

# **GTA ADVISORY & COMPLIANCE WORKSHOP**

**BROKER FAILURE, THE IMPLICATIONS FOR  
COMMINGLED CLIENT FUNDS &  
REGULATORY RESPONSE**

# FUTURES BROKER DEFAULT RISK

- Futures Clearing House guarantee extends only to the Members of the Clearing House.
- Clients of a Futures Brokers have a very real default risk that they need to evaluate.
- Therefore, Futures Clients definitely have to Know their Clearer.

# FUTURES BROKER DEFAULT

Futures Broker Default can arise from the following:

- Business failure not involving Segregated Funds;
- Business failure as a result of the default of a large Futures Clearing Client which the Broker cannot cover;
- Business failure as result of gross mismanagement, misappropriation, fraud or theft of Segregated Funds.

# RECENT FUTURES BROKER FAILURES

- Sonray Capital Markets (2010 – 2016) - Local
- MF Global (2011 – 2016) - International (USA & Local)
- BBY (2015 - ongoing) - Local

# COMMINGLED CLIENT FUNDS

Yes, there is commingling in that funds of all clients are combined

Although , the funds of each Client are accounted for separately:

And, the Accounts holding the comingled Client funds must be denominated as Segregated Fund Accounts:

And, Clients must be rigorously Margined in accordance with regulatory requirements.

In theory, to enable Client positions to be transferred to another Broker along with the associated funds securing those positions.

However, this structure cannot withstand theft , fraud or gross mismanagement.

# CLIENT SEGREGATED FUNDS

- Clearing Houses Margin their Participant Members on a NET basis.
- As a result Client Segregated Funds will be held at both at the Clearing House and with the Futures Broker.
- Both Clearing House and Futures Broker Segregated Funds need to be intact to effect an effective transfer of Open Positions and Cash in event of a Futures Broker's bankruptcy.



# RESPONSES to MANAGING DEFAULT RISK

- Gross Margining,
- Individual Clearing Accounts,
- Separating Dealing and Clearing, deal through a Futures Broker and Clear through a Bank,
- Know your Futures Broker Counterparty by properly evaluating it by reference to a Check List of necessary characteristics,
- Regulatory emphasis on Culture, Conduct and Compliance and Whistleblowing



# KNOWING YOUR COUNTERPARTY

Your Counterparty evaluation Check List should cover the following:

1. Market and Clearing Participant of an Exchange
2. Longevity & experience with sharp corrections in the Market
3. Origins of the Futures Broker
4. Nature of the Future Broker's Business
5. Directors
6. Management
7. Proprietary trading
8. Availability of Audited Accounts
9. Auditor
10. Segregated Funds Daily Reconciliation
11. Margin Daily Reporting
12. Corporate Governance and Compliance Culture

# CONCLUSION

- The failures of Futures Brokers that were Market and Clearing Participants of a Futures Market are limited to MF Global.
- MF Global's Clients recovered 97% of their Segregated Funds.
- Futures Market users can split Dealing and Clearing services between a Broker and a Bank.
- For those who want the convenience of Dealing and Clearing through the same Futures Broker can find a Futures Broker Counterparty with the characteristics which will effectively eliminate the default risk.