducting transactions through a central giro institution, a cooperative central bank or a central credit institution, permit the report required pursuant to subsection (1) to be made by the central giro institution, cooperative central bank or central credit institution, if and to the extent that this does not detract from the intended purpose of the reporting requirement.

(5) The Federal Ministry of Finance may, by means of a Regulation, delegate the authority pursuant to subsection (3) to the Supervisory Authority.

## **Section 10**

### **Reporting of suspicious transactions**

(1) Investment services enterprises, other credit institutions, asset management companies (*Kapitalanlagegesellschaften*) and operators of off-exchange markets on which financial instruments are traded are obliged to notify the Supervisory Authority without undue delay of any facts giving rise to suspicion that a transaction with financial instruments is in contravention of a prohibition or requirement pursuant to section 14, section 20a, section 30h or section 30j. The above are prohibited from informing persons other than state agencies and such persons who, based on their profession, are subject to a statutory obligation of confidentiality, regarding the report or any investigation begun in response thereto.

(2) The Supervisory Authority is obliged to forward without undue delay reports pursuant to subsection (1) to the competent supervisory authorities of those organised markets within the European Union or the European Economic Area on which the financial instruments

pursuant to subsection (1) are traded. The content of the report pursuant to subsection (1) may only be utilised by the Supervisory Authority for performance of its supervisory functions. Beyond this, the information may only be used for the purposes of prosecuting criminal offences pursuant to section 38 and for criminal proceedings relating to a criminal offence subject to a maximum penalty of more than three years imprisonment. The Supervisory Authority may not provide access to the identity of a person filing a report pursuant to subsection (1) for anyone other than state authorities. The right of the Supervisory Authority pursuant to section 40b shall remain unaffected.

(3) Anyone filing a report pursuant to subsection (1) may not be held liable, unless the report is intentionally or negligently untrue.

(4) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning the form and content of a report pursuant to subsection (1). The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Federal Financial Supervisory Authority.

## **Section 11**

### **Duty of the insolvency administrator**

(1) If insolvency proceedings are initiated over the assets of anyone obliged to perform an action under this Act, the insolvency administrator shall support the debtor in fulfilling his duties under this Act, in particular by providing the necessary funds from the assets involved in the insolvency proceedings.

(2) If a provisional insolvency administrator is appointed prior to the opening of insolvency proceedings, such provisional insolvency administrator shall support the debtor in fulfilling his duties, in particular by consenting to the funds being used by the obliged party or, if a general restraint on disposition has been imposed upon the obliged party, by providing the funds from the assets under his management.

## **Part 3**

### **Insider surveillance**

## **Section 12**

### **Insider securities**

Insider securities are financial instruments

1. admitted to trading on a German stock exchange or included in the regulated market (*regulierter Markt*) or the regulated unofficial market (*Freiverkehr*);
2. admitted to trading on an organised market in another member state of the European Union or signatory to the Agreement on the European Economic Area and
3. the prices of which depend directly or indirectly on financial instruments within the meaning of nos.1 or 2.

Securities shall be deemed admitted to trading on an organised market or included on the regulated market or the regulated unofficial market if the application for such admission or inclusion has been made or publicly announced.

## **Section 13**

### **Inside information**

(1) Inside information is any specific information about circumstances which are not public knowledge relating to one or more issuers of insider securities, or to the insider securities themselves, which, if it became publicly known, would likely have a significant effect on the stock exchange or market price of the insider security. Such a likelihood is deemed to exist if a reasonable investor would take the information into account for investment decisions. The term *circumstances* within the meaning of sentence 1 also applies to cases which may reasonably be expected to come into existence in the future. Specifically, inside information refers to information about circumstances which are not public knowledge within the meaning of sentence 1, which

1. is related to orders by third parties for the purchase or sale of financial instruments or
2. is related to derivatives within the meaning of section 2 (2) no. 2 relating to commodities and which market participants would expect to receive in accordance with the accepted practice of the markets in question.

(2) A valuation based solely on information about publicly known circumstances is not inside information, even if it could have a significant effect on the price of insider securities.

## **Section 14**

### **Prohibition of insider dealing**

(1) It is prohibited

1. to make use of inside information to acquire or dispose of insider securities for own account or for the account or on behalf of a third party;
2. to disclose or make available inside information to a third party without the authority to do so; or
3. to recommend, on the basis of inside information, that a third party acquire or dispose of insider securities, or to otherwise induce a third party to do so.

(2) Trading with own shares within the framework of a buy-back programme and price stabilisation measures for financial instruments shall in no case constitute a contravention of the prohibition pursuant to subsection (1), provided that this is performed in compliance with the provisions of Commission Regulation no. 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and the Council - as regards exemptions for buy-back programmes and stabilisation of financial instruments (OJ EC No. L 336 p. 33). For financial instruments included in the regulated unofficial market (*Freiverkehr*) or regulated market (*regulierter Markt*), the provisions of Commission Regulation no. 2273/2003 apply *mutatis mutandis*.

## **Section 15**

### **Notification, publication and transmission of inside information to the company register**

(1) A domestic issuer of financial instruments must, without undue delay, publish all inside information which directly concerns that issuer; furthermore, the domestic issuer must transmit such inside information without undue delay, however not before its publication, to the company register within the meaning of section 8b of the Commercial Code (*Handelsgesetzbuch*) in order to be stored there. In accordance with this provision, an issuer shall also be deemed a domestic issuer if he has merely applied for admission of his financial instruments. In particular, inside information directly concerns an issuer if it relates to developments within the issuer's sphere of activity. Any issuer or person acting on behalf or for the account of an issuer, who as part of his function communicates or grants access to inside information to a third party, must at the same time publish the information in accordance with sentence 1 and transmit it to the company register within the meaning of section 8b of the Commercial Code in order to be stored there, unless the third party is legally obliged to observe confidentiality. In the event of inadvertent communication or granting of access to inside information pursuant to sentence 4, late publication and transmission must be made without undue delay. The key figures employed in the context of publication shall be those customarily used in business and must permit comparison with previously employed figures.

(2) Other information which obviously fails to meet the requirements of subsection (1) may not be published even in connection with information subject to the publication requirement pursuant to subsection (1). False information published pursuant to subsection (1) must be corrected without undue delay in a publication pursuant to subsection (1) even if the requirements in subsection (1) are not met.

(3) The issuer is exempt from the publication requirement pursuant to subsection (1) sentence 1 as long as necessary to protect his legitimate interests, provided there is no reason to expect a misleading of the public and the issuer is able to ensure that the inside information will remain confidential. Late publication must be effected without undue delay. Subsection (4) applies *mutatis mutandis*. The issuer is obliged to notify the Supervisory Authority regarding the grounds for exemption together with the notification pursuant to subsection (4) sentence 1, stating the time of the decision concerning the postponement of the publication.

(4) Before publishing the information referred to in subsection (1) or (2) sentence 2, the issuer shall notify

1. the management of the organised markets in Germany on which the financial instruments are admitted to trading;
2. the management of the organised markets in Germany on which derivatives are traded, which are based on the financial instruments and
3. the Supervisory Authority.

Subsection (1) sentence 6 as well as subsections (2) and (3) apply *mutatis mutandis*. Prior to publication, the management may only utilise the information provided to it pursuant to sentence 1 for the purpose of making the decision as to whether or not calculation of the stock exchange price is to be suspended or discontinued. The Supervisory Authority may permit issuers domiciled abroad to effect the notification pursuant to sentence 1 together with the publication, provided this does not impinge upon the decision of the management concerning suspension or discontinuation of calculation of the stock exchange price.

(5) Publication of inside information in a form other than that set forth in subsection (1) in conjunction with a Regulation pursuant to subsection (7) sentence 1 no. 1 may not be made prior to publication pursuant to subsection (1), sentence 1, 4 or 5, or subsection (2) sentence 2. Simultaneously with the publications pursuant to subsection (1) sentence 1, sentence 4 or sentence 5 or subsection (2) sentence 2, the domestic issuer shall make a notification to the management of the organised markets covered by subsection (4) sentence 1 nos. 1 and 2 and to the Supervisory Authority in respect of such publication; this obligation shall not apply if the Supervisory Authority has already granted permission pursuant to subsection (4) sentence 4 to make the notification under subsection (4) sentence 1 together with the publication.

(6) If the issuer fails to comply with the requirements pursuant to subsections (1) to (4), he shall only be liable to compensate any third party for damage resulting from such non-compliance subject to the conditions of sections 37b and 37c. This is without prejudice to claims for compensation having other legal bases.

(7) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning

1. the minimum content, nature, language, scope and form of the publication pursuant to subsection (1) sentence 1, 4, and 5 or subsection (2) sentence 2;
2. the minimum content, nature, language, scope and form of the notification pursuant to subsection (3) sentence 4, subsection (4) and subsection (5) sentence 2; and
3. legitimate interests of the issuer and the guarantee of confidentiality pursuant to subsection (3).

The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Federal Financial Supervisory Authority.

## **Section 15a**

### **Notification of transactions, publication and transmission to the company register**

(1) Persons discharging managerial responsibilities within an issuer of shares are obliged to notify the issuer and the Supervisory Authority of own transactions in shares of the issuer or financial instruments based on them, in particular derivatives, within five business days (including Saturdays). The obligation pursuant to sentence 1 also applies to other parties who are closely associated with such persons. The obligation pursuant to sentence 1 applies only to issuers of such shares that

1. are admitted to trading on a domestic stock exchange; or
2. are admitted to trading on a foreign organised market if the issuer is domiciled in Germany or if these shares are issued by an issuer domiciled outside the European Union and the European Economic Area and their home country within the meaning of the Securities Prospectus Act (*Wertpapierprospektgesetz*) is the Federal Republic of Germany.

The submission or public announcement of an application for admission is deemed equivalent to admission to trading on an organised market. The obligation pursuant to sentence 1 does not apply as long as the total sum of transactions by a person discharging

managerial responsibilities and parties closely associated with them is less than 5,000 euros by the end of the calendar year.

(2) Persons discharging managerial responsibilities within the meaning of subsection (1) sentence 1 are personally liable partners or members of the management, administrative or supervisory bodies of the issuer as well as other persons with regular access to inside information and who are authorised to make important managerial decisions.

(3) Parties within the meaning of subsection (1) sentence 2, which are closely associated with the persons referred to in subsection (2), are spouses, registered civil partners, dependent children and other relatives living in the same household as the person referred to in subsection (2) for a period of at least one year at the point when the transaction subject to disclosure was concluded. Legal persons for which persons discharge managerial responsibilities within the meaning of subsection (2) or sentence 1 are also deemed parties within the meaning of subsection (1) sentence 2. Such legal persons, companies and organisations which are controlled directly or indirectly by a person referred to in subsection (2) or sentence 1, which were established for the benefit of such persons or the economic interests of which are substantially equivalent to those of such a person, also fall within the scope of sentence 2.

(4) The domestic issuer shall, without undue delay, publish the information pursuant to subsection (1) and simultaneously notify the Supervisory Authority of the publication; furthermore, the domestic issuer shall transmit such information to the company register within the meaning of section 8b of the Commercial Code (*Handelsgesetzbuch*) without undue delay, however not before its publication, to be stored there. Section 15 (1) sentence 2 shall apply *mutatis mutandis*, provided that the public announcement of an application for admission is deemed equivalent to the submission of an application for admission.

(5) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions about the minimum content, nature, language, scope and form of the disclosure pursuant to subsection (1) and subsection (4) sentence 1 as well as the publication pursuant to subsection (4). The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Federal Financial Supervisory Authority.

## **Section 15b**

### **Maintenance of insider lists**

(1) Issuers pursuant to section 15 (1) sentence 1 or sentence 2 and persons acting on behalf or for the account of the issuer are required to maintain lists of persons working for them who have access to inside information as part of their function. Those subject to the requirement set forth in sentence 1 are obliged to update these lists without undue delay and submit them to the Supervisory Authority upon request. The issuer is obliged to inform the persons included in the list regarding the legal obligations associated with access to inside information, and the legal consequences of violations. The persons named in section 323 (1) sentence 1 of the Commercial Code (*Handelsgesetzbuch*) are not deemed to be persons acting on behalf of the issuer.

(2) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning

1. the scope and form of the lists;

2. the data included in the lists;
3. updating and maintenance of the data in the lists;
4. the period of time for which the lists must be retained and
5. the deadlines for destruction of the lists.

The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Federal Financial Supervisory Authority.

## **Section 16**

### **Record-keeping obligations**

Before executing orders relating to insider securities within the meaning of section 12, investment services enterprises as well as companies domiciled within Germany that are admitted to trading on a German stock exchange are required to establish and record in the case of natural persons the name, date of birth and address and in the case of companies the name and address of the principals and the persons or companies acquiring rights or incurring liabilities from the transactions. The information recorded pursuant to subsection (1) shall be retained for a period of at least six years. Section 257 (3) and (5) of the Commercial Code (*Handelsgesetzbuch*) shall apply *mutatis mutandis* to the retention of the records.

## **Section 16a**

### **Monitoring of the transactions effected by the persons employed by the Supervisory Authority**

(1) The Supervisory Authority must have adequate control mechanisms which are capable of preventing any contravention of the prohibitions as set out in section 14 by persons in the employ of the Supervisory Authority.

(2) The superior or the person commissioned by him may require the employees of the Supervisory Authority to furnish information and submit documents relating to transactions in insider securities which they have concluded for own account or for the account or on behalf of a third party. The provisions of section 4 (9) shall apply. Employees who in carrying out their official duties possess or may possess inside information are obliged to notify, without undue delay, the superior or the person commissioned by him in writing of any transactions in insider securities which they have concluded for own account or for the account or on behalf of a third party. The superior or the person commissioned by him shall designate the employees named in sentence 3.

## **Section 16b**

### **Retention of call data**

(1) Investment services enterprises and enterprises domiciled in Germany which are admitted to trading on a German stock exchange, as well as issuers of insider securities and enterprises affiliated with them which are domiciled in Germany or whose securities are admitted to trading on a German stock exchange or are included in the regulated market (*regulierter Markt*) or the regulated unofficial market (*Freiverkehr*), may be required by the Supervisory Authority in writing to retain existing call data on telecommunications for a certain group of persons, provided that the Supervisory Authority has evidence indicating contraventions of section 14 or section 20a by such persons of the particular company. The

basic right granted by Article 10 of the Basic Law (*Grundgesetz*) is, to this extent, restricted. The parties concerned shall be notified in accordance with section 101 (4) and (5) of the Criminal Procedure Code (*Strafprozessordnung*). The Supervisory Authority may not on the basis of sentence 1 require retention of future call data.

(2) The period of retention concerning existing data may be no longer than six months from receipt of the order to retain such data. If retention of the call data is no longer required to investigate suspected contraventions of a prohibition pursuant to section 14 or section 20a, the Supervisory Authority shall, without undue delay, inform the party required to retain such data of this fact and destroy existing documents without undue delay. The duty to destruct the documents without undue delay also applies to the party obliged to retain the data.

### **Part 3a** **Credit rating agencies**

#### **Section 17** **Monitoring of credit rating agencies**

(1) The Supervisory Authority is the competent authority within the meaning of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (OJ L 302, 17.11.2009, p. 1). Unless otherwise provided in Regulation (EC) No 1060/2009, the provisions of Part 1 and Part 2 of this Act shall apply *mutatis mutandis* with the exception of section 7 (4) sentences 5 to 8, section 8 (1) sentence 3 and sections 9 and 10.

(2) The Supervisory Authority shall exercise the powers conferred on it by Regulation (EC) No 1060/2009 insofar as this is necessary for performing its functions and monitoring compliance with the obligations defined in Regulation (EC) No 1060/2009.

(3) Subject to the provisions of Article 15(3) of Regulation (EC) No 1060/2009, the documents to be submitted to the Supervisory Authority pursuant to the Regulation shall be prepared and submitted in German and, upon request by the Supervisory Authority, additionally in English. The Supervisory Authority may permit preparation and submission of the documents exclusively in English if the party subject to such obligation belongs to a group of credit rating agencies within the meaning of Article 3(1)(m) of Regulation (EC) No 1060/2009 or is a company domiciled in a third country.

(4) For the purpose of monitoring compliance with the obligations defined in Regulation (EC) No 1060/2009, the Supervisory Authority may conduct examinations without any particular reason at credit rating agencies, companies affiliated with them and persons or companies involved in the performance of credit rating activities.

(5) Without prejudice to subsection (4), credit rating agencies shall be examined annually for compliance with the obligations defined in Regulation (EC) No 1060/2009 by an auditor commissioned by the Supervisory Authority. The Supervisory Authority shall commission auditors or auditing firms that have sufficient knowledge relating to the subject matter to be examined. The Supervisory Authority shall determine the date on which the examination shall start and the reporting period. The Supervisory Authority may, upon request, waive the annual examination in full or in part if this appears appropriate for special reasons, in particular with respect to the nature and scale of the business conducted. The Supervisory Authority may participate in the examination. The Supervisory Authority may issue rules for the credit rating agencies with regard to the content of the examination and define points of

emphasis for the same which the auditor is required to observe. After conclusion of the examination, the auditor shall without undue delay file an examination report with the Supervisory Authority. The auditor shall without undue delay inform the Supervisory Authority of any serious contraventions of the obligations defined in Regulation (EC) No 1060/2009.

(6) Objections and actions to annul measures of the Supervisory Authority in accordance with subsections (2), (4) and (5), also in conjunction with Regulation (EC) No 1060/2009, shall have no suspensory effect.

(7) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning the nature, scope and time of the examination pursuant to subsections (4) and (5). The Federal Ministry of Finance may, by means of a Regulation and without requiring the consent of the *Bundesrat*, delegate this authority to the Federal Financial Supervisory Authority.

## **Section 18**

(Repealed)

## **Section 19**

(Repealed)

## **Section 20**

(Repealed)

## **Part 4**

### **Monitoring of compliance with the prohibition of stock exchange and market manipulation**

#### **Section 20a**

##### **Prohibition of market manipulation**

(1) It is prohibited

1. to supply false or misleading information concerning circumstances that are of crucial importance for the valuation of financial instruments or to withhold such information in contravention of statutory provisions, if the provision or withholding of the information has the potential to influence the domestic stock exchange or market price of a financial instrument or the price of a financial instrument on an organised market in another member state of the European Union or another signatory to the Agreement on the European Economic Area,
2. to initiate transactions or issue purchase or sell orders that have the potential to generate false or misleading signals affecting supply, demand or the stock exchange

or market price of financial instruments or to create an artificial price level or

3. to execute any other deceptive act that has the potential to influence the domestic stock exchange or market price of a financial instrument or the price of a financial instrument on an organised market in another member state of the European Union or another signatory to the Agreement on the European Economic Area.

Sentence 1 applies to financial instruments that

1. are admitted to trading on a German stock exchange or included in the regulated market (*regulierter Markt*) or the regulated unofficial market (*Freiverkehr*); or
2. are admitted to trading on an organised market in another member state of the European Union or another signatory to the Agreement on the European Economic Area.

Securities shall be deemed admitted to trading on an organised market or included in the regulated market or the regulated unofficial market if the application for such admission or inclusion has been made or publicly announced.

(2) The prohibition pursuant to subsection (1) sentence 1 no. 2 does not apply if the action is in accordance with accepted market practice on the organised or regulated unofficial market in question and the initiator has legitimate grounds. Only such conduct which can be reasonably expected on the market in question qualifies as acceptable market practice and is recognised as such by the Supervisory Authority. A specific market practice is not assumed to be unacceptable simply because it has not been previously expressly accepted.

(3) Trading with own shares within the framework of a buy-back programme and price stabilisation measures for financial instruments shall in no case constitute a contravention of the prohibition pursuant to subsection (1) sentence 1, provided that this is performed in compliance with the provisions of Commission Regulation (EC) No. 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments (OJ EC No. L 336 p. 33). For financial instruments included in the regulated unofficial market or the regulated market, the provisions of Commission Regulation No. 2273/2003 apply *mutatis mutandis*.

(4) Subsections (1) to (3) apply *mutatis mutandis* to

1. commodities within the meaning of section 2 (2c);
2. emission allowances within the meaning of section 3 (4) sentence 1 of the Greenhouse Gas Emissions Trading Act (*Treibhausgas-Emissionshandelsgesetz*); and
3. foreign currencies within the meaning of section 51 of the Exchange Act (*Börsengesetz*)

which are traded on a German stock exchange or on a comparable market in another member state of the European Union or in another signatory to the Agreement on the European Economic Area.

(5) The Federal Ministry of Finance may, by means of a Regulation requiring the consent of the *Bundesrat*, issue more detailed provisions concerning

1. circumstances of crucial importance for the valuation of financial instruments;
2. false or misleading signals affecting supply and demand or the stock exchange or market price of financial instruments or the existence of an artificial price level;
3. other deceptive acts;
4. actions and omissions that shall in no case constitute a violation of the prohibition pursuant to subsection (1) sentence 1 and
5. actions deemed acceptable market practice and the recognition process for an acceptable market practice.

The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Federal Financial Supervisory Authority. The latter shall issue the provisions in agreement with the stock exchange supervisory authorities of the Federal States.

(6) In respect of journalists acting in their professional capacity, judgement concerning the existence of the prerequisites pursuant to subsection (1) sentence 1 no. 1 must take into account the rules governing their profession, unless those persons derive, directly or indirectly, an advantage or profits from the distribution of such false or misleading information.

## **Section 20b**

(Repealed)

## **Part 5**

### **Notification, publication and transmission of changes in the percentage of voting rights to the company register**

#### **Section 21**

##### **Notification requirements applicable to the notifying party**

(1) Any person (the notifying party) whose shareholding in an issuer whose home country is the Federal Republic of Germany reaches, exceeds or falls below 3 percent, 5 percent, 10 percent, 15 percent, 20 percent, 25 percent, 30 percent, 50 percent or 75 percent of the voting rights by purchase, sale or by any other means shall, without undue delay, and within four trading days at the latest, notify this to the issuer and simultaneously to the Supervisory Authority in compliance with section 22 (1) and (2). In respect of certificates representing shares, the notification requirement shall apply exclusively to the holder of the certificates. The notification period set forth in sentence 1 begins at the point when the notifying party learns or in consideration of the circumstances must have learned that his percentage of voting rights has reached, exceeded or fallen below the above-mentioned thresholds. It is assumed that the notifying party learns of this two trading days after reaching, exceeding or falling below the thresholds mentioned.

(1a) Any person who, at the time the shares are admitted to trading on an organised market for the first time, holds 3 percent or more of the voting rights in an issuer whose home country is the Federal Republic of Germany, shall notify this issuer and the Supervisory Authority pursuant to subsection (1) sentence 1. Subsection (1) sentence 2 shall apply *mutatis mutandis*.

(2) Domestic issuers and issuers whose home country is the Federal Republic of Germany within the meaning of this part are only those whose shares are admitted to trading on an organised market.

(3) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning the contents, nature, language, scope and form of the notification pursuant to subsection (1) sentence 1 and subsection (1a).

## **Section 22**

### **Attribution of voting rights**

(1) For the purpose of the notification requirements under section 21 (1) and (1a), the following voting rights attached to shares in the issuer whose home country is the Federal Republic of Germany shall be equivalent to the voting rights of the notifying party:

1. voting rights of a subsidiary of the notifying party;
2. voting rights of a third party which are held by such third party for the account of the notifying party;
3. voting rights which are assigned as security by the notifying party to a third party, unless such third party is authorised to exercise the voting rights attached to the shares and declares its intention to do so independently of the notifying party's instructions;
4. voting rights in respect of which usufruct has been created in favour of the notifying party;
5. voting rights which may be acquired by the notifying party by a declaration of intent;
6. voting rights which have been entrusted to the notifying party or which it may exercise by means of proxy voting, provided that the notifying party may exercise the voting rights attached to the shares at its own discretion in the absence of specific instructions from the shareholder.

For the purpose of attribution pursuant to sentence 1 nos. 2 to 6, subsidiaries of the notifying party shall be deemed equivalent to the notifying party. Any voting rights of a subsidiary shall be attributed in full to the notifying party.

(2) Any voting rights attached to shares in the issuer whose home country is the Federal Republic of Germany which belong to a third party shall also be attributed to the notifying party in full if the notifying party or its subsidiary coordinates with such third party, on the basis of an agreement or in another manner, its conduct in respect of the issuer; agreements in individual cases shall be excluded. Coordinated conduct requires that the notifying party or its subsidiary and the third party reach a consensus on the exercise of voting rights or collaborate in another manner with the aim of bringing about a permanent

and material change in the issuer's business strategy. Subsection (1) shall apply *mutatis mutandis* to the calculation of the percentage of voting rights held by the third party.

(3) Subsidiaries are companies which are deemed subsidiaries within the meaning of section 290 of the Commercial Code (*Handelsgesetzbuch*) or upon which a controlling influence can be exerted, irrespective of their legal form and domicile.

(3a) For the purpose of attribution of voting rights pursuant to this provision, an investment services enterprise shall not be deemed a subsidiary within the meaning of subsection (3) in respect of the holdings which are managed by such enterprise as part of an investment service pursuant to section 2 (3) sentence 1 no. 7, provided that the following conditions are satisfied:

1. the investment services enterprise may only exercise the voting rights attached to the shares concerned on the basis of instructions given in writing or by electronic means, or if it ensures by putting into place appropriate mechanisms that portfolio management services are conducted independently of any other services and under conditions equivalent to those provided for under Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ EC No. L 375 p. 3), last amended by Article 9 of Directive 2005/1/EC of the European Parliament and of the Council of 9 March 2005 (OJ EU No. L 79 p. 9);
2. the investment services enterprise exercises its voting rights independently from the notifying party;
3. the notifying party informs the Supervisory Authority of the name of the investment services enterprise and of the competent authority responsible for the supervision of the investment services enterprise or the lack of such authority; and
4. the notifying party declares to the Supervisory Authority that the conditions under no. 2 are satisfied.

However, in respect of the attribution of voting rights, an investment services enterprise shall be deemed a subsidiary within the meaning of subsection (3) if the notifying party or another subsidiary of the notifying party owns shares in holdings managed by the investment services enterprise, and the investment services enterprise may not exercise the voting rights attached to such holdings at its own discretion but only under direct or indirect instructions from the notifying party or another subsidiary of the notifying party.

(4) If in the case of subsection (1) sentence 1 no. 6 a proxy is granted for the exercise of the voting rights at one shareholders' meeting only, the notification requirement pursuant to section 21 (1) and (1a) in conjunction with subsection (1) sentence 1 no. 6 shall be deemed fulfilled if the notification is submitted upon conferral of the proxy. The notification must include information as to the date of the shareholders' meeting and the amount of the percentage of voting rights to be attributed to the person executing the proxy once the proxy or the voting rights discretion has expired.

(5) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning the circumstances under which, in the case of subsection (3a), the investment services enterprise is deemed to be independent from the notifying party, and concerning electronic means which may be used for giving instructions within the meaning of subsection (3a).

## **Section 23**

### **Non-consideration of voting rights**

(1) Voting rights attached to shares in an issuer whose home country is the Federal Republic of Germany shall remain unconsidered when calculating the percentage of voting rights if their holder

1. provides investment services as an undertaking domiciled in a member state of the European Union or another signatory to the Agreement on the European Economic Area;
2. holds or intends to hold the shares in question in its trading portfolio and if this holding does not exceed 5 percent of the voting rights; and
3. ensures that the voting rights attached to such shares are not exercised or otherwise used to exert influence over the management of the issuer.

(2) Voting rights attached to shares in an issuer whose home country is the Federal Republic of Germany shall remain unconsidered when calculating the percentage of voting rights if

1. the shares concerned are held for a maximum period of three trading days for the sole purpose of clearing and settlement, even if the shares are also traded outside an organised market; or
2. a custodian can only exercise the voting rights attached to the shares held in custody under instructions given in writing or by electronic means.

(3) Voting rights attached to shares provided to or by the members of the European System of Central Banks in carrying out their functions as monetary authorities shall remain unconsidered when calculating the percentage of voting rights in the issuer whose home country is the Federal Republic of Germany, if the above transactions are short-term deals and provided that the voting rights attached to such shares are not exercised. Sentence 1 shall apply in particular to voting rights attached to shares which are transferred as security from or to a member within the meaning of sentence 1, and to voting rights attached to shares provided to or by a member under a pledge or repurchase or similar agreement for liquidity granted for monetary policy purposes or within a payment system.

(4) For the notifying thresholds of 3 percent and 5 percent, the voting rights attached to those shares in an issuer whose home country is the Federal Republic of Germany shall remain unconsidered that are purchased or sold by a person who holds himself out on a market on a continuous basis as being willing to buy or sell, by way of proprietary trading, financial instruments at prices defined by him (market maker), if

1. this person acts in his capacity as market maker;
2. he holds a licence pursuant to section 32 (1) sentence 1 in conjunction with section 1 (1a) sentence 2 no. 4 of the Banking Act (*Kreditwesengesetz*);

3. he neither intervenes in the management of the issuer nor exerts any influence on the issuer to buy such shares or back the share price, and
4. he informs the Supervisory Authority without undue delay and within four trading days at the latest that he acts as market maker in the shares concerned; section 21 (1) sentences 3 and 4 shall apply *mutatis mutandis* to the beginning of the notification period.

The person may submit the notification at the time from which he intends to commence market making activities in the shares concerned.

(5) Voting rights attached to shares which, in accordance with subsections (1) to (4), remain unconsidered when calculating the percentage of voting rights, may not be exercised with the exception of subsection (2) no. 2.

(6) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*,

1. determine a lower maximum period for holding shares pursuant to subsection (2) no. 1;
2. issue more detailed provisions concerning the non-consideration of voting rights of a market maker pursuant to subsection (4); and
3. issue more detailed provisions concerning the electronic means by which instructions may be given pursuant to subsection (2) no. 2.

## **Section 24**

### **Notification by group companies**

If the notifying party belongs to a group for which consolidated financial statements must be prepared in accordance with sections 290 and 340i of the Commercial Code (*Handelsgesetzbuch*), the notification requirements specified in section 21 (1) and (1a) may be met by the parent undertaking or, if the parent undertaking is itself a subsidiary, by its parent undertaking.

## **Section 25**

### **Notification requirements relating to holdings in financial instruments**

(1) Anyone holding, directly or indirectly, financial instruments that result in an entitlement to acquire, unilaterally and under a legally binding agreement, shares in an issuer whose home country is the Federal Republic of Germany that carry voting rights and have already been issued, must, without undue delay as specified in section 21 (1) sentence 1, notify this to the issuer and simultaneously to the Supervisory Authority if the thresholds set forth in section 21 (1) sentence 1 have been reached, exceeded or fallen below, with the exception of the three-percent threshold. Sections 23 and 24 shall apply *mutatis mutandis*. An aggregation with the holdings as specified in sections 21 and 22 shall take place; financial instruments within the meaning of section 22 (1) sentence 1 no. 5 shall be considered in the calculation only once. Where a notification pursuant to section 21, also in conjunction with section 22, is being or has been submitted, an additional notification in respect of an

aggregation within the meaning of sentence 3 shall only be necessary if, as a consequence, further thresholds mentioned under section 21 (1) sentence 1 are reached, exceeded or fallen below.

(2) If several financial instruments specified in subsection (1) refer to shares in the same issuer, the notifying party must aggregate the voting rights attached to those shares.

(3) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning the contents, nature, language, scope and form of the notification pursuant to subsection (1).

## **Section 26**

### **Publication obligations of the issuer and transmission to the company register**

(1) A domestic issuer shall publish information pursuant to section 21 (1) sentence 1, subsection (1a) and section 25 (1) sentence 1 or pursuant to equivalent provisions of other member states of the European Union or other signatories to the Agreement on the European Economic Area without undue delay, but not later than three trading days following receipt of the notification; furthermore, the domestic issuer shall transmit such information also to the company register within the meaning of section 8b of the Commercial Code (*Handelsgesetzbuch*) without undue delay, however not before its publication, to be stored there. Where a domestic issuer reaches, exceeds or falls below the thresholds of 5 percent or 10 percent through acquisition, disposal or otherwise in respect of his own shares, either the issuer himself or through a person acting in his own name but on the issuer's behalf, sentence 1 shall apply *mutatis mutandis* provided that, by way of derogation from sentence 1, a statement is to be published whose content shall be determined by section 21 (1) sentence 1, also in conjunction with a Regulation pursuant to section 21 (2), and that the publication is made not later than four trading days after having reached, exceeded or fallen below the thresholds specified; if the Federal Republic of Germany is the home country of the issuer, the three-percent threshold shall also apply.

(2) The domestic issuer shall make the publication pursuant to subsection (1) sentences 1 and 2 and simultaneously notify the Supervisory Authority of this publication.

(3) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning

1. the contents, nature, language, scope and form of the publication pursuant to subsection (1) sentence 1; and
2. the contents, nature, language, scope and form of the notification pursuant to subsection (2).

## **Section 26a**

### **Publication of the total number of voting rights and transmission to the company register**

A domestic issuer shall publish in the manner provided for in section 26 (1) sentence 1, also in conjunction with a Regulation pursuant to subsection (3) no. 1, the total number of voting

rights at the end of each calendar month during which the number of voting rights has increased or decreased, and simultaneously notify such publication to the Supervisory Authority in accordance with section 26 (2), also in conjunction with a Regulation pursuant to subsection (3) no. 2. Furthermore, the domestic issuer shall transmit such information without undue delay, however not before its publication, to the company register within the meaning of section 8b of the Commercial Code (*Handelsgesetzbuch*) to be stored there.

## **Section 27**

### **Proof of reported holdings**

Any person having made a notification pursuant to section 21 (1), (1a) or section 25 (1) must prove the existence of the reported holding if so requested by the Supervisory Authority or the issuer whose home country is the Federal Republic of Germany.

## **Section 27a**

### **Notification requirements applicable to owners of qualifying holdings**

(1) Any notifying party within the meaning of sections 21 and 22 whose shareholding reaches or exceeds the threshold of 10 percent, or a higher threshold, of voting rights attached to shares must, within 20 trading days after reaching or exceeding the threshold, inform the issuer whose home country is the Federal Republic of Germany of the aims underlying the purchase of the voting rights and of the origin of the funds used to purchase the voting rights. Any changes to the aims within the meaning of sentence 1 must be notified within 20 trading days. In respect of the aims underlying the purchase of the voting rights, the notifying party shall notify whether

1. the investment is aimed at implementing strategic objectives or at generating a trading profit;
2. it plans to acquire further voting rights within the next twelve months by means of a purchase or by any other means;
3. it intends to exert an influence on the appointment or removal of members of the issuer's administrative, managing and supervisory bodies and
4. it intends to achieve a material change in the company's capital structure, in particular as regards the ratio between own funds and external funds and the dividend policy.

With regard to the origin of the funds used, the notifying party must state whether these are own funds or external funds raised by the notifying party in order to finance the purchase of the voting rights. No notification requirement pursuant to sentence 1 shall apply if the threshold has been reached or exceeded as a result of an offer within the meaning of section 2 (1) of the Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*). Moreover, no notification requirement shall apply to asset management companies, investment stock corporations as well as foreign management companies and investment companies within the meaning of Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ EC L 375 p. 3) which are subject to a prohibition pursuant to Article 25 (1) sentence 1 of Directive 85/611/EEC, to the extent that an investment threshold of 10 percent or less has

been determined; in addition, no notification requirement shall apply in the event of a permissible exception for exceeding investment thresholds in accordance with Article 26 (1) sentence 1 and (2) of Directive 85/611/EEC.

(2) The issuer shall publish the information received or the fact that the notification requirement pursuant to subsection (1) has not been fulfilled in accordance with section 26 (1) sentence 1 in conjunction with the Regulation pursuant to section 26 (3) no. 1.

(3) The articles of association of a domestic issuer may provide that subsection (1) does not apply. Moreover, subsection (1) shall not apply to issuers domiciled abroad whose articles of association or other provisions stipulate non-application.

(4) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning the contents, nature, language, scope and form of the notification pursuant to subsection (1).

## **Section 28**

### **Loss of rights**

Voting rights attached to shares held by or attributed to a notifying party pursuant to section 22 (1) sentence 1 no. 1 or 2 are not valid during the period for which the notification requirements pursuant to section 21 (1) or (1a) have not been met. This does not apply to claims under section 58 (4) and section 271 of the Stock Corporation Act (*Aktiengesetz*), provided that the notification was not deliberately omitted and was subsequently submitted. Where the percentage of the voting rights is concerned, the period under sentence 1 shall be extended by six months if the notification requirements have been breached intentionally or by gross negligence. Sentence 3 shall not apply if the actual percentage of voting rights is less than 10 percent higher or lower than the percentage of voting rights indicated in the previously submitted incorrect notification and if no notification is omitted relating to any threshold mentioned under section 21 being reached, exceeded or fallen below.

## **Section 29**

### **Guidelines of the Supervisory Authority**

The Supervisory Authority may establish guidelines which it shall use to judge in standard cases whether or not the preconditions are met for an action to fall under notification requirements or whether the prerequisites for an exemption from the notification requirements pursuant to section 21 (1) are fulfilled. The guidelines shall be published in the electronic Federal Gazette (*elektronischer Bundesanzeiger*).

## **Section 29a**

### **Exemptions**

(1) The Supervisory Authority may exempt domestic issuers domiciled in a third country from the duties set forth in section 26 (1) and section 26a if such issuers are subject to equivalent rules of a third country or if they submit to such rules.

(2) Issuers whom the Supervisory Authority has granted an exemption pursuant to subsection (1) must publish in the manner specified in section 26 (1) sentence 1, also in conjunction with a Regulation pursuant to subsection (3), and must simultaneously notify

the Supervisory Authority of information on circumstances which corresponds to the information specified in section 21 (1) sentence 1, subsection (1a), section 25 (1) sentence 1, section 26 (1) sentences 1 and 2 as well as section 26a and which must be made available to the public pursuant to the equivalent rules of a third country. Furthermore, such information must be transmitted without undue delay, however not before its publication, to the company register within the meaning of section 8b of the Commercial Code (*Handelsgesetzbuch*) in order to be stored there.

(3) For the purpose of the attribution of voting rights pursuant to section 22, a company domiciled in a third country which would have required a licence for conducting portfolio management services pursuant to section 32 (1) sentence 1 in conjunction with section 1 (1a) sentence 2 no. 3 of the Banking Act (*Kreditwesengesetz*) if it had its registered office or head office in Germany, shall not be deemed a subsidiary within the meaning of section 22 (3) in respect of the shares managed by such company as part of its portfolio management services. This presupposes that

1. the company complies with requirements concerning its independence that are equivalent to those governing investment services enterprises pursuant to section 22 (3a), also in conjunction with a Regulation pursuant to section 22 (5);
2. the notifying party informs the Supervisory Authority of the name of that company and of the competent authority responsible for the supervision of the company or the lack of such authority; and
3. the notifying party declares to the Supervisory Authority that the conditions under no. 1 are met.

(4) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning the equivalence of the rules of a third country and the exemption of issuers pursuant to subsection (1) and of companies pursuant to subsection (3).

## **Section 30**

### **Trading days**

(1) For the purpose of calculating the time limits for notifications and publications pursuant to this Part, all calendar days except Saturdays, Sundays or public holidays that are legally recognised in at least one Federal State shall be deemed trading days.

(2) The Supervisory Authority shall make available a calendar of trading days on its website.

## **Part 5a**

### **Information necessary for exercising rights attached to securities**

#### **Section 30a**

##### **Issuers' obligations vis-à-vis security holders**

(1) Issuers whose home country is the Federal Republic of Germany must ensure that

1. all holders of the admitted securities are treated equally under equal circumstances;

2. the facilities and information necessary to enable the holders of admitted securities to exercise their rights are made available to the public in Germany;
3. data on the holders of admitted securities are protected from unauthorised persons obtaining knowledge thereof;
4. for the entire duration of the admission of the securities, a minimum of one financial institution has been designated as paying agent in Germany where all necessary measures in respect of securities may be effected, or may be effected free of charge in the case of submission of the securities to this agent.
5. in the case of admitted shares, a form for granting a proxy for the shareholders' meeting is made available in writing to each person entitled to vote, together with the notice concerning the meeting or, upon request, after an announcement of the meeting;
6. in the case of admitted debt securities within the meaning of section 2 (1) sentence 1 no. 3 with the exception of securities that also fall within the scope of section 2 (1) sentence 1 no. 2 or that grant at least a contingent right to acquire securities pursuant to section 2 (1) sentence 1 no. 1 or 2, a form granting a proxy for a general meeting of debt securities holders is made available in writing and in a timely manner to each person entitled to vote, together with the notice concerning the meeting or, upon request, after an announcement of the meeting.

(2) An issuer of admitted debt securities within the meaning of subsection (1) no. 6 whose home country is the Federal Republic of Germany may hold the general meeting of debt securities holders in any member state of the European Union or another signatory to the Agreement on the European Economic Area. This presupposes that all the facilities and information necessary to exercise rights are made available to the debt securities holders in that member state, and that only holders of debt securities whose denomination per unit amounts to at least 50,000 euros or whose denomination per unit is, at the date of the issue, equivalent to at least 50,000 euros in another currency, are invited to the meeting.

(3) For the purpose of the provisions of subsection (1) nos. 1 to 5 as well as section 30b (3) no. 1, the holders of certificates representing shares shall be deemed equivalent to the holders of the shares represented.

## **Section 30b**

### **Publication of notifications and transmission by way of remote data transfer**

(1) The issuer of admitted shares whose home country is the Federal Republic of Germany must, without undue delay, publish in the electronic Federal Gazette (*elektronischer Bundesanzeiger*)

1. the convening of the shareholders' meeting, including the agenda, the total number of shares and voting rights at the time the meeting was convened as well as the shareholders' rights in respect of the participation in the shareholders' meeting; and

2. notifications on the distribution and payment of dividends, the issue of new shares and any arrangements for or exercise of conversion, cancellation and subscription rights.

If such publication in the electronic Federal Gazette is required also under other provisions, one single publication is sufficient.

(2) The issuer of debt securities within the meaning of section 30a (1) no. 6 whose home country is the Federal Republic of Germany must, without undue delay, publish in the electronic Federal Gazette

1. the place, time and agenda of the meeting of debt securities holders as well as notices concerning the right of those securities holders to participate therein; and
2. notices concerning the exercise of any conversion, subscription and cancellation rights as well as the payment of interest, repayments, drawings and units that have been cancelled or drawn but have not yet been redeemed.

Subsection (1) sentence 2 shall apply *mutatis mutandis*.

(3) Without prejudice to the publication requirements set forth in subsections (1) and (2), issuers whose home country is the Federal Republic of Germany may communicate information by way of remote data transfer to the holders of admitted securities if the costs entailed in such transmission are not imposed on the securities holders in contravention of the principle of equal treatment laid down in section 30a (1) no. 1, and if

1. in the case of admitted shares
  - a. the shareholders' meeting has given its consent thereto;
  - b. the choice concerning the type of the remote data transfer does not depend upon the location of the registered office or residence of the shareholders or the persons whose voting rights are attributed in the cases referred to in section 22;
  - c. mechanisms have been put into place for identifying and addressing in a safe manner the shareholders or those persons exercising the voting rights or who are entitled to issue instructions for the exercise of such voting rights; and
  - d. the shareholders, or in the cases of section 22 (1) sentence 1 nos. 1, 3, 4 and subsection (2) the persons entitled to exercise the voting rights, have given their explicit consent to the communication by means of remote data transfer or have not objected to a written request for consent within an appropriate period of time and have not revoked at a later point in time such consent which is thus deemed to have been given;
2. in the case of admitted debt securities within the meaning of section 30a (1) no. 6
  - a. a meeting of debt securities holders has given its consent thereto;
  - b. the choice concerning the type of the remote data transfer does not depend upon the location of the registered office or residence of the debt securities holders or their

proxies;

- c. mechanisms have been put into place for identifying and addressing in a safe manner the debt securities holders;
- d. the debt securities holders have given their explicit consent to the communication by means of remote data transfer or have not objected to a written request for consent within an appropriate period of time and have not revoked at a later point in time such consent which is thus deemed to have been given.

### **Section 30c** **Amendments to the issuer's legal basis**

The issuer of admitted securities whose home country is the Federal Republic of Germany must notify the Supervisory Authority and the Admission Offices of the domestic and foreign regulated markets (*regulierte Märkte*) on which his securities are admitted to trading of any intended amendments to his articles of association or any other legal basis that affect the rights of securities holders, without undue delay following the decision to present the draft amendments to the decision-making body that shall decide on the amendments, but at the time of convening the decision-making body at the latest.

### **Section 30d** **Provisions relating to issuers from the European Union and the European Economic Area**

The provisions of sections 30a to 30c shall also apply to issuers whose home country is not the Federal Republic of Germany but another member state of the European Union or another signatory to the Agreement on the European Economic Area, if their securities are admitted to trading on an organised market in Germany and if their home country does not set forth any provisions equivalent to those specified in sections 30a to 30c.

### **Section 30e** **Publication of additional information and transmission to the company register**

(1) A domestic issuer must publish without undue delay, and simultaneously notify the Supervisory Authority of such publication,

- 1. any change in the rights attached to the admitted securities; and
  - a. in the case of admitted shares, in those rights attached to derivative securities issued by the issuer himself provided that they grant conversion or acquisition rights in respect of the issuer's admitted shares;
  - b. in the case of securities other than shares, any changes in the terms of these securities, in particular changes in the interest rates or the conditions associated with them, provided that the rights attached to such securities are indirectly affected thereby;

- c. in the case of securities which grant conversion or subscription rights to the creditors in respect of shares, any changes in the rights attached to those shares to which the conversion or subscription rights relate;
2. new loan issue with the exception of government bonds within the meaning of section 36 of the Exchange Act (*Börsengesetz*) and the guarantees assumed for such loan issues provided that the domestic issuer is not a public international body of which at least one member state of the European Union or another signatory to the Agreement on the European Economic Area is a member, or if he does not issue exclusively securities which are guaranteed by the Federal Government; and
3. information which he publishes in a third country and which may be of importance to the public in the European Union and the European Economic Area.

Furthermore, the domestic issuer shall transmit such information without undue delay, but not before such information has been published, to the company register within the meaning of section 8b of the Commercial Code (*Handelsgesetzbuch*) in order to be stored there.

(2) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning the minimum content, nature, language, scope and form of the publication and the notification pursuant to subsection (1) sentence 1.

### **Section 30f Exemption**

(1) The Supervisory Authority may exempt domestic issuers domiciled in a third country from the duties set forth in sections 30a, 30b and 30e (1) sentence 1 nos. 1 and 2 if such issuers are subject to equivalent rules of a third country or if they submit to such rules.

(2) Issuers whom the Supervisory Authority has granted an exemption pursuant to subsection (1) must publish, in accordance with section 30e (1) in conjunction with a Regulation pursuant to section 30e (2), information on circumstances within the meaning of section 30e (1) sentence 1 nos. 1 and 2 which must be made available to the public pursuant to the equivalent rules of a third country, and simultaneously notify the Supervisory Authority of such publication; furthermore, they must transmit such information without undue delay, however not before its publication, to the company register within the meaning of section 8b of the Commercial Code (*Handelsgesetzbuch*) in order to be stored there.

(3) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning the equivalence of the rules of a third country and the exemption of issuers pursuant to subsection 1.

### **Section 30g Exclusion of appeal**

A shareholders' resolution shall not be appealed on the grounds of a contravention of the provisions set forth in this part.

**Part 5b**  
**Short selling and derivatives transactions**

**Section 30h**  
**Ban on naked short-selling transactions in shares and certain debt securities**

(1) It shall be prohibited to perform naked short-selling transactions in

1. shares; or
2. debt securities issued by central governments, regional governments or local authorities of member states of the European Union whose legal currency is the euro,

which are admitted to trading on the regulated market of a German stock exchange. To this extent section 37 of the Exchange Act (*Börsengesetz*) shall not apply. The foregoing shall not apply to shares of companies domiciled abroad, unless the shares are exclusively admitted to trading on the regulated market of a German stock exchange. A transaction shall be deemed a naked short sale if, by the close of the day on which the respective transaction has been entered into, the seller of the securities referred to in sentence 1

1. does not own all of the securities sold; and
2. does not have any unconditionally enforceable claim under the law of obligations or under property law to be transferred title to a corresponding number of securities of the same class.

(2) Exempt from the ban under subsection (1) are transactions entered into by investment services enterprises or equivalent enterprises domiciled abroad, provided they

1. trade in shares or debt securities within the meaning of subsection (1) by way of proprietary trading and hold themselves out on a regular and continuous basis as being willing to buy or sell such financial instruments at prices defined by them; or
2. regularly and continuously carry out client orders and hedge the resulting positions;

and the underlying transaction in each case is necessary for the performance of this function. Also exempt are transactions that trading participants enter into with a client for settlement of a transaction in financial instruments at a fixed or determinable price (fixed price transaction). The intention to take up an activity described in sentence 1 must be reported to the Supervisory Authority without undue delay, providing details of the financial instruments concerned in each case.

(3) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*,

1. issue more detailed provisions concerning the content, nature, scope and form of the reporting requirement under subsection (2) sentence 3; and
2. stipulate exceptions to the ban under subsection (1) for certain transactions.

The Federal Ministry of Finance may, by means of a Regulation and without requiring the consent of the *Bundesrat*, delegate the authority pursuant to sentence 1 no. 1 to the Supervisory Authority.

Section 30i will enter into force on 26 March 2012:

### **Section 30i**

#### **Notification and publication requirements for holders of net short-selling positions**

(1) Net short-selling positions which reach, exceed or fall below 0.2 percent of a company's shares in issue which are admitted to trading on the regulated market of a German stock exchange, must be notified by their holder, rounded to two places after the decimal point, to the Supervisory Authority in accordance with subsection (3) by the close of the next trading day as defined in section 30 (1). Net short-selling positions which reach, exceed or fall below a threshold of 0.5 percent must be published by their holder in addition to the notification pursuant to sentence 1 in the electronic Federal Gazette (*elektronischer Bundesanzeiger*) within the period specified in sentence 1. As soon as a net short-selling position reaches, exceeds or falls below the threshold referred to in sentence 1 plus 0.1 percent or a multiple thereof, the holder of such position must, within the period specified in sentence 1,

1. make a further notification in accordance with subsection (3) in cases where sentence 1 applies; and
2. make a further notification and publication in the electronic Federal Gazette in cases where sentence 2 applies.

(2) A net short-selling position shall be deemed to exist when netting all of a holder's financial instruments, the holder's economic exposure in the company's shares in issue is equivalent to a short-selling position in shares. The holder of the net short-selling positions is the legal entity or common fund that holds the netted financial instruments. For a common fund, the notification shall be effected by the person who is responsible for managing the common fund or who actually performs such management.

(3) Notifications pursuant to subsection (1) sentences 1 and 3 shall be made using a reporting channel stipulated by the Supervisory Authority.

(4) Exempt from the requirements under subsections (1) to (3) are net short-selling positions held by investment services enterprises or equivalent enterprises domiciled abroad, provided they

1. trade in shares within the meaning of subsection (1) by way of proprietary trading and hold themselves out on a regular and continuous basis as being willing to buy or sell such financial instruments at prices defined by them; or
2. regularly and continuously carry out client orders and hedge the resulting positions;

and the underlying transaction in each case is necessary for the performance of this function. The intention to take up an activity described in sentence 1 must be reported to the Supervisory Authority without undue delay, providing details of the financial instruments concerned in each case.

(5) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*,

1. issue more detailed provisions concerning the content, nature, scope and form of the notification and publication, concerning the calculation of net short-selling positions, and concerning the permitted data media and means of transmission;

2. permit notifications or publications by those subject to these requirements to be made at their own expense by a suitable third party, and set forth the relevant details.

The Federal Ministry of Finance may, by means of a Regulation and without requiring the consent of the *Bundesrat*, delegate the authority pursuant to sentence 1 to the Supervisory Authority.

### **Section 30j** **Ban on certain credit derivatives**

(1) A protection buyer is prohibited from contracting a credit derivative as defined in section 2 (2) no. 4 or from entering into a transaction in respect of the same in Germany if

1. as part of such transaction the protection seller has an obligation, on occurrence of a previously specified credit event, to make a compensation payment to the protection buyer, regardless of whether the compensation payment is made in the amount of the nominal value against physical delivery of a reference liability, in the form of compensation of the difference to the residual value of a reference liability after occurrence of the credit event, or as a fixed amount (credit default swap), also to the extent that such amount is embedded in a credit-linked note or a total return swap; and
2. at least one reference liability is a liability of a central government, regional government or local authority of a member state of the European Union whose legal currency is the euro.

(2) Exempt from the ban under subsection (1) are transactions in which, based on an economic view, the conclusion of the credit derivative pursuant to subsection (1) is intended to achieve a more than insignificant reduction in the risk associated with

1. an existing position in a reference liability of the credit derivative pursuant to subsection (1), or a position in same that is assumed in direct temporal connection with conclusion of the credit derivative; or
2. another existing position in a different financial instrument, or a position in the same that is assumed in direct temporal connection with conclusion of the credit derivative, or another existing liability which may fall in value if the creditworthiness of the reference entity under subsection (1) no. 2 deteriorates.

(3) Also exempt from the ban under subsection (1) are transactions entered into by investment services enterprises or equivalent enterprises domiciled abroad, provided they

1. trade in credit derivatives within the meaning of subsection (1) by way of proprietary trading and hold themselves out on a regular and continuous basis as being willing to buy or sell such credit derivatives at prices defined by them; and
2. the underlying transaction in each case is necessary for the performance of this function.

The intention to take up an activity described in sentence 1 must be reported to the Supervisory Authority without undue delay, providing details of the relevant credit derivatives pursuant to subsection (1) in each case.

(4) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent

of the *Bundesrat*,

1. issue more detailed provisions concerning the content, nature, scope and form of the reporting requirement under subsection (3) sentence 2; and
2. stipulate exceptions to the ban under subsection (1) for certain transactions.

The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, delegate the authority pursuant to sentence 1 to the Supervisory Authority.

## **Part 6**

### **Conduct of business obligations, organisational requirements, transparency obligations**

#### **Section 31**

##### **General rules of conduct**

(1) Investment services enterprises shall be required

1. to provide investment services and ancillary services with the requisite degree of expertise, care and diligence in the interests of their clients and
2. to avoid conflicts of interest wherever possible and, prior to the execution of transactions for clients, clearly inform those clients of the general nature and the source of the conflicts of interest if the organisational arrangements pursuant to section 33 (1) sentence 2 no. 3 prove insufficient to prevent, with reasonable certainty, clients' interests from being prejudiced.

(2) All information, including marketing communications, which investment services enterprises make available to their clients must be fair, clear and not misleading. Marketing communications must be clearly identifiable as such. This is without prejudice to section 124 of the Investment Act (*Investmentgesetz*) and section 15 of the Securities Prospectus Act (*Wertpapierprospektgesetz*). Where information is provided on financial instruments or their issuers containing either directly or indirectly a general recommendation for a particular investment decision,

1. investment services enterprises must comply with the requirements set forth in section 33b (5) and (6) as well as section 34b (5), also in conjunction with a Regulation pursuant to section 34b (8), or with comparable foreign provisions; or
2. to the extent that, failing compliance with no. 1, the information is described as financial analysis or in similar terms, or is otherwise presented as an objective or independent explanation of the matters contained in the recommendation, the information must be clearly identified as a marketing communication and contain a statement that it does not meet all legal requirements designed to guarantee the independence of financial analyses and that it is not subject to any prohibition on dealing ahead of the publication of financial analyses.

(3) Investment services enterprises shall be required to provide clients in a comprehensible form and in a timely manner with information that is reasonably appropriate for these clients to understand the nature and risks of the types of financial instruments or investment

services that are being offered or demanded, and to take investment decisions on this basis. This information may be provided in a standardised format. The information must relate to

1. the investment services enterprise and its services;
2. the types of financial instruments and proposed investment strategies, including the risks associated therewith;
3. the execution venues; and
4. the costs and associated charges.

If an investment services enterprise distributes units in investment funds (*Investmentvermögen*) within the meaning of the Investment Act, the information contained in the simplified prospectus pursuant to section 121 (1) to (3) and section 123 of the Investment Act shall be deemed appropriate pursuant to sentence 1.

(4) An investment services enterprise that provides investment advice or financial portfolio management must obtain from the clients all necessary information regarding the clients' knowledge and experience with respect to transactions in specific types of financial instruments or investment services, their investment objectives and their financial situation so as to enable the enterprise to recommend to the clients financial instruments or investment services that are appropriate for them. The appropriateness shall be assessed in relation to whether the specific transaction recommended to the client, or the specific investment service provided as part of financial portfolio management, complies with the investment objectives of the client, whether the client is able financially to bear any related investment risks consistent with his investment objectives, and whether the client has the necessary experience and knowledge in order to understand the related risks. Where an investment services enterprise does not obtain the information required, it may not recommend a financial instrument when providing investment advice, nor make any recommendation when providing financial portfolio management.

(5) Prior to the provision of investment services other than those specified in subsection (4) the purpose of which is the execution of client orders, an investment services enterprise shall obtain from the clients information regarding the clients' knowledge and experience with respect to transactions in specific types of financial instruments or investment services, to the extent that such information is necessary to assess whether the financial instruments or investment services are appropriate for the clients. The appropriateness shall be assessed with regard to whether the client has the necessary knowledge and experience in order to reasonably assess the risks associated with such type of financial instruments and investment services. In case an investment services enterprise considers, on the basis of the information received under sentence 1, that the financial instrument or investment service requested by the client is not appropriate for the client, it shall inform the client thereof. In case the investment services enterprise does not obtain the information required, it shall inform the client that an assessment of the appropriateness within the meaning of sentence 1 is not possible. The information pursuant to sentence 3 and sentence 4 may be provided in a standardised format.

(6) If the information mentioned in subsections (4) and (5) is based on information provided by the client, the investment services enterprise shall not be responsible for the inaccuracy or incompleteness of such information, unless it is aware of the inaccuracy or incompleteness of the information provided by the client or is unaware of it as a result of gross negligence.

(7) The obligations set forth in subsection (5) shall not apply to the extent that the investment services enterprise

1. provides, at the initiative of the client, principal broking, proprietary trading, contract broking or investment broking services in respect of shares which are admitted to trading on an organised market or an equivalent market, in respect of money market instruments, bonds and other forms of securitised debt that does not embed a derivative, units in investment funds (*Investmentvermögen*) which meet the requirements of Directive 85/611/EC, or in respect of other non-complex financial instruments; and
2. informs the client that an appropriateness test within the meaning of subsection (5) is not carried out. The information may be provided in a standardised format.

(8) The clients must receive from the investment services enterprises adequate reports on the transactions undertaken or the financial portfolio management provided.

(9) In the case of professional clients within the meaning of section 31a (2), the investment services enterprise shall, as part of its obligations pursuant to subsection (4), be entitled to assume that the professional clients have the degree of knowledge and experience in respect of the products, transactions or services for which they are classified as professional clients which is necessary for them to understand the risks inherent in these transactions or in the financial portfolio management, and that the clients are able financially to bear such risks consistent with their investment objectives.

(10) Subsection (1) no. 1 and subsections (2) to (9) as well as sections 31a, 31b, 31d and 31e shall apply *mutatis mutandis* to enterprises domiciled in a third country which provide investment services or ancillary services for clients having their habitual residence or place of management in Germany, provided that the investment services or ancillary services and related ancillary services are not provided exclusively in a third country.

(11) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning

1. the nature, scope and form of the disclosure pursuant to subsection (1) no. 2;
2. the nature, content and time of, and the data carrier for, the information for clients that is required pursuant to subsections (2) and (3);
3. the nature of the information to be obtained from the clients pursuant to subsections (4) and (5);
4. the classification of other financial instruments as non-complex financial instruments within the meaning of subsection (7) no.1;
5. the nature, content and time of, and the data carrier for, the reporting obligations pursuant to subsection (8).

The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Supervisory Authority.

### **Section 31a Clients**

(1) Clients within the meaning of this Act are any natural or legal persons for whom investment services enterprises provide or bring about investment services or ancillary services.

(2) Professional clients within the meaning of this Act are clients in respect of whom an investment services enterprise can assume they possess sufficient experience, knowledge and expertise to make their own investment decisions and properly assess the risks that they incur. Professional clients within the meaning of sentence 1 are

1. enterprises which, in order to be able to operate in the financial markets as
  - a. investment services enterprises;
  - b. other authorised or supervised financial institutions;
  - c. insurance undertakings;
  - d. collective investment undertakings and their management companies;
  - e. pension funds and management companies of such funds;
  - f. enterprises within the meaning of section 2a (1) no. 8;
  - g. exchange traders and commodity derivatives dealers;
  - h. other institutional investors whose main business is not covered by (a) to (g),are subject to authorisation or supervision requirements;
2. enterprises which are not subject to authorisation or supervision requirements under no. 1 and exceed at least two of the following three criteria:
  - a. balance sheet total of €20,000,000;
  - b. net turnover of €40,000,000;
  - c. own funds of €2,000,000;
3. national and regional governments as well as public bodies that manage public debt;
4. Central Banks, international and supranational institutions such as the World Bank, the International Monetary Fund, the European Central Bank, the European Investment Bank and other similar international organisations;
5. other institutional investors which are not subject to authorisation or supervision requirements and whose main activity is to invest in financial instruments, and entities offering the securitisation of assets and other financing transactions.

They shall be deemed professional clients with respect to all financial instruments, investment services and ancillary services.

(3) Retail clients within the meaning of this Act are clients who are not professional clients.

(4) Eligible counterparties are enterprises within the meaning of subsection (2) no. 1 (a) to (f), organisations pursuant to subsection (2) nos. 3 and 4 as well as enterprises within the meaning of section 2a (1) no. 12. The following shall be deemed equivalent to eligible counterparties if they have agreed to be treated as eligible counterparties for all transactions or for individual transactions:

1. enterprises within the meaning of subsection (2) no. 2, domiciled in or outside of Germany;
2. enterprises domiciled in another member state of the European Union or another signatory to the Agreement on the European Economic Area which, under the law of the home country, are to be considered eligible counterparties in accordance with Article 24 (3) sentence 1 of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ EU No. L 145 p. 1, 2005 No. L 45 p. 18), as amended from time to time.

(5) An investment services enterprise may, notwithstanding subsections (2) and (4), categorise eligible counterparties as professional clients or retail clients, and professional clients as retail clients. The investment services enterprise must inform its clients of any changes in the categorisation.

(6) A professional client may agree with the investment services enterprise that he be categorised as retail client. The agreement regarding a change in categorisation shall be concluded in writing. Where the change is not intended to apply to all investment services, ancillary services and financial instruments, this shall be expressly stated. An investment services enterprise must inform professional clients within the meaning of subsection (2) sentence 2 no. 2 and subsection (7) at the beginning of a business relationship that they are categorised as professional clients and that it is possible to change this categorisation in accordance with sentence 1. Where an investment services enterprise has categorised clients in accordance with subsection (2) sentence 1 prior to 1 November 2007 on the basis of an assessment procedure that focuses on the clients' expertise, knowledge and experience, the categorisation shall remain valid after 1 November 2007. These clients are to be informed about the conditions for categorisation pursuant to subsections (2), (5) and (6), and about the possibility to change such categorisation pursuant to subsection (6) sentence 4.

(7) A retail client may be categorised as professional client upon request or if the investment services enterprises so determines. Prior to changing the categorisation, the investment services enterprise is required to conduct an assessment as to whether the client possesses the experience, knowledge and expertise to make an investment decision in general or with respect to a specific type of transaction, and if he is capable of adequately assessing the risks involved. A change in the categorisation shall only be considered if the retail client satisfies, as a minimum, two of the following three criteria:

1. the client has carried out transactions, in significant size, on the market on which the financial instruments are traded for which he is intended to be categorised as professional client, at an average frequency of 10 per quarter over the previous year;
2. the client's cash deposits and financial instruments exceed €500,000;

3. the client has worked in the capital market for at least one year in a professional position which requires knowledge of the transactions, investment services and ancillary services envisaged.

The investment services enterprise must inform the retail client in writing that, owing to the change in categorisation, the protection provisions relating to retail clients set forth in this Act no longer apply. The client must confirm in writing that he has been informed of this fact. Where a professional client within the meaning of sentence 1 or subsection (2) sentence 2 no. 2 does not keep the investment services enterprise informed about any change which may affect his categorisation as a professional client, any erroneous categorisation made on this basis shall not constitute a breach of duty on the part of the investment services enterprise.

(8) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning the provisions on categorisation pursuant to subsection (2) no. 2, the procedure and organisational arrangements which investment services enterprises have in place for changing the categorisation in accordance with subsection (5), and the criteria, procedure and organisational arrangements in place for changing or maintaining a classification pursuant to subsections (6) and (7). The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Supervisory Authority.

### **Section 31b**

#### **Transactions executed with eligible counterparties**

(1) Investment services enterprises which provide to eligible counterparties principal broking services, investment broking, contract broking and proprietary trading as well as ancillary services directly related thereto, shall not be subject to the provisions set out in section 31 (2), (3) and (5) to (7) as well as sections 31c, 31d and 33a. Sentence 1 shall not apply if the eligible counterparty has agreed with the investment services enterprise to be treated as a professional client or retail client in respect of all transactions or individual transactions.

(2) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning the form and content of the agreement pursuant to subsection (1) sentence 2 and the manner in which the parties express their agreement pursuant to section 31a (4) sentence 2. The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Supervisory Authority.

### **Section 31c**

#### **Handling of client orders**

(1) An investment services enterprise must take all reasonable steps to

1. execute, or transmit to third parties, client orders without undue delay and in a fair manner, relative to other client orders and the trading interests of the investment services enterprise;
2. execute comparable client orders in chronological order of reception or transmit such orders to third parties for the purpose of execution, subject to the prevailing market conditions or other client interests;
3. ensure that client money and clients' financial instruments are booked correctly;

4. safeguard the interests of all clients involved when aggregating client orders with other client orders or with the investment services enterprise's proprietary transactions;
5. ensure that information related to orders not yet executed is not misused;
6. inform each client involved about the aggregation of orders and about the risks related thereto, and inform without undue delay each retail client involved about any material problem known to it which arises from the execution of the order.

(2) In the case of a client limit order in respect of shares admitted to trading on an organised market which cannot be immediately executed due to prevailing market conditions, the investment services enterprise must, without undue delay, publish that client limit order in a manner which is easily accessible to other market participants, unless the client instructs otherwise. The obligation set forth in sentence 1 shall be deemed met if the orders are or have been transmitted to an organised market or a multilateral trading facility which complies with the provisions of Article 31 of Regulation (EC) No. 1287/2006. The Supervisory Authority may waive the obligation set forth in sentence 1 in respect of orders that are significantly larger in scale compared with normal market size.

(3) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning the obligations set forth in subsections (1) and (2) sentence 1 and concerning the conditions under which the Supervisory Authority may waive the obligation set forth in subsection (2) sentence 3. The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Supervisory Authority.

### **Section 31d Inducements**

(1) An investment services enterprise may not, in relation to the provision of an investment or ancillary service, accept any inducement from third parties or provide any inducement to third parties that are not clients of this service, unless

1. the inducement is designed to enhance the quality of the service to the client and does not impair the proper provision of the service in the interest of the client in accordance with section 31 (1) no. 1; and
2. the existence, nature and scope of the inducement or, where the scope cannot be ascertained, the method of calculating that scope, is clearly disclosed to the client in a manner that is comprehensive, accurate and understandable, prior to the provision of the investment or ancillary service.

If the investment services enterprise accepts an inducement from a third party commissioned by the client, or if it grants such an inducement to such a third party, this shall not be deemed an inducement within the meaning of sentence 1.

(2) Inducements within the meaning of this provision are commissions, fees or other cash payments as well as any non-cash benefits.

(3) Pursuant to subsection (1) no. 2, the essential terms of the arrangements relating to the inducements may be disclosed in summary form, provided that the investment services

enterprise offers to disclose further details to the client and provides such details to the client upon request.

(4) If an inducement is accepted that relates to an investment service set out in section 2 (3) sentence 1 no. 9 or to general recommendations with respect to transactions in financial instruments, and if such services are provided in an unbiased manner despite such inducement, it may be presumed that the inducement is designed to enhance the quality of the investment service provided to the client.

(5) Fees or charges which allow or are necessary for the provision of investment services and which, by their nature, are not likely to jeopardise compliance with the obligations pursuant to section 31 (1) sentence 1 no. 1 shall be exempt from the prohibition set forth in subsection (1).

### **Section 31e**

#### **Provision of investment and ancillary services through another investment services enterprise**

Where an investment services enterprise receives an order through another investment services enterprise to provide investment or ancillary services on behalf of a client, the enterprise receiving the order shall be responsible for performing the investment or ancillary service in compliance with the provisions of this part subject to the following proviso:

1. the investment services enterprise receiving the order shall not be responsible for verifying the completeness and accuracy of the client information and instructions transmitted by the other investment services enterprise;
2. the investment services enterprise receiving the order shall be able to rely on recommendations in respect of the investment or ancillary service provided by the other investment services enterprise to clients being in compliance with the legal requirements.

### **Section 31f**

#### **Operation of a multilateral trading facility**

(1) The operator of a multilateral trading facility shall be obliged to

1. define rules for the access of trading participants to the multilateral trading facility which provide for at least the requirements for participating in exchange trading pursuant to section 19 (2) and (4) sentence 1 of the Exchange Act (*Börsengesetz*); section 19 (4) sentence 2 of the Exchange Act shall apply *mutatis mutandis*;
2. define rules for the inclusion of financial instruments, the orderly conduct of trading and determination of prices, the use of reference prices and the settlement of executed transactions in conformity with the contract; the rules concerning trading and determination of prices may not, however, grant the operator any discretionary powers;
3. have in place appropriate control mechanisms for monitoring compliance with the rules set out in no. 2 and for monitoring compliance with sections 14 and 20a;

4. ensure that the prices in the multilateral trading facility are fixed in accordance with the provisions of section 24 (2) of the Exchange Act;
5. ensure that the records pertaining to orders placed and transactions executed permit, on the multilateral trading facility, full and uninterrupted supervision by the Supervisory Authority; and
6. publish all information necessary for and relevant to the use of the multilateral trading facility, taking into account the nature of the users and the types of financial instruments traded.

(2) Issuers whose financial instruments have been included for trading on a multilateral trading facility without their consent shall not be required to publish information relating to these financial instruments with regard to that multilateral trading facility.

(3) The operator of a multilateral trading facility shall inform the Supervisory Authority of any serious contraventions of the trading rules and any other disruptions to market integrity; if there is evidence of a contravention of section 14 or section 20a, the Supervisory Authority shall be informed thereof without undue delay and be given full support in the performance of its investigations.

### **Section 31g**

#### **Pre-trade and post-trade transparency requirements for multilateral trading facilities**

(1) The operator of a multilateral trading facility shall, in respect of shares and certificates representing shares admitted to trading on an organised market that are included in the facility, publish continuously throughout normal business hours and on reasonable commercial terms the price of the highest limited purchase order and of the lowest limited selling order and the volume tradable at these prices.

(2) Pursuant to Chapter IV Section 1 of Commission Regulation (EC) No. 1287/2006, the Supervisory Authority may grant the operators of multilateral trading facilities exemptions from the requirements set forth in subsection (1).

(3) The operator of a multilateral trading facility shall publish, on reasonable commercial terms and as close to real-time as possible, the market price, volume and time of the transactions executed in accordance with subsection (1).

(4) Pursuant to Chapter IV Section 3 of Commission Regulation (EC) No. 1287/2006, the Supervisory Authority may permit deferred publication of the information set forth in subsection (3), depending on the type and size of the transactions executed. The operator of a multilateral trading facility shall publish such deferral pursuant to sentence 1.

(5) Chapter IV Sections 1, 3 and 4 of Commission Regulation (EC) No. 1287/2006 governs the details of the publication requirements pursuant to subsections (1), (3) and (4).

### **Section 31h**

#### **Post-trade publication requirements for investment services enterprises**

(1) Investment services enterprises which, in providing investment services pursuant to section 2 (3) sentence 1 nos. 1 to 4, conclude transactions in shares and certificates representing shares admitted to trading on an organised market outside an organised

market or multilateral trading facility are obliged to publish on reasonable commercial terms and as close to real-time as possible the volume and market price of these transactions and the time at which they were concluded.

(2) Pursuant to Chapter IV Section 3 of Commission Regulation (EC) No. 1287/2006, the Supervisory Authority may permit deferred publication of the information set forth in subsection (1), depending on the size of the transactions executed. The investment services enterprise shall publish such deferral pursuant to sentence 1.

(3) Chapter IV Sections 3 and 4 of Commission Regulation (EC) No. 1287/2006 governs the details of the publication requirements pursuant to subsections (1) and (2).

## **Section 32**

### **Systematic internalisation**

Sections 32a to 32d shall apply to systematic internalisers to the extent that they execute orders in shares and certificates representing shares admitted to trading on an organised market up to standard market size. Details are governed by Chapters III and IV Sections 2 and 4 of Commission Regulation (EC) No. 1287/2006. A market within the meaning of these provisions for each category of shares shall be comprised of all orders executed in the European Union in respect of that category of shares, excluding those large in scale compared to normal market size for that share.

### **Section 32a**

#### **Publication of quotes by systematic internalisers**

(1) Systematic internalisers within the meaning of section 32 sentence 1 are obliged to publish their binding bid and ask quotes on a regular and continuous basis during normal trading hours and on reasonable commercial terms in respect of the categories of shares offered by them, to the extent that there is a liquid market for these categories of shares. Where no liquid market exists, the systematic internalisers shall be obliged to disclose quotes to their clients on request in accordance with sentence 1. The prices quoted shall reflect the prevailing market conditions.

(2) Systematic internalisers may determine the number of shares or the value (size) of their bid and ask quotes in those categories of shares for which they provide quotes. The bid and ask prices quoted per share shall reflect the prevailing market conditions.

(3) Systematic internalisers may update their quotes at any time and withdraw their quotes under exceptional market conditions.

(4) Chapter IV Sections 2 and 4 of Commission Regulation (EC) No. 1287/2006 governs the details of the publication requirements pursuant to subsection (1) sentences 1 and 2.

### **Section 32b**

#### **Determination of the standard market size and functions of the Supervisory Authority**

(1) In order to determine the standard market size within the meaning of section 32 sentence 1, the Supervisory Authority shall determine at least annually, on the basis of the arithmetic average value of the orders executed in the market, the categories of shares which have their most relevant market in terms of liquidity in Germany.

(2) The Supervisory Authority publishes on its website the categories determined pursuant to subsection (1).

### **Section 32c**

#### **Execution of client orders by systematic internalisers**

(1) A systematic internaliser within the meaning of section 32 sentence 1 shall be obliged to execute orders at the prices quoted at the time of reception of the order. The execution of orders received from retail clients must comply with the requirements set out in section 33a.

(2) A systematic internaliser may execute the orders received from professional clients at prices differing from those mentioned in subsection (1) sentence 1, provided that

1. the orders are executed at a better price that falls within a public range close to market conditions and the order volume exceeds 7,500 euros;
2. portfolio trades are executed in 10 or more securities that are part of one order; or
3. the orders are executed subject to conditions other than those applying to the current market price.

(3) Where a systematic internaliser who quotes only one quote or whose highest quote is lower than the standard market size receives a client order of a size bigger than his quotation size but lower than the standard market size, he may execute this order to the extent that it exceeds his quotation size, provided that it is executed at the quoted price. This is without prejudice to subsection (2).

(4) Where a systematic internaliser is quoting in different sizes, he may execute a client order received between those sizes at one of the quoted prices in accordance with subsections (1) to (3).

### **Section 32d**

#### **Access to quotes, terms of business of systematic internalisers**

(1) A systematic internaliser within the meaning of section 32 sentence 1 shall give access to his quotes in an objective non-discriminatory way. His terms of business shall regulate access to his quotes in a clear manner.

(2) Furthermore, the terms of business may stipulate that

1. the systematic internaliser may refuse to enter into or continue business relationships with clients on the basis of commercial considerations, in particular the clients' credit status, the counterparty risk or the settlement of the transactions;
2. the systematic internaliser may limit, in a non-discriminatory way, the execution of the orders from a particular client provided that this is necessary to reduce the counterparty risk; and
3. the systematic internaliser may limit, in a non-discriminatory way and in compliance with the requirements of section 31c, the total number of orders from different clients to be executed at the same time provided that the number or volume of the orders considerably exceeds the norm.

## **Section 33**

### **Organisational requirements**

(1) Investment services enterprises must comply with the organisational requirements pursuant to section 25a (1) and (4) of the Banking Act (*Kreditwesengesetz*). Furthermore, they must

1. establish adequate policies, keep available resources and put in place procedures designed to ensure that the investment services enterprise itself and its employees comply with the requirements under this Act, and in particular establish a permanent and effective compliance function which may discharge its responsibilities independently;
2. take reasonable steps to ensure continuity and regularity in the performance of investment and ancillary services;
3. maintain permanent and effective arrangements with a view to taking all reasonable steps designed to identify conflicts of interest between the investment services enterprise itself, including its employees and any persons and enterprises directly or indirectly linked to it by control as defined by section 1 (8) of the Banking Act, and its clients or between one client and another that arise in the course of providing any investment or ancillary services, and to prevent such conflicts of interests from adversely affecting the interests of its clients;
4. have in place effective and transparent procedures for the reasonable and prompt handling of complaints received from retail clients and keep a record of each complaint and the measures taken for its resolution;
5. ensure that senior management and the supervisory function receive at appropriate intervals, at least annually, reports on the appropriateness and effectiveness of the policies, resources and procedures under no. 1 from the employees commissioned with the compliance function; such reports shall indicate in particular whether appropriate measures have been taken to remedy any contraventions by the investment services enterprise or its employees of the requirements under this Act, or to eliminate the risk of such contraventions;
6. monitor and periodically assess the appropriateness and effectiveness of the organisational measures taken in accordance with this part, and take the steps necessary to remedy any deficiencies.

As part of the arrangements to be established pursuant to sentence 2 no. 1, the investment services enterprise must take into consideration the nature, scale, complexity and risk content of its business as well as the nature and range of its investment services offered.

(2) An investment services enterprise must comply with the requirements set forth in section 25a (2) of the Banking Act when it outsources activities, processes and financial services. The outsourcing must not alter the legal relationship of the enterprise with its clients and its obligations towards its clients defined in this part. The outsourcing must not alter the conditions under which the investment services enterprise has been granted an authorisation under section 32 of the Banking Act.

(3) An investment services enterprise may outsource portfolio management for retail clients within the meaning of section 31a (3) to an enterprise domiciled in a third country only if

1. the company to which the service is outsourced is authorised or registered in that third country in respect of this service and is supervised by an authority which maintains an adequate cooperation agreement with the Supervisory Authority; or
2. the Supervisory Authority was notified of the outsourcing agreement and did not object to it within a reasonable period of time.

The Supervisory Authority publishes on its website a list of the foreign supervisory authorities with which it maintains adequate cooperation agreements within the meaning of sentence 1 no. 1, and the conditions under which it generally raises no objections to outsourcing agreements within the meaning of sentence 1 no. 2, including a statement of reasons explaining why this may ensure compliance with the provisions set out in subsection (2).

(4) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions on the organisational requirements under subsection (1) sentence 2. The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Supervisory Authority.

### **Section 33a**

#### **Best execution of client orders**

(1) An investment services enterprise which executes client orders for the purchase or sale of financial instruments within the meaning of section 2 (3) sentence 1 nos. 1 to 3 must

1. take all reasonable steps, in particular by establishing an execution policy and annually reviewing such policy, to obtain the best possible result for its clients; and
2. ensure that each individual order is executed in accordance with this execution policy.

(2) The investment services enterprise must, when establishing its execution policy, take into account all relevant criteria for obtaining the best possible result, in particular the prices of the financial instruments, the costs related to the execution of the order, the speed, the likelihood of the execution and settlement of the order as well as the size and nature of the order, and weigh the criteria by taking into consideration the characteristics of the client, the client order, the financial instrument and the execution venue.

(3) Where an investment services enterprise executes orders on behalf of retail clients, its execution policy must contain arrangements allowing for the best possible results being determined in terms of the total consideration. The total consideration shall represent the price of the financial instrument and all costs related to execution. Where the execution policy allows for more than one competing venue to execute an order for a financial instrument, the costs shall also include the investment services enterprise's own commissions and fees charged to the client for an investment service. Investment services enterprises must not structure or charge their commissions in such a way as to discriminate unfairly between execution venues.

(4) Where an investment services enterprise executes an order following specific instructions from the client, the obligation to deliver the best possible result shall be deemed fulfilled in accordance with the scope of the order.

(5) The execution policy must include

1. in respect of each category of financial instruments, information on the different execution venues and the factors affecting the choice of the venue;
2. at least those execution venues that enable the investment services enterprise to obtain, on a consistent basis, the best possible result for the execution of client orders.

Where the execution policy within the meaning of subsection (1) no. 1 allows order execution also outside organised markets and multilateral trading facilities, the investment services enterprise must inform its clients thereof separately; furthermore it must obtain, prior to the execution of the client order on such venue, the express consent of its clients in general or in respect of individual transactions.

(6) The investment services enterprise must

1. inform its clients of its execution policy prior to the first-time provision of investment services and obtain the consent of its clients to that policy;
2. expressly inform its retail clients that, if a client instruction exists, it will execute the order following this instruction and that it is not obliged to execute the order in accordance with its execution policy which is aimed at obtaining the best possible results;
3. inform its clients without undue delay of material changes to the reasonable steps pursuant to subsection (1) no. 1.

(7) The investment services enterprise must be able to demonstrate to its clients, at their requests, that it has executed their orders in accordance with its execution policy.

(8) Where investment services enterprises transmit the orders of their clients to third parties for execution or provide portfolio management services without executing the orders or decisions themselves, subsections (1) to (7) shall apply *mutatis mutandis* subject to the proviso that

1. the reasonable steps taken shall take into account the execution policy to be complied with pursuant to subsections (2) and (3) when executing orders;
2. the execution policy to be established pursuant to subsection (1) no. 1 must identify, in respect of each category of financial instruments, the entities which the investment services enterprise commissions to execute its decisions or to which it transmits its client orders for execution; the investment services enterprise must ensure that the entities identified have arrangements in place that enable it to comply with its obligations under this subsection;
3. as part of its obligations under subsection (1) no. 2, the investment services enterprise must review its execution policy at least annually and monitor on a regular basis whether the commissioned entities execute the orders in compliance with the reasonable steps taken and, where appropriate, correct any deficiencies.

(9) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning the minimum requirements for establishing the execution policy pursuant to subsections (1) to (5), the execution policy within the meaning of subsection (8) no. 2, and the monitoring of the reasonable steps

pursuant to subsections (1) and (8) as well as the nature, scope and medium of the information concerning the execution policy pursuant to subsection (6). The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Supervisory Authority.

### **Section 33b Employees and personal account dealing**

(1) The following shall be deemed employees of an investment services enterprise:

1. board members, personally liable partners and persons having equivalent status, executive directors as well as tied agents within the meaning of section 2 (10) sentence 1 of the Banking Act (*Kreditwesengesetz*);
2. board members, personally liable partners and persons having equivalent status as well as executive directors of tied agents;
3. all natural persons assisting the investment services enterprise or its tied agent in providing investment services, in particular under an employment contract, agency contract or service contract; and
4. all natural persons directly involved in the provision of services to the investment services enterprise or to its tied agent under an outsourcing arrangement for the purpose of the provision of investment services;

(2) Personal account dealing within the meaning of subsections (3) to (6) shall mean transactions in a financial instrument effected by an employee

1. for own account;
2. for the account of persons with whom he is closely associated within the meaning of section 15a (3) sentence 1, underage stepchildren or persons in whose successful transaction outcome the employee has at least an indirect material interest, other than a fee or commission for the execution of the transaction; or
3. for own account or for the account of others outside the scope of the activities he carries out in that capacity.

(3) Investment services enterprises must use adequate resources and procedures for the purpose of preventing an employee who is involved in activities that may give rise to a conflict of interest or who has access to inside information within the meaning of section 13 or to other confidential information relating to clients or transactions with or for clients by virtue of an activity carried out by him from

1. engaging in personal account dealing which
  - a. may contravene a provision of this part or section 14; or
  - b. involves the misuse or improper disclosure of that confidential information;
2. advising, other than in the proper course of his employment, any other person to enter into a transaction in financial instruments which, if it was personal account dealing,

- a. would fulfil the requirements set out in no. 1 or subsection (5) no. 1 or no. 2; or
- b. would contravene section 31c (1) no. 5;

or from inducing any other person to enter into such transaction;

- 3. granting, without prejudice to the prohibition pursuant to section 14 (1) no. 2 and other than in the proper course of his employment, any other person access to any opinion or information if he knows that as a result of that disclosure that other person would be induced to
  - a. enter into a transaction which, if it was personal account dealing, would fulfil the requirements of no. 1 or subsection (5) no. 1 or no. 2 or contravene section 31c (1) no. 5; or
  - b. advise another person to enter into a transaction under (a) or induce another person to enter into such transaction.

(4) The organisational arrangements under subsection (3) must at least be designed to ensure that

- 1. all employees covered by subsection (3) are aware of the restrictions on personal account dealing and of the arrangements established by the investment services enterprise pursuant to subsection (3);
- 2. the investment services enterprise is informed without undue delay of any personal account dealing by an employee pursuant to subsection (3), either by notification by the employee or by another procedure;
- 3. in the case of outsourcing arrangements within the meaning of section 25a (2) of the Banking Act, the enterprise to which the activity is outsourced maintains a record of personal account dealings effected by persons within the meaning of subsection (1) no. 4 who fulfil the requirements under subsection (3), and provides that information to the investment services enterprise upon request; and
- 4. the investment services enterprise keeps a record of all personal account dealing of which it becomes aware pursuant to no. 2 or no. 3, and any authorisation or prohibition in connection therewith.

(5) The organisational arrangements of investment services enterprises which under their own responsibility or under that of a member of their group produce, or arrange for the production of, financial analyses of financial instruments within the meaning of section 2 (2b) or of their issuers, with such analyses being intended or likely to be distributed to their clients or to the public, shall also be designed to ensure that

- 1. employees do not undertake transactions, other than as market makers acting in good faith and in the ordinary course of market making or in the execution of an unsolicited client order, for own account or for account of a third party, including the investment services enterprise, in financial instruments to which the financial analyses relate, or in any related financial instrument, if they are familiar with the contents and the likely timing of that financial analysis of financial instruments within the meaning of section 2 (2b) or of their issuers, where such analysis is not published or made available to clients and where its recommendation may not be anticipated by

third parties in view of publicly available information, until the recipients of the financial analyses have had a reasonable opportunity to act on it;

2. in cases not covered by no. 1, employees involved in the production of financial analyses of financial instruments within the meaning of section 2 (2b) or their issuers, engage in personal account dealing in financial instruments to which the financial analyses relate, or in any related financial instruments, contrary to current recommendations, only in exceptional circumstances and with the prior approval of the legal or compliance function.

(6) The requirements under subsection (5) shall also apply to investment services enterprises which distribute financial analyses produced by a third party to the public or to clients, unless

1. the third party which produces the financial analysis is not a member of the group; and
2. the investment services enterprise
  - a. does not substantially alter the recommendations contained in the financial analysis;
  - b. does not present the financial analysis as having been produced by it;
  - c. verifies that the producer of the financial analysis is subject to requirements equivalent to the requirements under subsection (5), or has established a policy setting such requirements.

(7) Subsections (3) and (4) shall not apply to personal account dealing

1. effected under a portfolio management service where there is no prior communication between the portfolio manager and the employee or other person for whose account the transaction is executed;
2. in units in investment funds (*Investmentvermögen*) which
  - a. comply with the provisions of Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (OJ EC No. L 375 p. 3); or
  - b. are supervised in Germany, another member state of the European Union or another signatory to the Agreement on the European Economic Area and must provide an equivalent level of risk spreading in their assets, where the employee or any other person for whose account the transactions are effected are not involved in the management of investment funds (*Investmentvermögen*).

## **Section 34**

### **Record-keeping and retention obligations**

(1) Without prejudice to the record-keeping obligations pursuant to Articles 7 and 8 of Commission Regulation (EC) No. 1287/2006, investment services enterprises must keep

records of the investment and ancillary services provided by them as well as records of the transactions undertaken by them so as to enable the Supervisory Authority to monitor compliance with the requirements set forth in this part.

(2) Investment services enterprises shall keep records of agreements with clients that set out the rights and obligations of the parties, and the other terms on which the investment services enterprise will provide investment and ancillary services to the client. Where investment services enterprises provide investment services other than investment advice to retail clients for the first time, the records within the meaning of sentence 1 must document the entering into a written basic agreement that sets out at least the essential rights and obligations of the investment services enterprise and the retail client. The rights and obligations set forth or agreed upon in other documents or legal texts may be incorporated into the basic agreement by reference. The basic agreement must be made available to the retail client on paper or in another durable medium. Durable medium shall mean any instrument which enables a client to store information addressed to that client in a way accessible for a period of time adequate for the purposes of the information and which allows the unchanged reproduction of the information.

(2a) Investment services enterprises must always take, in writing, the minutes when providing investment advice to retail clients. The minutes are to be signed by the person providing the investment advice; the client shall be provided with a copy of the minutes, on paper or in another durable medium, without undue delay after the conclusion of such investment advice and, in any case, prior to the conclusion of a transaction based on the investment advice. If a client chooses, for the investment advice and conclusion of the transaction, means of communication not allowing for the transmission of the minutes prior to the conclusion of the transaction, the investment services enterprise must send the client a copy of the minutes without undue delay after the conclusion of the investment advice. In this case, and at the express request of the client, the transaction may be concluded prior to the receipt of the minutes if the investment services enterprise expressly grants the client the right to withdraw from the transaction concluded on the basis of the investment advice if the minutes are not correct or not complete; this right must be exercised within one week after having received the minutes. The client must be informed of this right and of the period to withdraw from the transaction. If the investment services enterprise contests the right to withdraw from the transaction specified under sentence 4, it must furnish evidence that the minutes are correct and complete.

(2b) Clients may request from the investment services enterprise to be provided with a copy of the minutes as set forth in subsection (2a).

(3) All records required under this part shall be retained for a period of at least five years after they are made. Records relating to the rights and obligations of the investment services enterprise and its clients and to the terms on which the investment services enterprise provides investment and ancillary services shall be retained for at least the duration of the relationship with the client. In exceptional cases, the Supervisory Authority may set longer retention periods for individual or all records if, due to exceptional circumstances and in light of the nature of the financial instrument or transaction, this is necessary to enable the Supervisory Authority to exercise its supervisory functions. The Supervisory Authority may require the investment services enterprise to comply with the retention period under sentence 1 also if the authorisation of that enterprise terminates before the expiry of the period set forth in sentence 1.

(4) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning the record-keeping obligations

and suitability of the media to be used pursuant to subsections (1) to (2a). The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Supervisory Authority.

(5) The Supervisory Authority publishes on its website a list of the minimum records investment services enterprises are required to keep under this Act in conjunction with a Regulation pursuant to subsection (4).

### **Section 34a** **Segregation of assets**

(1) Investment services enterprises which have no authorisation to conduct deposit business within the meaning of section 1 (1) sentence 2 no. 1 of the Banking Act (*Kreditwesengesetz*) shall without undue delay segregate client money held in safe custody, which they accept in connection with an investment service or ancillary service, from the money of the enterprise and from other clients' money in a trustee account with credit institutions, enterprises within the meaning of section 53b (1) sentence 1 of the Banking Act or comparable institutions domiciled in a third country and authorised to conduct deposit business, a central bank or a qualifying money market fund until the money is used for its intended purpose. A client may, by way of individual contractual stipulation, give any other instruction in respect of the segregation of client money if he has been informed of the protective purpose of the segregation of client money. Where client money is to be held in safe custody with a qualifying money market fund, the investment services enterprise shall seek prior consent of the client. Before giving the money into safe custody, the investment services enterprise shall disclose to the institution holding the money in safe custody that the money is deposited on a trust basis. It shall without undue delay inform the client with which institution and in which account the client money is deposited and whether or not the institution holding the client money is a member of a scheme designed to protect the claims of depositors and investors as well as the extent to which the client money is protected by any such scheme.

(2) Investment services enterprises which are not authorised to conduct deposit business within the meaning of section 1 (1) sentence 2 no. 5 of the Banking Act shall without undue delay pass on for safe custody securities which they accept in connection with an investment service or ancillary service to a credit institution authorised to conduct safe custody business in Germany or to an institution domiciled abroad which is authorised to conduct safe custody business and with which the client is granted a legal status equivalent to that under the Safe Custody Act (*Depotgesetz*). Subsection (1) sentence 5 shall apply *mutatis mutandis*.

(3) Investment services enterprises are obliged to provide each client at least annually and in a durable medium with a statement of the funds and financial instruments which are held in safe custody for that client pursuant to subsection (1) or subsection (2).

(4) Only under clearly defined conditions to which the client is to give his prior consent may investment services enterprises use, for own account or for the account of another client, financial instruments which are held in safe custody on behalf of a client in accordance with subsection (2) or the provisions of the Safe Custody Act, with such use being made in particular by way of agreements on securities financing transactions within the meaning of Article 2 (10) of Commission Regulation (EC) No. 1287/2006. Where financial instruments are held in an omnibus account with a third party and are to be used pursuant to sentence 1, all other clients of the omnibus account must have given their prior consent or the investment services enterprise must have in place systems and controls which ensure that only financial instruments are used to which consent has been given pursuant to sentence 1.

In the case of a retail client, the consent pursuant to sentences 1 and 2 must be evidenced by the client's signature or equivalent alternative mechanisms. In the cases of sentence 2, the investment services enterprise must keep records relating to clients on whose instructions the use of the financial instruments has been effected as well as the number of the financial instruments used belonging to each client who has given his consent, so as to enable the clear and correct allocation of any loss incurred in using the financial instrument.

(5) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions on the extent of the obligations pursuant to subsections (1) to (4) and on the requirements applicable to qualifying money market funds within the meaning of subsection (1) in order to protect the client money or securities entrusted to an investment services enterprise. The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Supervisory Authority.

### **Section 34b** **Analysis of financial instruments**

(1) Persons who, as part of their professional or business activities, prepare information concerning financial instruments or their issuers containing a direct or indirect recommendation for a particular investment decision and intended to be made available to an unspecified group of individuals (financial analysis) are obliged to do so with the requisite degree of expertise, care and diligence. Financial analyses may only be communicated or publicly distributed if they have been produced and presented in a fair manner, and

1. the identity of the person responsible for communicating or distributing the financial analysis; and
2. circumstances or relationships that could create conflicts of interest among the producers, the legal persons responsible for preparing the analysis or undertakings affiliated with these

are disclosed together with the financial analysis.

(2) A summary of a financial analysis produced by a third party may only be communicated if the contents of the analysis are presented in a clear and not-misleading manner, and if the summary makes reference to the source document and the place where the disclosure pursuant to subsection (1) sentence 2 related to the source document can be directly and easily accessed, provided this information has been publicly distributed.

(3) Financial instruments within the meaning of subsection (1) are only those which

1. are admitted to trading on a stock exchange in Germany or included in the regulated market (*regulierter Markt*) or the regulated unofficial market (*Freiverkehr*); or
2. are admitted to trading on an organised market in another member state of the European Union or another signatory to the Agreement on the European Economic Area.

Financial instruments shall be deemed admitted to trading on an organised market or included in the regulated market or regulated unofficial market if the application for such admission or inclusion has been filed or publicly announced.

(4) The provisions set forth in subsections (1), (2) and (5) do not apply to journalists, if they are subject to self-regulation, including effective control mechanisms, comparable to the regulation of subsections (1), (2) and (5) as well as of section 34c.

(5) Companies which produce or communicate financial analyses pursuant to subsection (1) sentence 1 must be organised in such a way that conflicts of interest within the meaning of subsection (1) sentence 2 are kept to a minimum. In particular, they must maintain appropriate control mechanisms capable of countering any contravention of the obligations set forth in subsection (1). In respect of investment services enterprises which, under their own responsibility or that of a member of their group, produce, or arrange for the production of, financial analyses that are intended or likely to be distributed to clients or to the public, sentence 1 shall also apply to financial analyses concerning financial instruments within the meaning of section 2 (2b) other than those mentioned under subsection (3), or to their issuers. Sentence 3 shall not apply to investment services enterprises within the meaning of section 33b (6).

(6) (Repealed)

(7) The powers of the Supervisory Authority pursuant to section 35 shall apply *mutatis mutandis* in relation to compliance with the requirements set forth in subsections (1), (2) and (5). Section 36 shall apply *mutatis mutandis* in the event that a financial analysis is produced, made accessible to others or publicly distributed by an investment services enterprise.

(8) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions about the fair production and presentation of financial analyses, about circumstances or relationships that could create conflicts of interest, about their disclosure as well as appropriate organisation pursuant to subsection (5). The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Federal Financial Supervisory Authority.

### **Section 34c Notification obligation**

Persons other than investment services enterprises, asset management companies (*Kapitalanlagegesellschaften*) or investment stock corporations (*Investmentaktiengesellschaften*), who, in the exercise of their profession or as part of their business activities, are responsible for producing or communicating financial analyses, must notify the Supervisory Authority of this without undue delay pursuant to sentence 3. Notification is also required for the termination of the activities described in sentence 1. The notification must include the name or company name and address of the party required to submit the notification. The party required to submit the notification must also disclose whether it is aware of facts that could produce conflicts of interest at affiliated enterprises. The Supervisory Authority must be notified of changes to the data and facts within four weeks. The exemption provided for under section 34b (4) shall apply *mutatis mutandis*.

### **Section 35 Monitoring of compliance with the reporting requirements and the rules of conduct**

(1) For the purpose of monitoring compliance with the obligations set out in this part, the Supervisory Authority may audit the investment services enterprises, affiliated enterprises, branches within the meaning of section 53b of the Banking Act (*Kreditwesengesetz*), enterprises with which an outsourcing arrangement within the meaning of section 25a (2) of

the Banking Act is or was maintained, and other persons and enterprises commissioned to carry out tasks, without any particular reason.

(2) The Supervisory Authority may also require enterprises domiciled in a third country which provide investment services for clients having their habitual residence or place of management in Germany, to furnish information and submit documents, in order to monitor compliance with the obligations set out in this part, provided that the investment services and related ancillary services are not provided exclusively in a third country.

(3) Objections and actions to annul measures in accordance with subsections (1) and (2) shall have no suspensive effect.

(4) The Supervisory Authority may establish guidelines which it shall use in normal cases to judge, in accordance with Directive 2004/39/EC and Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (OJ EU No. L 241 p. 26), whether or not the obligations pursuant to this part have been met. The *Deutsche Bundesbank* and the central associations of the economic sectors concerned shall be consulted before the guidelines are issued. The guidelines shall be published in the electronic Federal Gazette (*elektronischer Bundesanzeiger*).

## **Section 36**

### **Examination of reporting requirements and rules of conduct**

(1) Without prejudice to section 35, compliance with the reporting requirements pursuant to section 9, the obligations set out in this part and the duties arising from Commission Regulation (EC) No. 1287/2006 shall be examined once a year by a suitable auditor. In the case of credit institutions which are engaged in safe custody business within the meaning of section 1 (1) sentence 2 no. 5 of the Banking Act (*Kreditwesengesetz*), the auditor shall examine this business particularly carefully; this examination shall also cover compliance with section 128 of the Stock Corporation Act (*Aktiengesetz*) on notification requirements and section 135 of the Stock Corporation Act on the exercise of voting rights. The Supervisory Authority may, upon application, fully or in part waive the requirement for an annual examination, with the exception of the examination with respect to compliance with the requirements set out in section 34a, also in conjunction with a Regulation pursuant to section 34a (5), if this is deemed appropriate for specific reasons, in particular due to the nature or scale of the business conducted. The investment services enterprise shall appoint the auditor not later than the end of the financial year to which the examination relates. In the case of credit institutions which are members of a cooperative auditing association (*genossenschaftlicher Prüfungsverband*) or which are audited by the auditing body of a savings bank and giro association (*Sparkassen- und Giroverband*), the examination shall be carried out by the competent auditing association or auditing body, to the extent that this is provided for by the law of the respective State in the latter case. Suitable auditors are also German certified accountants (*Wirtschaftsprüfer*), German sworn auditors (*vereidigte Buchprüfer*) as well as German accounting and auditing firms (*Wirtschaftsprüfungs- und Buchprüfungsgesellschaften*) which have sufficient knowledge relating to the subject matter to be examined. After conclusion of the examination, the auditor shall without undue delay file an examination report with the Supervisory Authority and the *Deutsche Bundesbank*. If the examinations pursuant to sentence 4 are conducted by cooperative auditing associations or auditing bodies of savings banks and giro associations, the auditing associations or auditing bodies shall be required to file the examination report only upon request of the Supervisory Authority or the *Deutsche Bundesbank*.

(2) Before appointing an auditor, the investment services enterprise shall notify the Supervisory Authority about the auditor. The Supervisory Authority may demand the appointment of a different auditor within a month after having received the notification if this is deemed necessary to achieve the purpose of the examination; objections and actions to annul any such measure shall have no suspensive effect. Sentences 1 and 2 shall not apply to credit institutions which are members of a cooperative auditing association or are audited by an auditing body of a savings bank or giro association.

(3) The Supervisory Authority may issue rules for the investment services enterprise with regard to the content of the examination, which the auditor is required to observe. In particular, it may determine main points of emphasis for the examination. The auditor shall without undue delay inform the Supervisory Authority of any serious contraventions of the reporting requirements pursuant to section 9 or of the obligations set forth in this part. The Supervisory Authority may participate in the examinations. To this end, the Supervisory Authority must be notified about the start of the examination in good time.

(4) In individual cases, the Supervisory Authority may replace the auditor and conduct the examination pursuant to subsection (1) itself or through an entity commissioned by it. The investment services enterprise shall be notified of this in good time.

(5) The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions on the nature, scope and time of the examination pursuant to subsection (1), insofar as this is necessary for the performance of the functions of the Supervisory Authority, and especially to counteract undesirable developments in trading with financial instruments, to ensure compliance with the reporting requirements pursuant to section 9 and the obligations set out in this part and to obtain consistent records for this purpose. The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Federal Financial Supervisory Authority.

### **Section 36a**

#### **Enterprises, organised markets and multilateral trading facilities domiciled in another member state of the European Union or another signatory to the Agreement on the European Economic Area**

(1) With the exception of section 31 (1) no. 2, sections 31f, 31g, 33, 33b, 34a and 34b (5) as well as section 34c, the rights and obligations set forth in this part shall apply *mutatis mutandis* to branches within the meaning of section 53b of the Banking Act (*Kreditwesengesetz*) which provide investment services. Enterprises domiciled in another member state of the European Union or another signatory to the Agreement on the European Economic Area, which provide investment services alone or in connection with ancillary services and which intend to establish a branch within the meaning of section 53b of the Banking Act in Germany, shall be informed by the Supervisory Authority within the period specified in section 53b (2) sentence 1 of the Banking Act about the reporting requirements pursuant to section 9 and about the rights and obligations applicable to branches pursuant to sentence 1.

(2) The Supervisory Authority may request branches to change the arrangements established to meet the obligations applicable to them, provided that the changes are necessary and proportionate so as to enable the Supervisory Authority to verify compliance with the obligations. If the Supervisory Authority finds that an enterprise fails to comply with the obligations applicable to its branch pursuant to subsection (1) sentence 1, it shall require the enterprise to comply with its obligations within a period of time to be specified by the Supervisory Authority. If the company fails to comply with the request, the Supervisory

Authority shall take all appropriate measures to ensure compliance with the obligations and inform the competent authorities of the home member state of the nature of the measures taken. If the company fails to remedy the deficiency, the Supervisory Authority may, after informing the competent authority of the home member state, take all measures to prevent or penalise further contraventions. Where necessary, the Supervisory Authority may prevent the enterprise concerned from initiating any further transactions in Germany. The Supervisory Authority shall inform the Commission of the European Communities without undue delay of the measures taken pursuant to sentences 4 and 5.

(3) If the Supervisory Authority finds that an enterprise within the meaning of subsection (1) sentence 2 which has established a branch in Germany contravenes provisions under this Act other than those set forth in subsection (1) sentence 1 or if the enterprise contravenes equivalent foreign provisions, it shall inform the competent authority of the home member state thereof pursuant to section 7 (5) sentence 1. If the measures subsequently taken by the competent authority of the home member state are inadequate or if the enterprise continues to contravene other provisions of this part for other reasons, thus jeopardising the interests of investors or the orderly functioning of the market, the Supervisory Authority shall, after informing the competent authority of the home member state, take all the measures needed in order to guarantee investor protection and the orderly functioning of the markets. Subsection (2) sentences 4 and 5 shall apply *mutatis mutandis*.

(4) Subsection (3) shall apply *mutatis mutandis* to any enterprise domiciled in another member state of the European Union or in another signatory to the Agreement on the European Economic Area which, under the freedom to provide cross-border services, provides investment or ancillary services to clients who have their habitual residence or place of management in Germany if such enterprise contravenes the provisions of this part or equivalent foreign provisions.

(5) Subsection (3) shall apply *mutatis mutandis* to operators of organised markets and multilateral trading facilities subject to the proviso that, with respect to measures taken by the Supervisory Authority vis-à-vis such operators, the provisions set forth in this part, in the Exchange Act (*Börsengesetz*) or in equivalent foreign provisions have been contravened and that measures pursuant to subsection (3) sentence 2 may include, in particular, prohibiting operators of organised markets or multilateral trading facilities from making available their trading facilities to members in Germany.

(6) The Supervisory Authority shall inform the enterprises or markets concerned of the measures taken pursuant to subsections (2) to (5), stating the reasons on which the measures are based.

### **Section 36b**

#### **Advertising by investment services enterprises**

(1) In order to counter undesirable developments in respect of the advertising of investment services and ancillary services, the Supervisory Authority may prohibit certain types of advertising.

(2) Before general measures pursuant to subsection (1) are taken, the central associations of the economic sectors concerned and of consumer advocacy groups shall be heard.

### **Section 36c**

(Repealed)

## **Section 37 Exceptions**

The provisions of section 31 (1) no. 1 and subsections (2) to (8) as well as sections 31c, 31d and 33a shall not apply to transactions concluded on an organised market or in a multilateral trading facility between two investment services enterprises or between such investment services enterprises and other members or participants of these markets or facilities. If a transaction within the meaning of sentence 1 is concluded in the execution of a client order, the investment services enterprises must however comply with the obligations to its client which are set forth in section 31 (1) no. 1 and subsections (2) to (8) as well as sections 31c, 31d and 33a.

## **Section 37a (Repealed)**

## **Part 7 Liability for incorrect or omitted capital market information**

### **Section 37b Liability for damages due to failure to publish inside information without undue delay**

(1) If an issuer of financial instruments that are admitted to trading on a German stock exchange fails to publish, without undue delay, inside information that directly affects that issuer, he shall be liable to compensate a third party for the damage resulting from the omission if the third party

1. has bought the financial instruments after the omission and still owns the financial instruments upon disclosure of the information or
2. has bought the financial instruments before the existence of the relevant insider fact and sells them after the omission

(2) Those issuers who can prove that the omission was made neither deliberately nor in an act of gross negligence shall not be liable for damages pursuant to subsection (1).

(3) Claims for damages pursuant to subsection (1) shall not exist if, in the case of subsection (1) no. 1, the third party knew about the undisclosed fact at the time of purchase and, in the case of subsection (1) no. 2, the third party knew about the undisclosed fact at the time of sale.

(4) Claims for damages pursuant to subsection (1) are subject to a limitation period of one year from the date on which the third party learned of the omission, but not more than three years after the omission.

(5) This is without prejudice to further contractual claims or claims in intentional tort which may be raised under the provisions of civil law.

(6) Any agreement which reduces the claims to be brought by an issuer against the members of the board of management based on claims for damages against the issuer pursuant to subsection (1) or which relieves the members of the board of management of such claims shall be deemed invalid.

### **Section 37c**

#### **Liability for damages based on the publication of false inside information**

(1) If an issuer of financial instruments that are admitted to trading on a domestic stock exchange publishes false inside information that directly affects that issuer in a notification pursuant to section 15, he shall be liable to compensate a third party for the damage resulting from the fact that the third party relied on the accuracy of the inside information, if the third party

1. has bought the financial instruments after publication and still owns the financial instruments at the point in time at which it becomes publicly known that the information was inaccurate or
2. has bought the financial instruments before publication and sells them before it becomes clear that the information was inaccurate.

(2) Those issuers who can prove that they were not aware of the inaccuracy of the inside information and that such lack of awareness does not constitute an act of gross negligence shall not be liable for damages pursuant to subsection (1).

(3) Claims for damages pursuant to subsection (1) shall not exist if, in the case of subsection (1) no. 1, the third party knew that the inside information was inaccurate at the time of purchase and, in the case of subsection (1) no. 2, the third party knew that the information was incorrect at the time of sale.

(4) Claims for damages pursuant to subsection (1) are subject to a limitation period of one year from the date on which the third party learns of the inaccuracy, but no more than three years after publication.

(5) This is without prejudice to further contractual claims or claims in intentional tort which may be raised under the provisions of civil law.

(6) Any agreement which reduces the claims to be brought by an issuer against the members of the board of management on grounds of claims for damages pursuant to subsection (1) or which relieves the members of the board of management of such claims shall be deemed invalid.

## **Part 8**

### **Financial futures and forward transactions**

### **Section 37d**

(Repealed)

### **Section 37e**

#### **Exclusion of the objection pursuant to section 762 of the Civil Code**

Objections pursuant to section 762 of the Civil Code (*Bürgerliches Gesetzbuch*) may not be made against claims arising from financial futures and forward transactions involving at least one party which is an enterprise that concludes financial futures and forward transactions commercially or on a scale which requires commercially organised business operations or which purchases, sells or brokers financial futures and forward transactions. Financial futures and forward transactions within the meaning of sentence 1 and sections 37g and 37h are derivatives within the meaning of section 2 (2) and warrants.

### **Section 37f**

(Repealed)

### **Section 37g**

#### **Prohibited financial futures and forward transactions**

(1) The Federal Ministry of Finance may, by means of a Regulation, prohibit or impose a restriction on financial futures and forward transactions, insofar as this is necessary for the protection of investors.

(2) Any financial futures and forward transactions contravening a Regulation pursuant to subsection (1) (prohibited financial futures and forward transactions) are void. Sentence 1 shall apply *mutatis mutandis* to

1. the provision of margin for prohibited financial futures and forward transactions;
2. an agreement by means of which one party incurs a liability towards the other party for the purpose of meeting a liability from prohibited financial futures and forward transactions, in particular for an acknowledgement of debt;
3. the placing and acceptance of orders for the purpose of concluding prohibited financial futures and forward transactions and
4. associations established for the purpose of concluding prohibited financial futures and forward transactions.

## **Part 9**

### **Arbitration agreements**

#### **Section 37h**

##### **Arbitration agreements**

Arbitration agreements on future legal disputes relating to investment services, ancillary services or financial futures and forward transactions shall be binding only if both parties to

the agreement are merchants within the meaning of the Commercial Code (*Handelsgesetzbuch*) or legal persons under public law.

## **Part 10**

### **Markets in financial instruments domiciled outside the European Union**

#### **Section 37i**

##### **Authorisation**

(1) Markets in financial instruments domiciled outside Germany which are not organised markets or multilateral trading facilities within the meaning of this Act, or their operators, wishing to grant trading participants domiciled in Germany direct market access by means of an electronic trading system shall require written authorisation from the Supervisory Authority. The application for authorisation shall contain

1. the name and address of the management of the market or its operator;
2. information required in order to assess the reliability of the management;
3. a business plan showing the type of planned market access for the trading participants, the organisational structure and the internal control mechanisms of the market;
4. the name and address of an authorised recipient in Germany;
5. information about the bodies responsible for supervising the market and its trading participants in the home country and their powers of supervision and intervention;
6. information on the type of financial instruments which shall be traded by the trading participants by means of direct market access; and
7. the name and address of trading participants domiciled in Germany who shall be granted direct market access.

The Federal Ministry of Finance shall, by means of a Regulation not requiring the consent of the *Bundesrat*, provide details with regard to the information required under sentence 2 and the documents to be presented. The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Federal Financial Supervisory Authority.

(2) The Supervisory Authority may grant the authorisation subject to conditions which must be consistent with the intended purpose of this Act. Prior to granting the authorisation, the Supervisory Authority shall afford the stock exchange supervisory authorities of the Federal States an opportunity to comment on the application within a period of four weeks.

(3) The Supervisory Authority shall announce the authorisation in the electronic Federal Gazette (*elektronischer Bundesanzeiger*).

(4) (Repealed)

#### **Section 37j**

##### **Refusal of the authorisation**

The authorisation shall be refused if

1. there is evidence indicating that the management is not reliable;
2. direct market access is to be granted to trading participants domiciled in Germany which fail to meet the requirements of section 19 (2) of the Exchange Act (*Börsengesetz*);
3. the home country fails to meet standards in supervision of the market or investor protection equivalent to those under German law; or
4. exchange of information is not guaranteed with the bodies responsible for supervising the market in the home country.

### **Section 37k Revocation of the authorisation**

(1) The Supervisory Authority may revoke the authorisation in addition to the possibility of revocation under the provisions of the Act on Administrative Procedure (*Verwaltungsverfahrensgesetz*) if

1. it learns of facts which warrant the refusal of the authorisation pursuant to section 37j; or
2. the market or its operator has persistently contravened provisions of this Act or the Regulations or orders issued to implement this Act.

(2) The Supervisory Authority shall announce the revocation of the authorisation in the electronic Federal Gazette (*elektronischer Bundesanzeiger*).

### **Section 37l Prohibition**

The Supervisory Authority may prohibit trading participants domiciled in Germany who offer investment services in Germany from executing client orders through an electronic trading system of a foreign market if such markets or their operators grant trading participants domiciled in Germany direct market access through this electronic trading system without being authorised to do so.

### **Section 37m**

(Repealed)

## **Part 11 Monitoring of company financial statements, publication of financial reports**

### **Sub-part 1 Monitoring of company financial statements**

### **Section 37n Auditing of company financial statements and reports**

Pursuant to the provisions set forth in this part, subject to section 342b (2) sentence 3 nos. 1 and 3 of the Commercial Code (*Handelsgesetzbuch*), the Supervisory Authority is responsible for auditing the annual financial statements and the corresponding management report or the consolidated financial statements and the corresponding group management report as well as the condensed set of financial statements and the corresponding interim management report of companies whose securities within the meaning of section 2 (1) sentence 1 are admitted to trading on the regulated market (*regulierter Markt*) of a stock exchange in Germany, to ensure that they comply with the legal requirements including the German Generally Accepted Accounting Principles or other accounting standards permitted by law.

### **Section 37o**

#### **Ordering of an accounting audit and investigatory powers of the Supervisory Authority**

(1) The Supervisory Authority orders an accounting audit if specific evidence exists of a contravention of accounting regulations; no order is issued if it is apparent that clarification of the case does not serve the public interest. The Supervisory Authority can also order an accounting audit without any particular reason (sampling). The scope of each individual audit shall be defined in the audit order. Only the most recent approved annual financial statements and the corresponding management report or the most recent approved consolidated financial statements and the corresponding group management report as well as the most recent published condensed set of financial statements and the corresponding interim management report are subject to the audit; without prejudice to this, in the case of section 37p (1) sentence 2, the Supervisory Authority may audit the financial statements which were examined by the enforcement panel within the meaning of section 342b (1) of the Commercial Code (*Handelsgesetzbuch*) (enforcement panel). If the Supervisory Authority orders an accounting audit after receiving a report from the enforcement panel pursuant to section 37p (1) sentence 2 no. 1, it may publish the order and the grounds pursuant to section 37p (1) sentence 2 no. 1 in the electronic Federal Gazette (*elektronischer Bundesanzeiger*). Sentence 2 shall not apply to the audit of the condensed set of financial statements and the corresponding interim management report.

(2) The annual financial statements and the corresponding management report are not audited by the Supervisory Authority if an action to declare the financial statements void within the meaning of section 256 (7) of the Stock Corporation Act (*Aktiengesetz*) is pending. If a special auditor has been appointed pursuant to section 142 (1) or (2) or section 258 (1) of the Stock Corporation Act, no audit is performed either, provided that the subject of the special audit, the audit report or a court decision concerning the ultimate findings by the special auditors are sufficient pursuant to section 260 of the Stock Corporation Act.

(3) In conducting the audit, the Supervisory Authority may make use of the enforcement panel as well as other institutions or persons.

(4) The company within the meaning of section 37n, the members of its bodies, its employees and its auditors are required to furnish, upon request, information and documentation to the Supervisory Authority and persons assisting the Supervisory Authority in fulfilling its functions, to the extent that this is required for the audit; the auditors' obligation to provide information is restricted to facts disclosed to them within the context of the audit. Sentence 1 also applies to subsidiaries that are to be included in the consolidated financial statements in accordance with the provisions of the Commercial Code. For the right

of refusal to furnish information and the obligation to inform affected persons of this right, section 4 (9) applies *mutatis mutandis*.

(5) Persons obliged to furnish information and documentation as set out in subsection (4) are required to grant employees of the Supervisory Authority and persons commissioned by it access to their property and business premises during normal business hours, to the extent that this is necessary for the performance of the functions of the Supervisory Authority. Section 4 (4) sentence 2 applies *mutatis mutandis*. The inviolability of the home (Article 13 of the Basic Law (*Grundgesetz*)) shall be restricted accordingly.

### **Section 37p The Supervisory Authority's powers in the case of recognition of an enforcement panel**

(1) If an enforcement panel is recognised pursuant to section 342b (1) of the Commercial Code (*Handelsgesetzbuch*), sampling is only carried out at the request of the enforcement panel. Furthermore, the Supervisory Authority may only exert the powers as defined in section 37o if

1. it is informed by the enforcement panel that a company refuses to cooperate in an audit or does not agree with the result of the audit, or
2. there are substantial doubts with regard to the accuracy of the enforcement panel's audit result or with regard to the proper conduct of the audit by the enforcement panel.

At the request of the Supervisory Authority, the enforcement panel must explain the result and the conduct of the audit and submit an audit report. Without prejudice to sentence 2, the Supervisory Authority may take over the audit at any time if it is also conducting or has conducted an audit pursuant to section 44 (1) sentence 2 of the Banking Act (*Kreditwesengesetz*) or section 83 (1) no. 2 of the Insurance Supervision Act (*Versicherungsaufsichtsgesetz*) and the audits concern the same subject.

(2) If the conditions of section 37o (1) sentence 1 are met, the Supervisory Authority may request that the enforcement panel commences an audit.

(3) The Supervisory Authority informs the enforcement panel of notifications pursuant to section 142 (7), section 256 (7) sentence 2 and section 261a of the Stock Corporation Act (*Aktiengesetz*) if the enforcement panel intends to or has commenced an audit of a company that is affected by such a notification.

### **Section 37q Results of the audit by the Supervisory Authority or the enforcement panel**

(1) If the audit by the Supervisory Authority establishes that accounting is faulty, the Supervisory Authority states that an error has been made.

(2) The Supervisory Authority orders the company to publish the error identified by the Supervisory Authority or the enforcement panel in agreement with the company, together with the primary grounds for identifying the error. The Supervisory Authority waives the order pursuant to sentence 1 if the publication does not serve the public interest. Upon request by the company, the Supervisory Authority may waive the order pursuant to sentence 1 if the publication is likely to damage the legitimate interests of the company. The publication must be made without undue delay in the electronic Federal Gazette (*elektronischer Bundesanzeiger*) as well as in either a national newspaper for statutory stock exchange announcements (*überregionales Börsenpflichtblatt*) or by way of an electronic system for the dissemination of information which is broadly used by credit institutions, enterprises operating under section 53 (1) sentence 1 of the Banking Act (*Kreditwesengesetz*), other enterprises domiciled in Germany which are admitted to trading on a German stock exchange and insurance undertakings.

(3) The Supervisory Authority informs the company in the event that the audit conducted by it results in no findings of fault.

### **Section 37r Notifications to other authorities**

(1) The Supervisory Authority must report facts giving reason to suspect a criminal offence in relation to the company's accounting to the competent prosecuting authority. It may communicate to these authorities the personal data of persons suspected of the offence, or persons who may be required to act as witnesses.

(2) The Supervisory Authority communicates all facts indicating the violation of professional obligations by the auditor to the German Chamber of Public Accountants (*Wirtschaftsprüferkammer*). The Supervisory Authority communicates all facts indicating a violation of exchange law provisions by the company to the competent exchange supervisory authority. Subsection (1) sentence 2 applies *mutatis mutandis*.

### **Section 37s International cooperation**

(1) The Supervisory Authority is responsible for cooperation with foreign authorities charged with investigating possible violations of accounting regulations by companies whose securities are admitted to trading on an organised market. To meet this obligation, it may communicate information to these authorities in accordance with section 7 (2) sentences 1 and 2, also in conjunction with subsection (7). Section 37o (4) and (5) applies *mutatis mutandis*, with the proviso that the powers regulated therein shall extend to all companies covered by the cooperation referred to in sentence 1, as well as all entities included in the consolidated financial statements of such companies.

(2) The Supervisory Authority may cooperate with the competent authorities of other member states of the European Union or signatories to the Agreement on the European

Economic Area in order to guarantee uniform implementation of international accounting standards. To this end, it may provide these authorities with transcripts of decisions that it or the enforcement panel have made in individual cases. The transcripts of decisions may only be made available in anonymous form.

(3) The Supervisory Authority's cooperation with international authorities as described in subsections (1) and (2) is carried out in consultation with the enforcement panel.

### **Section 37t Objection procedure**

(1) Before a complaint is filed, the legality and suitability of orders issued by the Supervisory Authority pursuant to the provisions of this part must be reviewed in an objection procedure. Such a review is not required if the remedial decision or the ruling on the objection contains a gravamen for the first time. Sections 68 to 73 and 80 (1) of the Rules of the Administrative Courts (*Verwaltungsgerichtsordnung*) apply *mutatis mutandis* to the objection procedure, unless otherwise provided for in this part.

(2) Objections against measures by the Supervisory Authority pursuant to section 37o (1) sentence 1, 2 and 5 as well as (4) and (5), section 37p (1) sentence 3 and 4 as well as (2), and section 37q (1) as well as (2) sentence 1 shall have no suspensive effect.

### **Section 37u Complaints**

(1) Complaints may be filed against orders by the Supervisory Authority pursuant to this part. Complaints shall have no suspensive effect.

(2) Sections 43 and 48 (2) to (4), section 50 (3) to (5) and sections 51 to 58 of the Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*) apply *mutatis mutandis*.

## **Sub-part 2 Publication and transmission of financial reports to the company register**

### **Section 37v Annual financial report**

(1) A company which issues securities as a domestic issuer shall prepare an annual financial report as per the end of each financial year and make such report available to the public four months after the end of each financial year at the latest if the company is not required pursuant to the provisions under commercial law to disclose the accounting documents specified in subsection (2). Prior to making the accounting documents specified in subsection (2) publicly available for the first time, any company which issues securities as a domestic issuer shall make a publication concerning the time and the website on which the accounting documents specified in subsection (2) will be publicly available in addition to their availability in the company register. Simultaneously with the publication of such announcement, the company shall notify the Supervisory Authority thereof and transmit the

announcement without undue delay, however not before its publication, to the company register within the meaning of section 8b of the Commercial Code (*Handelsgesetzbuch*) in order to be stored there. Furthermore, the company shall transmit without undue delay, but not before the publication of the announcement pursuant to sentence 2, the accounting documents specified in subsection (2) to the company register in order to be stored there, unless the transmission is effected pursuant to section 8b (2) no. 4 in conjunction with subsection (3) sentence 1 no. 1 of the Commercial Code.

(2) The annual financial report shall at least contain

1. the annual financial statements prepared and audited in accordance with the national law of the member state in which the company is registered;
2. the management report;
3. a statement made in accordance with the provisions of section 264 (2) sentence 3, section 289 (1) sentence 5 of the Commercial Code; and
4. a certificate of registration of the auditor issued by the Chamber of German Public Auditors (*Wirtschaftsprüferkammer*) pursuant to section 134 (2a) of the Act on the Profession of Auditors (*Wirtschaftsprüferordnung*) or a certification of exemption from the registration obligation issued by the Chamber of German Public Auditors pursuant to section 134 (4) sentence 8 of the Act on the Profession of Auditors.

(3) In agreement with the Federal Ministry of Justice, the Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning

1. the minimum content, nature, language, scope and form of the publication pursuant to subsection (1) sentence 2;
2. the minimum content, nature, language, scope and form of the notification pursuant to subsection (1) sentence 3;
3. how long the information specified in subsection (2) must generally remain available in the company register and when it is to be deleted; and
4. a coordinated procedure according to which the annual financial report and the annual document pursuant to section 10 of the Securities Prospectus Act (*Wertpapierprospektgesetz*) shall be made known to the Supervisory Authority.

### **Section 37w** **Half-yearly financial report**

(1) A company which, as a domestic issuer, issues shares or debt securities within the meaning of section 2 (1) sentence 1 shall prepare a half-yearly financial report covering the first six months of each financial year and make such report available to the public without undue delay, but two months after the end of the relevant reporting period at the latest, unless the admitted securities are debt securities that fall within the scope of section 2 (1) sentence 1 no. 2, or that grant at least a contingent right to acquire securities pursuant to section 2 (1) sentence 1 no. 1 or 2. Furthermore, prior to making the half-yearly financial

report publicly available for the first time, the company shall publish an announcement concerning the time and the website on which the report will be publicly available in addition to its availability in the company register. Simultaneously with the publication of such announcement, the company shall notify the Supervisory Authority thereof and transmit the announcement without undue delay, however not before its publication, to the company register within the meaning of section 8b of the Commercial Code (*Handelsgesetzbuch*) in order to be stored there. Moreover, the company shall transmit without undue delay, but not before the publication of the announcement pursuant to sentence 2, the half-yearly financial report to the company register in order to be stored there.

(2) The half-yearly financial report shall at least contain

1. the condensed set of financial statements;
2. an interim management report; and
3. a statement made in accordance with section 264 (2) sentence 3, section 289 (1) sentence 5 of the Commercial Code.

(3) The condensed set of financial statements shall at least contain a condensed balance sheet, a condensed profit and loss account and notes. The condensed set of financial statements shall be prepared in accordance with the accounting standards applicable to the annual financial statements. Where, in the case of publication, the annual financial statements are replaced by separate financial statements within the meaning of section 325 (2a) of the Commercial Code, the condensed set of financial statements shall be prepared in accordance with the international accounting standards and provisions specified in section 315a (1) of the Commercial Code.

(4) The interim management report shall at least include an indication of important events that have occurred during the reporting period in the issuer's company and their impact on the condensed set of financial statements as well as a description of the principal opportunities and risks for the six months of the financial year following the reporting period. In respect of companies that issue shares as domestic issuers, the interim management report shall include major related parties transactions; such data may be provided in the notes to the half-yearly financial report instead.

(5) The condensed set of financial statements and the interim management report may be reviewed by auditors. The provisions concerning the appointment of the auditor shall apply *mutatis mutandis* to the auditors' review. The auditors' review shall be effected in such way that, when conscientiously exercising the profession, it can be excluded that the condensed set of financial statements and the interim management report are inconsistent with the applicable accounting standards in material aspects. The auditor shall summarise the findings of his review in a certification in respect of the half-yearly financial report and publish such certification together with the half-yearly financial report. If the condensed set of financial statements and the interim management report have been audited in accordance with section 317 of the Commercial Code, the auditors' report or the non-affirmative auditors' report shall be reproduced in full and published together with the half-yearly financial report. If the condensed set of financial statements and half-yearly financial report have not been reviewed by auditors or audited in accordance with section 317 of the Commercial Code, a statement to that effect shall be made in the half-yearly financial report. Sections 320 and 323 of the Commercial Code shall apply *mutatis mutandis*.

(6) In agreement with the Federal Ministry of Justice, the Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning

1. the content and the auditors' review of the half-yearly financial report;
2. the minimum content, nature, language, scope and form of the publication pursuant to subsection (1) sentence 2;
3. the minimum content, nature, language, scope and form of the notification pursuant to subsection (1) sentence 3; and
4. how long the half-yearly financial report must remain publicly available in the company register and when it is to be deleted.

### **Section 37x** **Interim management statement**

(1) A company which issues shares as a domestic issuer shall make publicly available an interim statement by its management in a period between ten weeks after the beginning and six weeks before the end of the first half of the financial year and another statement in a period between ten weeks after the beginning and six weeks before the end of the second half of the financial year. Prior to this, the company must publish an announcement concerning the time and website on which the interim management statement will be made publicly available in addition to its availability in the company register. The company shall notify the Supervisory Authority of the announcement simultaneously with its publication and transmit it without undue delay, however not before its publication, to the company register within the meaning of section 8b of the Commercial Code (*Handelsgesetzbuch*) in order to be stored there. Furthermore, the company shall without undue delay, but not before the publication of the announcement pursuant to sentence 2, transmit the interim management statement to the company register in order to be stored there.

(2) The interim management statement shall contain information covering the period between the beginning of the relevant half of the financial year and the time at which the statement will be made publicly available in accordance with subsection (1) sentence 1; such information shall allow to assess how the issuer's business performed during the three months prior to the expiry of the period covered by the interim statement. The interim management statement shall contain an explanation of the material events and transactions that have taken place at the issuer's company during the period covered by the interim statement and their impact on the financial position of the issuer, and a description of the financial position and performance of the issuer during the period covered by the interim statement.

(3) The obligation set forth in subsection (1) shall not apply if a quarterly financial report is prepared and published in accordance with the provisions laid down in section 37w (2) nos. 1 and 2, subsections (3) and (4). The quarterly financial report shall be transmitted to the company register without undue delay, however not before its publication. If the quarterly financial report is reviewed by auditors, sections 320 and 323 of the Commercial Code shall apply *mutatis mutandis*.

(4) In agreement with the Federal Ministry of Justice, the Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning

1. the minimum content, nature, language, scope and form of the publication pursuant to subsection (1) sentence 2; and
2. the minimum content, nature, language, scope and form of the notification pursuant to subsection (1) sentence 3.

### **Section 37y Consolidated financial statements**

If a parent enterprise has the obligation to prepare consolidated financial statements and a group management report, sections 37v to 37x shall apply subject to the following proviso:

1. The annual financial report shall also contain the audited consolidated financial statements prepared in accordance with Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (OJ EC No. L 243, p. 1), the group management report, a statement made in accordance with the provisions set forth in section 297 (2) sentence 3, section 315 (1) sentence 6 of the Commercial Code (*Handelsgesetzbuch*) and a certificate of registration of the auditor issued by the Chamber of German Public Auditors (*Wirtschaftsprüferkammer*) pursuant to section 134 (2a) of the Act on the Profession of Auditors (*Wirtschaftsprüferordnung*) or a certification of exemption from the registration obligation issued by the Chamber of German Public Auditors pursuant to section 134 (4) sentence 8 of the Act on the Profession of Auditors.
2. The statutory representatives of the parent enterprise shall prepare and publish the half-yearly financial report for the parent enterprise and the subsidiaries to be included in the consolidation taken as a whole. Section 37w (3) shall apply *mutatis mutandis* if the parent enterprise has the obligation to prepare the consolidated financial statements in accordance with the international accounting standards and provisions specified in section 315a (1) of the Commercial Code.
3. The information provided in the interim management statement of a parent enterprise pursuant to section 37x (2) sentence 2 shall refer to the parent enterprise and the subsidiaries to be included in the consolidation taken as a whole.

### **Section 37z Exemptions**

(1) Sections 37v to 37y shall not apply to companies that exclusively issue debt securities admitted to trading on an organised market, the denomination per unit of which is at least 50,000 euros or the value of such denomination per unit in another currency at the date of the issue.

(2) Section 37w shall not apply to credit institutions that issue securities as domestic issuers if their shares are not admitted to trading on an organised market and if they have, in a continuous or repeated manner, exclusively issued debt securities whose total nominal amount remains below 100 million euros, and for which a prospectus under the Securities Prospectus Act (*Wertpapierprospektgesetz*) has not been published.

(3) Section 37w shall also not apply to companies that issue securities as domestic issuers if they already existed on 31 December 2003 and exclusively issue debt securities admitted to trading on an organised market which are unconditionally and irrevocably guaranteed by the

Federal Government or one of the Federal States, or by one of the regional or local authorities.

(4) The Supervisory Authority may exempt a company domiciled in a third country that issues securities as a domestic issuer from the requirements set forth in sections 37v to 37y, also in conjunction with a Regulation pursuant to section 37v (3), section 37w (6) or section 37x (4), if such issuers are subject to equivalent rules of a third country or if they submit to such rules. However, the information to be prepared pursuant to the provisions of a third country shall be made available to the public, published and simultaneously notified to the Supervisory Authority in the manner prescribed in section 37v (1) sentences 1 and 2, section 37w (1) sentences 1 and 2, and section 37x (1) sentences 1 and 2, each of which also in conjunction with a Regulation pursuant to section 37v (3), section 37w (6) or section 37x (4). Furthermore, the information shall be transmitted to the company register within the meaning of section 8b of the Commercial Code (*Handelsgesetzbuch*) without undue delay, however not before its publication, in order to be stored there. The Federal Ministry of Finance may, by means of a Regulation not requiring the consent of the *Bundesrat*, issue more detailed provisions concerning the equivalence of a third country's rules and the exemption of companies under sentence 1.

(5) By way of derogation from subsection (4), companies domiciled in a third country shall be exempted from preparing their annual financial statements in accordance with sections 37v and 37w with regard to financial years starting before 1 January 2007 if such companies prepare their annual financial statements in accordance with the internationally accepted standards referred to in Article 9 of Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (OJ EC No. L 243, p. 1).

## **Part 12**

### **Provisions concerning criminal penalties and administrative fines**

#### **Section 38**

##### **Provisions concerning criminal penalties**

(1) Any person who

1. acquires or disposes of an insider security in contravention of a prohibition pursuant to section 14 (1) no. 1; or
2.
  - a. by virtue of his membership of the management or supervisory body of the issuer, or as a personally liable partner of the issuer or of an undertaking affiliated with the issuer;
  - b. by virtue of his holding in the capital of the issuer or a company affiliated with the issuer;
  - c. by virtue of his profession, activities or duties performed as part of his function; or
  - d. due to the preparation or perpetration of a criminal offence

is privy to inside information and in using such inside information commits any intentional act named in section 39 (2) no. 3 or 4 shall be liable to imprisonment for a term not exceeding five years or to a criminal fine.

(2) Any person who commits intentional tort as named in section 39 (1) no. 1 or 2 or section 39 (2) no. 11 and thereby exerts an influence

1. on the domestic stock exchange or market price of a financial instrument, a commodity within the meaning of section 2 (2c), an emission allowance within the meaning of section 3 (4) sentence 1 of the Greenhouse Gas Emissions Trading Act (*Treibhausgas-Emissionshandelsgesetz*) or a foreign currency within the meaning of section 51 of the Exchange Act (*Börsengesetz*);
2. on the price of a financial instrument as quoted on an organised market in another member state of the European Union or another signatory to the Agreement on the European Economic Area;
3. on the price of a commodity within the meaning of section 2 (2c), an emission allowance within the meaning of section 3 (4) sentence 1 of the Greenhouse Gas Emissions Trading Act or a foreign currency within the meaning of section 51 of the Exchange Act on a market comparable to a domestic stock exchange in another member state of the European Union or in another signatory to the Agreement on the European Economic Area

shall also be subject to punishment.

(3) For the cases listed in subsection (1), the attempt is punishable.

(4) If an offence given in subsection (1) no. 1 is committed through negligence, the punishment shall be a term of imprisonment not exceeding one year or a criminal fine.

(5) In the cases listed in subsection (1) no. 1 or 2 in conjunction with section 39 (2) no. 3 or 4 or in subsection (2) in conjunction with section 39 (1) no. 1 or 2 or in subsection (2) no. 11, a foreign prohibition shall also be deemed a prohibition.

### **Section 39**

#### **Provisions concerning administrative fines**

(1) An administrative offence shall be deemed to be committed by any person who

1. in contravention of section 20a (1) sentence 1 no. 2, also in conjunction with subsection (4), each of which in conjunction with a Regulation pursuant to subsection (5) sentence 1 no. 2 or no. 5, enters into a transaction or issues a buy or sell order;
2. in contravention of section 20a (1) sentence 1 no. 3, also in conjunction with subsection (4), or a Regulation pursuant to subsection (5) sentence 1 no. 3, carries out an action aimed at deception;
3. in contravention of section 31g (1) fails to effect a publication, or fails to effect a publication correctly, completely or within the prescribed period;

4. in contravention of section 32d (1) sentence 1 fails to grant access;
5. in contravention of section 34b (1) sentence 2 in conjunction with a Regulation pursuant to subsection (8) sentence 1 communicates or publicly distributes a financial analysis; or
6. in contravention of section 34b (2) in conjunction with a Regulation pursuant to subsection (8) sentence 1 communicates a summary of a financial analysis.

(2) An administrative offence shall be deemed to be committed by any person who wilfully or negligently,

1. in contravention of section 4 (8) or section 10 (1) sentence 2, provides information to an individual;
2. in contravention of
  - a. section 9 (1) sentence 1, also in conjunction with sentence 2, each of which in conjunction with sentence 3, 4 or 5, each of which in conjunction with a Regulation pursuant to subsection (4) no. 1 or 2;
  - b. section 10 (1) sentence 1, also in conjunction with a Regulation pursuant to subsection (4) sentence 1;
  - c. section 15 (3) sentence 4, subsection (4) sentence 1, or subsection (5) sentence 2, each of which also in conjunction with a Regulation pursuant to subsection (7) sentence 1 no. 2;
  - d. section 15a (1) sentence 1, also in conjunction with sentence 2, subsection (4) sentence 1, each of which also in conjunction with a Regulation pursuant to subsection (5) sentence 1;
  - e. section 21 (1) sentence 1 or 2 or subsection (1a), each of which also in conjunction with a Regulation pursuant to section 21 (3);
  - f. section 25 (1) sentence 1, also in conjunction with a Regulation pursuant to section 25 (3);
  - g. section 26 (2), also in conjunction with a Regulation pursuant to section 26 (3) no. 2;
  - h. section 26a sentence 1;
  - i. section 29a (2) sentence 1;
  - j. section 30c, also in conjunction with section 30d;
  - k. section 30e (1) sentence 1, also in conjunction with a Regulation pursuant to section 30e (2);
  - l. section 30f (2);

- m. section 30i (1) sentence 1 or sentence 3 no. 1, each of which also in conjunction with a Regulation pursuant to section 30i (5) sentence 1 no. 1;
- n. section 37v (1) sentence 3, also in conjunction with section 37y, each of which also in conjunction with a Regulation pursuant to section 37v (3) no. 2;
- o. section 37w (1) sentence 3, also in conjunction with section 37y, each of which also in conjunction with a Regulation pursuant to section 37w (6) no. 3;
- p. section 37x (1) sentence 3, also in conjunction with section 37y, each of which also in conjunction with a Regulation pursuant to section 37x (4) no. 2; or
- q. section 37z (4) sentence 2

fails to make a notification or makes such notification incorrectly, incompletely, not in the prescribed form or not within the prescribed period;

- 3. discloses or makes available inside information in violation of section 14 (1) no. 2;
- 4. recommends that a third party acquire or dispose of insider securities, or otherwise induces a third party to do so, in violation of section 14 (1) no. 3;
- 5. in contravention of
  - a. section 15 (1) sentence 1, also in conjunction with sentence 2, section 15 (1) sentence 4 or 5, each of which also in conjunction with a Regulation pursuant to subsection (7) sentence 1 no. 1;
  - b. section 15a (4) sentence 1 in conjunction with a Regulation pursuant to subsection (5) sentence 1;
  - c. section 26 (1) sentence 1, also in conjunction with sentence 2, each of which also in conjunction with a Regulation pursuant to section 26 (3) no. 1, or in contravention of section 26a sentence 1 or section 29a (2) sentence 1;
  - d. section 30b (1) or (2), each of which also in conjunction with section 30d;
  - e. section 30e (1) sentence 1 in conjunction with a Regulation pursuant to section 30e (2) or in contravention of section 30f (2);
  - f. section 30i (1) sentence 2 or sentence 3 no. 2, each of which also in conjunction with a Regulation pursuant to section 30i (5) sentence 1 no. 1;
  - g. section 37v (1) sentence 2 in conjunction with a Regulation pursuant to section 37v (3) no. 1, each of which also in conjunction with section 37y, or in contravention of section 37z (4) sentence 2;
  - h. section 37w (1) sentence 2 in conjunction with a Regulation pursuant to section 37w (6) no. 2, each of which also in conjunction with section 37y; or

- i. section 37x (1) sentence 2 in conjunction with a Regulation pursuant to section 37x (4) no. 1, each of which also in conjunction with section 37y

fails to make a publication or makes such publication incorrectly, incompletely, not in the prescribed form or within the prescribed period or either fails to rectify these shortcomings or to rectify them in a timely manner;

- 6. fails to transmit information or an announcement or fails to do so within the prescribed period in contravention of section 15 (1) sentence 1, section 15a (4) sentence 1, section 26 (1) sentence 1, section 26a sentence 2, section 29a (2) sentence 2, section 30e (1) sentence 2, section 30f (2), section 37v (1) sentence 3, section 37w (1) sentence 3 or section 37x (1) sentence 3, each of which also in conjunction with section 37y, or in contravention of section 37z (4) sentence 3;
- 7. effects a publication in contravention of section 15 (5) sentence 1;
- 8. fails to keep a list or keeps such a list incorrectly or incompletely in contravention of section 15b (1) sentence 1 in conjunction with a Regulation pursuant to subsection (2) sentence 1 no. 1 or 2;
- 9. fails to submit this list or fails to submit it within the prescribed period in contravention of section 15b (1) sentence 2;
- 10. fails to record information, or fails to record it correctly, completely or within the prescribed period in contravention of
  - a) section 16 sentence 1; or
  - b) section 34 (1) or (2) sentence 1 or 2, each of which also in conjunction with a Regulation pursuant to section 34 (4) sentence 1;
- 11. supplies or withholds information in contravention of section 20a (1) sentence 1 no. 1, also in conjunction with subsection (4) or a Regulation pursuant to subsection (5) sentence 1 no. 1;
- 12. fails to ensure that facilities and information are publicly available in Germany in contravention of section 30a (1) sentence 1 no. 2, also in conjunction with subsection (3) or section 30d;
- 13. fails to ensure that data are protected from unauthorised persons obtaining knowledge thereof in contravention of section 30a (1) no. 3, also in conjunction with subsection (3) or section 30d;
- 14. fails to ensure that an institution mentioned there has been designated in contravention of section 30a (1) no. 4, also in conjunction with subsection (3) or section 30d;
- 14a. engages in a naked short-selling transaction in contravention of section 30h (1) sentence 1, also in conjunction with a Regulation pursuant to section 30h (3) sentence 1 no. 2;

- 14b. engages in a credit derivatives transaction in contravention of section 30j (1), also in conjunction with a Regulation pursuant to section 30j (4) sentence 1 no. 2;
15. fails to disclose a conflict of interest, or fails to disclose it correctly, completely or within the prescribed period in contravention of section 31 (1) no. 2;
16. recommends a financial instrument or makes a recommendation when providing financial portfolio management services in contravention of section 31 (4) sentence 3;
17. fails to provide information, or fails to provide it within the prescribed period in contravention of section 31 (5) sentence 3 or 4;
18. fails to provide information, or fails to provide it within the prescribed period, or fails to obtain consent, or fails to obtain it within the prescribed period in contravention of section 33a (5) sentence 2 or subsection (6) no. 1 or 2;
19. fails to make a notification correctly or completely in contravention of section 33a (6) no. 3;
- 19a. fails to take the minutes, or fails to do so correctly or within the prescribed period in contravention of section 34 (2a) sentence 1 in conjunction with a Regulation pursuant to section 34 (4) sentence 1;
- 19b. fails to provide the client with a copy of the minutes, or provides an incomplete copy or fails to provide the copy in the prescribed form or within the prescribed period in contravention of section 34 (2a) sentence 2;
- 19c. fails to send the copy of the minutes, or sends an incomplete copy or fails to send the copy in the prescribed form or within the prescribed period in contravention of section 34 (2a) sentences 3 and 5 in conjunction with a Regulation pursuant to section 34 (4) sentence 1;
20. fails to retain a record, or fails to do so for a minimum period of five years in contravention of section 34 (3) sentence 1;
21. fails to comply with a provision on segregation of assets under section 34a (1) sentence 1, 3, 4 or 5, also in conjunction with subsection (2) sentence 2, or under section 34a (2) sentence 1, each of which also in conjunction with a Regulation pursuant to section 34a (5) sentence 1 or section 34a (4);
22. fails to make a notification or fails to do so within the prescribed period, or makes such notification incorrectly or incompletely in contravention of section 34c sentence 1, 2 or 4 or section 36 (2) sentence 1;
23. fails to appoint an auditor or fails to do so within the prescribed period in contravention of section 36 (1) sentence 4;
24. fails to make available an annual financial report including a statement in accordance with section 37v (2) no. 3 and the certificate of registration or the certification pursuant to section 37v (2) no. 4, a half-yearly financial report including a statement

in accordance with section 37w (2) no. 3 or an interim management statement, or fails to do so within the prescribed period in contravention of section 37v (1) sentence 1, section 37w (1) sentence 1 or section 37x (1) sentence 1, each of which also in conjunction with section 37y; or

25. fails to transmit an annual financial report including a statement in accordance with section 37v (2) no. 3 and the certificate of registration or the certification pursuant to section 37v (2) no. 4, a half-yearly financial report including a statement in accordance with section 37w (2) no. 3 or an interim management report, or fails to do so within the prescribed period in contravention of section 37v (1) sentence 4, section 37w (1) sentence 4 or section 37x (1) sentence 4, each of which also in conjunction with section 37y.

(2a) An administrative offence shall be deemed to be committed by any person who wilfully or negligently fails to make a record or makes such record incorrectly, incompletely or not within the prescribed period, in contravention of Article 7 or Article 8 of Commission Regulation (EC) No. 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive (OJ EC No. L 241 p. 1).

(2b) An administrative offence shall be deemed to be committed by any person who acts in contravention of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (OJ L 302, 17.11.2009, p. 1) by wilfully or negligently

1. failing to make a notification or making a notification incorrectly, incompletely or not within the prescribed period in contravention of Article 6(2) in conjunction with point (a), (b), (c) or (d) of sentence 1 of paragraph 3 of Section B of Annex I or sub-paragraph 2 of Article 14(3);
2. failing to make a publication or making a publication incorrectly, incompletely, not in the prescribed form or within the prescribed period, or failing to rectify these shortcomings in a timely manner in contravention of Article 6(2) in conjunction with paragraph 2 of Section B of Annex I or Article 12;
3. failing to make a record or making a record incorrectly or incompletely in contravention of Article 6(2) in conjunction with paragraph 7(a), (b), (c), (d), (e), (f), (g) or (h) of Section B of Annex 1;
4. failing to retain a record or failing to retain a record for a minimum period of five years in contravention of Article 6(2) in conjunction with sub-paragraph 1 of paragraph 8 of Section B of Annex 1;
5. using a credit rating for regulatory purposes in contravention of sub-paragraph 1 of Article 4(1);
6. failing to ensure that the information referred to in sub-paragraph 2 of Article 4(1) is included in the prospectus in contravention of this Article;
7. failing to identify a credit rating in contravention of Article 4(2) or sub-paragraph 2 of Article 10(5);

8. endorsing a credit rating issued in a third country in contravention of Article 4(3);
9. failing to ensure that the compliance function is able to discharge its responsibilities properly and independently in contravention of Article 6(2) in conjunction with paragraph 6 of Section A of Annex I;
10. failing to disclose conflicts of interest or disclosing such conflicts of interest incorrectly or incompletely in contravention of Article 6(2) in conjunction with paragraph 1 of Section B of Annex I;
11. issuing a credit rating in contravention of Article 6(2) in conjunction with sentence 1 of paragraph 3 of Section B of Annex I;
12. providing consultancy or advisory services in contravention of Article 6(2) in conjunction with sentence 1 of sub-paragraph 1 of paragraph 4 of Section B of Annex I;
13. failing to disclose any ancillary services or disclosing such ancillary services incorrectly or incompletely in contravention of Article 6(2) in conjunction with sub-paragraph 3 of paragraph 4 of Section B of Annex I;
14. failing to retain a record or failing to retain a record for a minimum period of three years in contravention of Article 6(2) in conjunction with sub-paragraph 2 of paragraph 8 of Section B of Annex I;
15. failing to retain a record or failing to retain a record for the prescribed period set forth in Article 6(2) in conjunction with paragraph 9 of Section B of Annex I in contravention of this Article;
16. failing to ensure that a person referred to in Article 7(1) has appropriate knowledge and experience in contravention of this Article;
17. failing to ensure that a person referred to in Article 7(2) does not initiate or participate in negotiations regarding fees or payments in contravention of this Article;
18. failing to ensure that a person referred to in Article 7(3) in conjunction with paragraph 1 of Section C of Annex I neither buys nor sells any financial instrument nor engages in any transaction in any financial instrument in contravention of this Article;
19. failing to ensure that a person referred to in Article 7(3) in conjunction with paragraph 2 of Section C of Annex I neither participates in nor influences the determination of a credit rating in contravention of this Article;
20. failing to ensure that a person referred to in Article 7(3) in conjunction with paragraph 3(b), (c) or (d) of Section C of Annex I does not disclose, share or use information in contravention of this Article;
21. failing to ensure that a person referred to in Article 7(3) in conjunction with paragraph 4 of Section C of Annex I neither solicits nor accepts money, gifts and favours in contravention of this Article;
22. failing to ensure that a person referred to in Article 7(3) in conjunction with paragraph 5 of Section C of Annex I reports the conduct of any person in

- contravention of this Article;
23. failing to ensure that a person referred to in Article 7(3) in conjunction with paragraph 7 of Section C of Annex I does not take up a key position in contravention of this Article;
  24. failing to ensure that a lead rating analyst is not involved in credit rating activities for a period exceeding four years in contravention of Article 7(4) in conjunction with sub-paragraph 1(a) of paragraph 8 of Section C of Annex I;
  25. failing to ensure that a rating analyst is not involved in credit rating activities for a period exceeding five years in contravention of Article 7(4) in conjunction with sub-paragraph 1(b) of paragraph 8 of Section C of Annex I;
  26. failing to ensure that a person approving credit ratings is not involved in credit rating activities for a period exceeding seven years in contravention of Article 7(4) in conjunction with sub-paragraph 1(c) of paragraph 8 of Section C of Annex I;
  27. failing to ensure that a person referred to in Article 7(4) in conjunction with sub-paragraph 2 of paragraph 8 of Section C of Annex I is not involved in credit rating activities within the period set forth in this Article;
  28. taking the amount of revenue referred to in Article 7(5) as a basis for compensation or performance evaluation in contravention of this Article;
  29. failing to make a disclosure or making a disclosure incorrectly, incompletely or not within the prescribed period in contravention of Article 8(1), Article 10(2) or (4), each of which also in conjunction with paragraph 4 of Part II of Section D of Annex I or sentence 1 of point 1 of Part II of Section E of Annex I;
  30. refusing to issue a credit rating in contravention of sub-paragraph 1 of Article 8(4);
  31. failing to provide documentation or providing documentation incorrectly or incompletely in contravention of sub-paragraph 2 of Article 8(4);
  32. failing to monitor or review credit ratings and methodologies or failing to do so within the prescribed period in contravention of sentence 1 of Article 8(5);
  33. failing to make a disclosure or making a disclosure incorrectly, incompletely or not within the prescribed period in contravention of Article 8(6)(a), sentence 1 of sub-paragraph 1 of Article 10(1), also in conjunction with sub-paragraph 2, or Article 11(1), also in conjunction with Part I of Section E of Annex I;
  34. failing to review a credit rating or failing to review a credit rating within the prescribed period in contravention of Article 8(6)(b);
  35. failing to re-rate a credit rating or failing to re-rate a credit rating within the prescribed period in contravention of Article 8(6)(c);
  36. failing to ensure that a credit rating is presented in accordance with the requirements set out in Article 10(2) in conjunction with paragraph 1, points (a), (b), (c), (d) or (e) of paragraph 2 of Part I of Section D of Annex I, sub-paragraph 1 of paragraph 4 or paragraph 5 or paragraph 1, 2 or 3 of Part II in contravention of this Article;

37. failing to provide information or providing information incorrectly or incompletely or not within the prescribed period in contravention of Article 10(2) in conjunction with paragraph 3 of Part I of Section D of Annex I;
38. issuing a credit rating or failing to withdraw a credit rating in contravention of Article 10(2) in conjunction with sub-paragraph 2 of paragraph 4 of Part I of Section D of Annex I;
39. failing to ensure that an additional symbol is used in contravention of Article 10(3);
40. failing to provide a statement or providing a statement incorrectly or incompletely in contravention of sub-paragraph 1 of Article 10(5);
41. failing to make available information or making information available incorrectly or incompletely or not within the prescribed period in contravention of Article 11(2);
42. failing to provide information or providing information incorrectly or incompletely or not within the prescribed period in contravention of Article 11(3) in conjunction with point 2 of Part II of Section E of Annex I.

(3) An administrative offence shall be deemed to be committed by any person who wilfully or negligently

1. fails to comply with an enforceable order pursuant to
  - a. section 4 (3) sentence 1;
  - b. section 36b (1);
  - c. section 37o (4) sentence 1 or section 37q (2) sentence 1;
2. fails to allow or tolerate entry in contravention of section 4 (4) sentence 1 or 2 or section 37o (5) sentence 1;
3. outsources portfolio management services in contravention of section 33 (3) sentence 1 no. 2.

(3a) An administrative offence shall be deemed to be committed by any person who acts in contravention of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (OJ L 302, 17.11.2009, p. 1) by wilfully or negligently failing to comply with an enforceable order pursuant to

1. Article 6(2) in conjunction with sub-paragraph 1 of paragraph 8 of Section B of Annex I;
2. Article 6(2) in conjunction with sub-paragraph 7 of paragraph 2 of Section A of Annex I;
3. points (a), (b), (c) or (d) of sub-paragraph 1 of Article 23(3);
4. points (b), (c) or (d) of Article 24(1).

(4) The administrative offence is punishable by a fine not exceeding one million euros in the cases referred to in subsection (1) nos. 1 and 2 and subsection (2) no. 5 (a), nos. 7 and 11, by a fine not exceeding five hundred thousand euros in the cases referred to in subsection (2) nos. 14a and 14b, by a fine not exceeding two hundred thousand euros in the cases referred to in subsection (1) nos. 3 and 5 and subsection (2) no. 2 (c), (e) to (i) and (m) to (q), nos. 3, 4 and 5 (c) to (i) and nos. 6, 18, 24 and 25, and subsection (3) no. 3, by a fine not exceeding one hundred thousand euros in the cases referred to in subsection (2) no. 2 (d), no. 5 (b), nos. 12 to 14 and 16, and subsection (3) no. 1 (b), and by a fine not exceeding fifty thousand euros in all other cases.

(5) The provisions set forth in subsection (2) no. 2 (a), no. 10 (b), nos. 15, 16, 18 to 20, 22 and 23, subsection (2a) and subsection (3) no. 1 (b) and no. 3, each of which also in conjunction with subsection (4), shall also apply to investment management requiring authorisation within the meaning of section 2 (3) sentence 3.

#### **Section 40 Competent administrative authority**

The administrative authority (*Verwaltungsbehörde*) within the meaning of section 36 (1) no. 1 of the Act on Breaches of Administrative Regulations (*Gesetz über Ordnungswidrigkeiten*) shall be the Federal Financial Supervisory Authority.

#### **Section 40a**

##### **Involvement of the Supervisory Authority and information in criminal cases**

(1) The public prosecutor's office shall inform the Supervisory Authority of preliminary proceedings relating to criminal offences in accordance with section 38. If experts are required for these preliminary proceedings, competent staff members of the Supervisory Authority may be called upon. The Supervisory Authority must be informed of the indictment and the application for an order imposing punishment. If the public prosecutor's office intends to discontinue prosecution, it is required to hear the Supervisory Authority.

(2) The court shall inform the Supervisory Authority of the date of the main proceedings relating to criminal offences in accordance with section 38.

(3) The Supervisory Authority shall be granted access to the files at its request unless this is contrary to warranted interests of the party concerned or would endanger the success of the investigations.

(4) If public action is brought in criminal proceedings against the owners or managers of investment services enterprises or their legal representatives or personally liable partners because of criminal offences to the disadvantage of clients in respect of or in connection with operating the investment services enterprise, furthermore in criminal proceedings concerned with criminal offences pursuant to section 38, the Supervisory Authority shall be provided with

1. the indictment or the petition in lieu of an indictment;
2. the application for the issuing of a summary order; and
3. the decision concluding the proceedings together with the grounds for the decision;

if an appeal has been lodged against the decision, the decision shall be transmitted together with a reference to the appeal that has been lodged. In the case of proceedings in respect of criminal offences that have been committed by negligence, the communications set forth in nos. 1 and 2 shall only be made if, in the view of the authority making the communication, it is deemed necessary that the Supervisory Authority takes decisions or other measures without undue delay.

(5) If in criminal proceedings other facts indicating irregularities in the business operations of an investment services enterprise become known and if in the view of the authority making the communication the knowledge thereof is necessary for the Supervisory Authority to take measures pursuant to this Act, the court or the prosecuting or enforcement authority shall also communicate such facts, if it is not obvious to the authority making the communication that warranted interests of the persons concerned prevail. In this case it must be taken into consideration to which extent the information to be communicated is reliable.

## **Section 40b**

### **Publication of measures**

The Supervisory Authority may make publicly known incontestable measures that it has adopted due to contraventions of prohibitions or requirements of this Act on its website, provided that this is suitable and necessary to resolve or avoid irregularities in accordance with section 4 (1) sentence 2, unless such publication would place the financial markets in considerable danger or would cause disproportionate damage to the parties involved. The Supervisory Authority shall publish on its website without undue delay any orders pursuant to section 4 (2).

## **Part 13**

### **Transitional provisions**

#### **Section 41**

##### **Transitional provisions concerning notification and publication requirements**

(1) Enterprises within the meaning of section 9 (1) sentence 1 which exist on 1 August 1997 and have not been subject to the reporting requirement pursuant to section 9 (1) before this date, shall conduct reporting pursuant to this provision for the first time on 1 February 1998.

(2) Any person who, taking account of section 22 (1) and (2), holds, on 1 April 2002, five percent or more of the voting rights of a listed company must without undue delay, and within seven calendar days at the latest, notify the company and the Supervisory Authority in writing, stating his address, of the size of his percentage of the voting capital; the voting rights to be attributed to the notifying party shall be stated separately for each item in this notification. An obligation pursuant to sentence 1 shall not exist if a notification pursuant to section 21 (1) or (1a) was made after 1 January 2002 and prior to 1 April 2002.

(3) The company must publish any notifications pursuant to subsection (2) within one month of receipt pursuant to section 25 (1) sentences 1 and 2 and (2), and must without undue delay send the Supervisory Authority documentary evidence of such publication.

(4) The provisions of sections 23, 24, 25 (3) sentence 2, subsection (4) and sections 27 to 30 shall apply *mutatis mutandis* to the obligations pursuant to subsections (2) and (3).

(4a) Anyone who as per 20 January 2007 holds a percentage of voting rights attached to shares which reaches, exceeds or falls below the thresholds of 15, 20 or 30 percent, also in consideration of section 22 as amended prior to 19 August 2008, shall notify the issuer whose home country is the Federal Republic of Germany of his percentage of voting rights by no later than 20 March 2007. This does not apply if he submitted to the issuer prior to 20 January 2007 a notification containing equivalent information; the content of the notification shall be in compliance with section 21 (1), also in conjunction with a Regulation pursuant to subsection (2). Anyone who as per 20 January 2007 is entitled to a percentage of voting rights of five percent or more in an issuer whose home country is the Federal Republic of Germany on the basis of attribution pursuant to section 22 (1) sentence 1 no. 6 must notify the issuer by no later than 20 March 2007. This does not apply if he submitted to the issuer prior to 20 January 2007 a notification containing equivalent information and if he was not attributed the voting rights pursuant to section 22 (1) sentence 1 no. 6 as amended prior to 20 January 2007; the content of the notification shall be in compliance with section 21 (1), also in conjunction with a Regulation pursuant to subsection (2). Anyone who as per 20 January 2007 holds financial instruments within the meaning of section 25 as amended prior to 1 March 2009 must notify the issuer whose home country is the Federal Republic of Germany by no later than 20 March 2007 of the percentage of voting rights he would hold if he held, instead of financial instruments, those shares that may be acquired under the legally binding agreement, unless his percentage of voting rights was below 5 percent. This does not apply if he submitted a notification containing equivalent information to the issuer prior to 20 January 2007; the content of the notification shall be in compliance with section 25 (1) as amended prior to 1 March 2009, also in conjunction with sections 17 and 18 of the Securities Trading Reporting and Insider List Ordinance (*Wertpapierhandelsanzeige- und Insiderverzeichnisverordnung*) as amended prior to 1 March 2009. If a domestic issuer receives a notification pursuant to sentence 1, 3 or 5 he must publish it by no later than 20 April 2007 pursuant to section 26 (1) sentence 1, also in conjunction with a Regulation pursuant to subsection (3). Furthermore, he shall transmit such information without undue delay, however not before its publication, to the company register within the meaning of section 8b of the Commercial Code (*Handelsgesetzbuch*) in order to be stored there. He shall simultaneously with the publication pursuant to sentence 7 notify the Supervisory Authority pursuant to section 26 (2), also in conjunction with a Regulation pursuant to subsection (3) no. 2. Sections 23, 24, 27 to 29 and 29a (3) shall apply *mutatis mutandis* to the obligations pursuant to sentences 1 to 9. Section 29a (1) and (2) shall apply *mutatis mutandis* to the obligations pursuant to sentence 4.

(4b) Anyone who, also in consideration of section 22, holds a percentage of voting rights attached to shares as well as financial instruments within the meaning of section 25 shall not be required to submit a notification on the reaching or exceeding of the thresholds set forth in section 25 if he has reached or exceeded these thresholds on 1 March 2009, by way of aggregation pursuant to section 25 (1) sentence 3, exclusively on the basis of the amendment to section 25 taking effect on 1 March 2009. Such notification shall be submitted only after again reaching, exceeding or falling below a threshold under section 25. The notification requirements pursuant to section 25 in the version in force up to 1 March 2009 which were not fulfilled or were fulfilled incorrectly or incompletely or not in the prescribed manner are to be fulfilled in consideration of section 25 (1) sentence 3.

(4c) Anyone who, also in consideration of section 22, holds a percentage of voting rights attached to shares shall not be required to submit a notification on the reaching or exceeding of the thresholds set forth in section 21 if he has reached or exceeded these thresholds on 19 August 2008 exclusively by way of attribution of voting rights on the basis of the amendment to section 22 (2) taking effect on 19 August 2008. Such notification shall be submitted only after again reaching, exceeding or falling below a threshold under section

21. Sentences 1 and 2 shall apply *mutatis mutandis* to the notification requirement under section 25 subject to the proviso that the thresholds set forth in section 25 are authoritative.

(5) An administrative offence shall be deemed to be committed by any person who wilfully or negligently

1. fails to make a notification, fails to do so within the prescribed period or makes such notification incorrectly, incompletely or not in the prescribed manner in contravention of subsection (2) sentence 1 or subsection (4a) sentence 1, 3, 5 or 9; or
2. fails to effect publication, fails to do so within the prescribed period, or effects such publication incorrectly, incompletely or not in the prescribed manner, fails to forward documentary evidence or fails to do so within the prescribed period, or fails to communicate information or fails to do so within the prescribed period in contravention of subsection (3) or subsection (4a) sentence 7 or 8.

(6) The administrative offence is punishable by a fine not exceeding two hundred thousand euros in the cases referred to in subsection (5).

#### **Section 42**

##### **Transitional provisions concerning the obligation to reimburse costs pursuant to section 11**

(1) The parties obliged to reimburse the costs to the Supervisory Authority pursuant to section 11 (1) sentence 1 of the Act of 26 July 1994 (Federal Law Gazette I, p. 1749) may also prove the volume of the transactions in securities and derivatives for the time up until the end of 1996 and for the year 1997 on the basis of the number of transactions reported pursuant to section 9 in 1996 and 1997 respectively.

(2) Section 11 as amended prior to the entry into force of the Act Establishing the Federal Financial Supervisory Authority (*Gesetz über die integrierte Finanzdienstleistungsaufsicht*) of 22 April 2002 (Federal Law Gazette I, p. 1310) shall apply for the period up until 30 April 2002 to the costs incurred by the Supervisory Authority.

#### **Section 42a**

##### **Transitional provision governing the ban on naked short-selling transactions in shares and certain debt securities under section 30h**

Exempt from the ban under section 30h are transactions that were already concluded prior to 27 July 2010, provided they are not prohibited under any other provision.

#### **Section 42b**

##### **Transitional provision governing the notification and publication requirements for holders of net short-selling positions under section 30i**

(1) Any person who, on 26 March 2012 holds net short-selling positions as defined in section 30i (1) sentence 1 of 0.2 percent or more shall notify the Supervisory Authority hereof in accordance with section 30i (3), also in conjunction with a Regulation pursuant to section 30i (5), by the close of the next trading day. The holder of a net short-selling position as defined in section 30i (1) sentence 2 of 0.5 percent or more shall, in addition to the notification under sentence 1, publish the position in the electronic Federal Gazette (*elektronischer Bundesanzeiger*) in accordance with section 30i (3), also in conjunction with a Regulation

pursuant to section 30i (5), within the period specified in sentence 1; no such obligation exists if a comparable notification has already been made prior to 26 March 2012.

(2) An administrative offence shall be deemed to be committed by any person who wilfully or negligently

1. fails to make a notification, or makes such notification incorrectly or incompletely or not in the prescribed manner or within the prescribed period in contravention of subsection (1) sentence 1; or
2. fails to effect a publication, or effects such publication incorrectly or incompletely or not in the prescribed manner or within the prescribed period in contravention of subsection (1) sentence 2 first half-sentence.

(3) The administrative offence is punishable by a fine not exceeding two hundred thousand euros in the cases referred to in subsection (2).

### **Section 42c**

#### **Transitional position governing the ban on credit derivatives under section 30j**

Exempt from the ban under section 30j are transactions used to close out positions in a credit derivative within the meaning of section 30j (1) no. 1 under which the protection buyer was already vested with rights and obligations prior to 27 July 2010, as well as transactions in credit-linked notes already issued prior to 27 July 2010.

### **Section 43**

#### **Transitional provisions concerning the limitation of claims for damages pursuant to section 37a**

Section 37a in the version in force up to 4 August 2009 shall apply to claims for damages which have arisen from 1 April 1998 up to and including 4 August 2009.

### **Section 44**

#### **Transitional provisions concerning foreign organised markets**

(1) Organised markets requiring an authorisation pursuant to section 37i which on 1 July 2002 granted trading participants domiciled in Germany direct market access by means of an electronic trading system, shall notify the Supervisory Authority thereof by 31 December 2002 and file an application for authorisation by 30 June 2003.

(2) Organised markets obliged to submit a notification pursuant to section 37m which granted trading participants domiciled in Germany direct market access by means of an electronic trading system shall notify the Supervisory Authority thereof and of their intention to maintain such market access by 31 December 2002.

### **Section 45**

#### **Application of part 11**

The provisions of part 11 in the version in force since 21 December 2004 shall apply for the first time to financial statements for the financial year ending on 31 December 2004 or later.

The Supervisory Authority shall begin to execute the duties assigned to it in part 11 as of 1 July 2005.

## **Section 46**

### **Application of the Transparency Directive Implementation Act (*Transparenzrichtlinie-Umsetzungsgesetz*)**

(1) Sections 37n and 37o (1) sentence 4 as well as the provisions under part 11 sub-part 2 as amended on 20 January 2007 shall apply for the first time to financial reports covering the financial year which commences after 31 December 2006.

(2) In respect of issuers of whom only debts securities are admitted to trading on an organised market within the meaning of Article 4 (1) No. 14 of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (OJ EU No. L 145 p. 1) in a member state of the European Union or another signatory to the Agreement on the European Economic Area, and in respect of issuers whose securities are admitted to trading in a third country and who have been applying the internationally accepted accounting standards for this purpose since the financial year that commenced prior to 11 September 2002, sections 37w (3) sentence 2 and section 37y no. 2 as amended on 20 January 2007 shall apply under the proviso that the issuer may apply the accounting standards of the prior-year financial statements to the financial years commencing prior to 31 December 2007.

(3) Section 30b (3) no. 1 (a) as amended on 20 January 2007 shall apply for the first time to information which is communicated after 31 December 2007.

(4) Publications pursuant to section 30b (1) and (2) shall be effected, in addition to their publication in the electronic Federal Gazette (*elektronischer Bundesanzeiger*), in a national newspaper for statutory stock exchange announcements (*überregionales Börsenpflichtblatt*) up until 31 December 2010.

## **Section 47**

### **Application of section 34**

Section 34 in the version in force from 5 August 2009 shall apply for the first time to investment advice provided after 31 December 2009.

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[1]

Pursuant to Article 23 of the Law of 21 June 2002, as published in the announcement of 27 June 2002 (Federal Law Gazette I, p. 2316), section 9 (2) nos. 7 and 8 do not enter into force until 1 April 2003.

[2]

Important note:

1) A transitional provision for the obligation to reimburse costs pursuant to section 11 is set forth in section 42 (2) WpHG:

Section 11 as amended prior to the entry into force of the Act Establishing the Federal Financial Supervisory Authority (*Gesetz über die integrierte Finanzdienstleistungsaufsicht*) of 22 April 2002 (Federal Law Gazette I, p. 1310) shall apply for the period up until 30 April 2002 to the costs incurred by the Supervisory Authority.

#### Allocation of Costs and Costs

(1) The Federal Government is to be reimbursed for the costs of the Supervisory Authority as follows:

1. 68 percent by credit institutions and enterprises operating under section 53 (1) sentence 1 of the Banking Act (*Kreditwesengesetz*), insofar as these credit institutions or enterprises are authorised to provide investment services within the meaning of section 2 (3) nos. 1, 2 or 5 in Germany;
2. 4 percent by official exchange brokers and other enterprises admitted to trading on a German stock exchange and which do not come under the provisions of number 1 above;
3. 9 percent by financial services institutions and enterprises operating under section 53 (1) sentence 1 of the Banking Act, insofar as these financial services institutions or enterprises are authorised to provide investment services within the meaning of section 2 (3) nos. 3, 4 or 6 in Germany, and do not come under the provisions of numbers 1 or 2 above;
4. 9 percent by issuers domiciled in Germany, whose securities are admitted to trading on a German stock exchange or are traded on the regulated unofficial market (*Freiverkehr*) with their consent.

In the case of sentence 1 numbers 1 and 2, the costs are allocated proportionally based on the volume of transactions reported pursuant to section 9 (1); the number of transactions is the determining criterion in this context, with only a third of the transactions to be taken into account for bonds. In the case of sentence 1 number 3, the costs are allocated proportionally based on the result from ordinary activities or, in cases where corresponding evidence is submitted, based on the gross proceeds from investment services or proprietary trading. In the case of sentence 1 number 4, the costs are allocated to the issuers proportionally based on the stock exchange turnover of their securities admitted to trading or traded on the regulated unofficial market. The costs shall also include refundable amounts that could not be collected and shortfalls from the cost allocation of the previous year for which costs are to be reimbursed; refunds or shortfalls on which no final or incontestable judgement has yet been made shall be excepted from this provision. The refundable amounts and shortfalls shall be added in full to the respective proportion of the costs arrived at based on sentence 1.

(2) The parties subject to cost allocation pursuant to subsection 1 sentence 1 above and the German stock exchanges are required upon request to furnish the Supervisory Authority with information concerning the volume of transactions, the result from ordinary activities or the gross proceeds and stock exchange turnover. The cost allocation shall be enforced by the Supervisory Authority pursuant to the provisions of the Act on Administrative Enforcement (*Verwaltungsvollstreckungsgesetz*).

(3) Details concerning the allocation of the costs, in particular the allocation key and measurement date, the minimum allocation amount, the allocation procedure including a

suitable method of estimation, the payment deadlines and the amount of late payment penalties, and concerning collection shall be determined by the Federal Ministry of Finance by means of a Regulation not requiring the consent of the *Bundesrat*; such Ordinance may also include provisions governing the provisional determination of the allocation amount. The Federal Ministry of Finance may, by means of a Regulation, delegate this authority to the Supervisory Authority.

(4) The costs incurred by the Federal Government from the audit pursuant to section 35 (1) and section 36 (4) shall be reimbursed separately by the enterprises concerned and shall be paid in advance if so requested by the Supervisory Authority.