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Dear Sirs,

**CP 13/5 – REVIEW OF THE CLIENT ASSETS REGIME FOR INVESTMENT BUSINESS**
**Q48: Do you agree that our proposed changes will ensure that CASS is compatible with the EMIR RTS? If not, please provide reasons.**

You note in paragraph 8.6 of the consultation paper that:

The RTS contemplate that indirect clients should be '… included in the transfer of client positions to an alternative clearing member under the portability requirements…' To achieve this, the RTS require clearing members to have in place a 'credible mechanism for transferring the positions and assets to an alternative client or clearing member' as part of the management of the default of the client. This can be seen as somewhat similar to porting as conceived in the Level 1 regulation.

This is a most pleasing development. I very much doubt whether the average retail customer would know when dealing in contracts that are centrally cleared, whether his broker would be a direct member of the relevant central counterparty or not, let alone whether he would understand the implications of the distinction. It must be desirable that those implications should be kept to a minimum.

You go on at 8.10 to propose changes to the rules that would allow for the actual porting of money and positions. This proposal seems to provide for the same kind of porting as might be undertaken by the central counterparty in the event of a default by one of its members. However, I do not believe it is sufficient to allow 'clearing members to have in place a 'credible mechanism for transferring the positions and assets to an alternative client or clearing member' as part of the management of the default of the client.'

In CP12/22 you proposed to introduce multiple client money pools. Your stated purpose in doing so was 'To make porting net client transaction accounts a viable option.' (paragraph 1.10). This is an essential part of the overall framework. Successful porting requires the identification of an alternative firm that is willing and able to accept the transferred positions.

Most regulated firms will admit that customers are hard to come by and the ability to pick up a significant number on an occasion might be expected to attract significant interest. However, in a net omnibus account there would not, by definition, be sufficient margin to cover individual clients' positions. And the ability and willingness of those clients to immediately deposit additional margin to cover a shortfall caused not by market movements but by the default of their chosen broker may be limited.

For that reason you proposed to allow separately identifiable sub-pools to hold the difference between the net margin in the net omnibus account and the gross margin deposited by the individual clients.

This approach is not without its challenges. To work in practice it is likely to require that firms deposit their own money in the sub-pool to cover any outstanding margin calls. And even then it may not provide absolute security if the firm's default arises from a sharp market move resulting in unmet margin calls. Nevertheless, this is a key part of the framework without which porting is unlikely ever to be achievable in practice.

At paragraph 3.10 of CP 13/5 you state that you now propose to allow the use of multiple pools only for 'clearing member firms that offer net omnibus client transactions accounts at EMIR authorised of recognised CCPs'. If it is necessary to allow such firms to operate sub pools to facilitate porting in the event of a default then I believe it would equally be necessary to allow their clients to do the same to facilitate the porting of net omnibus accounts held not directly at the central counterparty but at an intermediate broker. Barring such a provision, I do not believe it will be possible for any net omnibus account to be ported unless it is held directly at the central counterparty.

Moreover, CASS 7.5.3G as proposed quite clearly only envisages gross omnibus accounts held directly at the central counterparty.

Without access to one or other of these alternatives, I can not envisage how arrangements could be made that would be capable of facilitating porting, in practice, of any omnibus account not held directly at a central counterparty.

I should add that I do believe the guidance at 7.5.3 to be important. It provides protection for the end client not only from a default by the intermediate broker (from which porting may provide some relief) but also by other fellow clients whose business is cleared through the same omnibus account. History has presented a number of occasions in which one client has, by his losses, caused a hole in an omnibus clearing account. Indeed this is a not uncommon cause of default by the firm itself.

I would suggest, therefore, that multiple pools are likely to be preferable to gross margining of omnibus accounts for the purpose of porting in the event of a firm's default. But certainly the prospect of porting without one alternative or the other is, as you noted in CP12/22, unlikely to be a viable option.

I hope that my thoughts will assist you in your deliberations and in the implementation of revisions to the CASS rules that will make porting a reality in the event of a firm default.

Yours Sincerely,

David Dudeney
Compound Growth Limited