Emad Aladhal/ Philippe Marie/ Andrea Ferguson/ Gerard Hurley
Client Assets and Wholesale Conduct
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

30th November 2012

Dear Mr Aladhal et al,

The Chartered Financial Analyst Society of the UK (CFA UK) welcomes the FSA consultation and discussion paper (CP 12/22) which sets out proposals for the introduction of multiple client money pools to support the new porting arrangements created by the European Market Infrastructure Regulations (EMIR). In addition, we are supportive of the FSA engaging industry with the intent of speeding up and increasing the rates of client assets returned in the event of a firm's insolvency.

As CP 12/22 points out, only after prominent failures has the regulator then discovered client money practices that fall short of what is required to safeguard client assets. Segregating client assets and client money should be a straightforward matter so that in the event of a firm becoming insolvent assets and monies can be identified and returned in the most efficient manner. This requires robust processes and controls that assure the client that the appropriate safeguards are in place. It makes it equally important that any changes to the existing regime underpin the segregation of client assets; and does not provide firms the opportunity to commingle client assets or create opacity regarding the true ownership of the assets. The regulator too, needs to ensure that UK regulated firms provide the safeguards in practice.

About CFA UK and CFA Institute

The CFA Society of the UK (CFA UK) serves society's best interests through the provision of education and training, the promotion of high professional and ethical standards and by informing policy-makers and the public about the investment profession.

The society supports the CFA Program® and is the awarding body for the Investment Management Certificate (IMC), the UK's leading entry level qualification for investment professionals.

Founded in 1955, CFA UK represents the interests of roughly 10,000 investment professionals. CFA UK is part of the worldwide network of member societies of CFA Institute

(the global, not-for-profit association of investment professionals that awards the CFA and CIPM designations) and is the largest society outside North America.

The aim of CFA UK's advocacy initiative is to work with policy-makers, regulators and standard-setters to promote fair and efficient markets, high standards in financial reporting and ethical standards across the investment profession. The society is committed to providing members with information regarding proposed regulatory and accounting standards changes and bases its responses on feedback direct from members or relevant committees. CFA UK has not surveyed its members.

Response to EMIR consultation

Part II - Introduction of multiple client money pools (Question 3- Question 19)

It is our understanding that multiple client money pools are being created as a way to facilitate the 'porting' of cleared positions and the distribution of surpluses as required by EMIR. To this extent we ask the FSA to remember that this is the reason for this proposed new regulation, and ensure that the final regulation is fit for purpose to achieve this end goal.

A number of questions still remain unclear and the challenges that come to mind when considering these new multiple client money pools:

1. Clear and easy identification of client money will aid both the porting and redistribution of surpluses, but the complexity of financial markets and the involvement of many third parties holding assets for and on behalf of the firm could complicate the distribution or return of assets in sub-pools.
2. Too much flexibility in the definition of these sub-pools could lead to varying/ confused application by firms, meaning less clarity or precedence to follow by an insolvency practitioner, or where multiple divisions are used e.g. by product and business units, possible double counting, or netting-off.
3. Partly as a result of the above two points, it is not clear if sub-pools will merely sub-divide assets further rather than increase the speed of asset return, or the total rate of return of client funds.
4. Multiple pools will lead to a greater risk of regulatory and operational failings, with segregation, reconciliations, and recording keeping obligations multiplying by the number of pools a firm has.
5. It is unclear whether in instances where a clearing broker has the right to rehypothecate assets (e.g. as part of banking group), client money pools will take precedent or whether only assets deemed as client money can form part of a sub-pool. The same question applies in the event of a CCP's failure, where it has rehypothecated client transaction account monies before its default.
6. It has not been clarified if the sub-pools will have legal status with the collapsed firm's counterparties – although they will be "legally distinct". It is also unclear if distribution of surpluses in these pools could be considered equitable, especially if the surpluses were to be shared on a pro-rata basis.
7. In the example of Singapore and Canada, the total prohibition of commingling of client and firm assets appears to have greatly speeded the recovery of client assets

and also helped to overcome the resistance of third parties to returning assets since ownership was more readily established. The prohibition of any commingling also appears to have prevented a greater loss of client assets through hypothecation and related activities.

The intervention of the relevant regulator and its willingness to work with its counterparts globally may also have been a key factor in the relatively rapid recovery of assets by MF Global Singapore's liquidators.

We believe reduced rights to rehypothecate, a prohibition of commingling of clients' and firm assets, and certainty concerning scope issues i.e. activities and entities will far more greatly improve the current regime. The introduction of multiple client money pools will likely add to the complexity without commensurately enhancing protections. If introduced, these rules must leave only the required amount of flexibility of interpretation. We should also learn from other jurisdictions' practices in returning clients assets efficiently and so have contributed to the integrity of their markets.

Q3: Do you agree that we should introduce multiple client money pools to facilitate porting of cleared positions?

Yes we can see the benefit of the introduction of multiple pools, but believe that a limited, well defined scope of when sub-pools can be created stands more chance of leading to more certainty of actual beneficial owners of client money.

Q4: Do you agree that we should make the option of multiple client money pools available to other types of investment businesses?

Given the complexity of the proposed solution, we do not believe that this option of creating multiple pools is something that should be available to be applied to all investment business immediately. We suggest a staggered approach, where relevant margined business for the purposes of porting is the first element subject to the new rules. Thereafter, if successful other investment business types can be introduced into the regime.

Q5: Do you think the sub-pool terms should include any further information?

No comment

Q6: Should firms be required to identify client money accounts in the sub-pool terms by account number or by name or both?

No comment

Q7: Do you think we should provide template sub-pool terms that can be completed by firms establishing new pools?

Q8: Do you agree with the content of the sub-pool disclosure document? Do you think it should contain any further information?

Q9: Should we provide a template that can be completed by firms?

A standard terms template would ensure more consistent application across the industry. In addition, we believe like client money trust letters the term sheet should go beyond just being a one way disclosure and should be something that is required to be signed by the customer. This is more likely to demonstrate that customers have read and understood the process and implications. In our view a two way notification ensures a greater chance of mutual understanding and changing of the status quo.

Q10: Do you agree that clients should be given one-way notification of any material amendments to a sub-pool three months before the proposed amendment?

Q11: Do you agree that the surpluses from the sub-pools and the general pool, if there are any, should be used to cover any shortfalls in other pools in the manner proposed?Q9: Should we provide a template that can be completed by firms?

No comment on Q10 and Q11

Q12: Do you agree that these benefits would result from the segregation of retail and non-retail client money?

Yes we agree with an intelligent delineation of retail and non-retail client money. Partly related to Q16, whereby, given the complexity and global nature of financial markets, protection should be considered according to overall nature of the client, including the question of real hardship. For example, farmers and small family firms in the US were badly impacted by the fallout from MFG, but were treated mostly as corporate entities, resulting in real, irreversible financial hardship to many individuals and families.

Q13: Do you agree that these benefits would result from the segregation of business into margined and non-margined business?

Q14: Do you think we should mandate the division of client money on this basis? If not, why not?

Q15: If we were to mandate the division of client money into sub-pools (for example, a pool for retail client money and a pool for non-retail client money) do you agree that we should also allow firms to create further sub-pools within each? If not, why not?

Q13-15 answered in Q12

Q16: Do you think that any mandating of certain client money pools should be dependent on complexity, size of client money holding and/or type of firm? (For example, should we mandate segregation only for investment banks or large brokers?)

The segregation of clients according to their sophistication may have merit, but the process needs to be simple, transparent, and defensible.

Q17: Do you think there is a way of dividing client money into more than one pool that delivers greater net benefits for firms and clients?

Q18: Should we incentivise the use of sub-pools by requiring firms to notify their clients of the risks associated with the general client money pool and the sub-pool options available?

Q19: Do you agree that the existing concept of designated client bank accounts and their use in a secondary pooling event should remain unchanged?

Q17-Q19: It is much easier to make a case that the use of sub-pools may offer more benefits to firms than their clients. In addition this introduces an even greater level of complexity that again would need to be untangled in the event of a firm's insolvency. Firms will again want to know whether the same level of controls, (reconciliation, segregation, reporting and disclosures etc) applied to a pool should also be applied to a sub-pool.

Part III – Client Assets Regime: Achieving better results

Return of Funds/Protection of Client assets:

Q20: Do you agree it is important to have speedy return of client assets following a firm's insolvency? Please explain your answer.

A speedy return of client assets is important since many clients will suffer real hardship from the inability to access these funds.

Q21: Does the status quo strike the right balance between speed and accuracy? Please explain your answer.

The status quo clearly does not strike a good balance between speed and accuracy since arguments over issues of accuracy are largely responsible for lengthy delays in the reaching agreements on distribution of non-segregated client assets and monies.

Q22: Given the potential trade off between costs and speed, how fast do you think client assets should be returned to retail clients following an insolvency and, as a percentage, what loss should a retail client be prepared to incur to have client assets back in that time period?

This is a question which is difficult to answer, but a fairly ambitious target of a recovery and return rate of 90% of client assets and funds within 6 months of a collapse could be considered a good outcome for most clients.

Q23: Given the potential trade off between costs and speed, how fast do you think client assets should be returned to wholesale clients following an insolvency and, as a percentage, what loss should a wholesale client be prepared to incur to have client assets back in that time period?

No comment

Q24: Should retail clients and wholesale clients be treated differently in respect of client assets protection and distribution? Please explain your answer.

No comment- largely covered in responses to Q12 and Q16

Q25: Are there any other impediments that impact on the speed of return of client assets not identified above?

The MFG case highlights the difficulty of achieving a rapid, equitable return of client assets where competing liquidators and trustees can only settle matters through litigation.

Q26: Are there any other potential measures (not identified above) that you think should be

Considered to increase the speed of return of client assets?

Q27: Are there any other potential measures (not identified above) that you think should be considered to reduce the market impact of an insolvency of a firm that holds client assets?

Q28: Are there any other potential measures (not identified above) that you think should be considered to achieve a greater return of client assets?

Q26-Q28: Already covered in previous questions

Summary:

The FSA's proposals may permit firms to continue many of their existing practices while being able to better identify and locate individual client monies. However, the proposals most likely do not support the case that this will aid the recovery of client assets or indeed help prevent a greater loss to individual clients from the collapse of a regulated financial firm.

Improved protection for a client following a bankruptcy of a bank, broker, investment manager etc, may be best achieved by a strict segregation of client and firm assets and a severe limitation of what a firm can do with the funds and assets of its customers. Alternatively, any firm wishing to take advantage of commingling of assets could be required to pay a substantial, additional annual contribution into an insurance fund to help alleviate hardship of its clients following a collapse. The size of the premium alluded to by CP 12/22 indicates the risks of moral hazard and adverse selection that may be incorporated by the insurer when considering such cover.

As much as it is the firm's responsibility that it adheres to the client assets rules, the regulator also has the responsibility to ensure that firms are acting in a responsible manner. We understand that the Financial Conduct Authority (FCA) is aiming to be a proactive regulator that is seeking to address issues at an earlier stage to limit the detriment on consumers. We hope the FCA will learn the lessons from the recent firm failures in the area of client assets. By supervising more effectively and be prepared to hold firms to account, the FCA can enhance the safeguards for client assets.

We hope our response is helpful and we would be open to discuss it further with you.

Yours,

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