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Response to the Central Bank of Ireland's consultation on enhancements to the Central Bank Client Asset Requirements, as contained in the Central Bank Investment Firms Regulations ("CP133")

Introduction

Virtu ITG Europe Limited ("Virtu", "we", the "Firm") is a MiFID authorised investment firm headquartered in Dublin, with branches in London and Paris. Virtu operates two material business units, namely; the provision of brokerage services to institutional clients and the operation of the POSIT multi-lateral trading facility. Virtu welcomes the opportunity to engage with the Central Bank of Ireland ("CBI") in its review of the existing Client Asset Requirements. We are generally supportive of the draft proposals contained in CP133. In this response document, we have provided commentary only on specific questions where the Firm has a view or wishes to highlight aspects of the existing regulations that, in our opinion, would benefit from consideration.

Virtu Responses

Question 22: Do you agree with the Central Bank's proposal to clarify in the CAR guidance the expectation that client funds should be deposited directly into a third party client asset account? If not, please explain why.

The Firm does not agree with this proposal as depositing client monies directly into a third party client asset account is not a feature / requirement of the provision of certain services, specifically scenarios where client monies are received on behalf of clients in the course of the trade settlement process.

In the context of the Firm's business model and the provision of brokerage services, the vast majority of company stock issues are issued via Central Securities Depositories ("CSD"), such as CREST in the UK or Clearstream in Germany. When shareholdings are delivered or received between trading counterparties in settlement of agreed trades, those shareholdings are (in the vast majority of cases) transferred between accounts held by both counterparties at the CSD, meaning that the shareholdings themselves remain within the confines of the CSD at all times.

When the Firm acts as a trading counterparty on behalf of clients, we will frequently be required to both purchase shareholdings in a specific company from the market and also to sell shareholdings in the same company in the market. In many cases, the Firm's market counterparties and clients will request that the Firm net the resulting deliveries and receipts in the CSD into a single transfer in the CSD. In other cases, clients will request that the Firm create multiple transfers of a single shareholding, to multiple investment funds being managed.

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In many cases this results in a number of aggregated and disaggregated transfers from the Firm's CSD account to the CSD accounts of market counterparties and clients in the shares of the same company.

As the above transfers (from the market to the Firm and then to the Firm's client, or vice versa) are carried out on a Delivery-Versus-Payment ("DVP") basis, they do not involve the Firm receiving monies or instruments which belong to the Firm's client, because the agreed consideration is transferred to the seller immediately by the CSD as the shareholdings are received by the buyer.

However, if the company whose shareholdings are being transferred announces the payment of a dividend (or similar shareholder entitlement) to shareholders – something most companies would do or consider doing on an annual basis – it is possible that the Firm may receive dividends to which the Firm's clients are entitled, when those dividends are being paid on shareholdings which the Firm has recently purchased on their behalf. This is due to the fact that such dividends are distributed by the CSD into the account of the party who held the relevant shareholding on the evening of dividend record date. If the Firm is in the process of arranging a transfer to a buyer at this point in time, the Firm will either receive the dividend directly from the CSD, or will be "compensated" with that dividend at a later date by the CSD, once the funds are available in the account of the seller.

This process will only involve client money if the following criteria are met:

1. The Firm is in possession of the dividend amount (rather than the amount being due to the Firm from a seller);
2. The dividend the Firm holds is due to a client, rather than due to a market counterparty; and
3. The dividend the Firm holds relates to shareholdings which the Firm has previously delivered to the client (and have been paid for by them under DVP settlement).

This is further complicated by the fact that any dividend allocation by a CSD to the Firm's account may need to be allocated/split by the Firm between amounts due to clients (i.e. client money received on behalf of clients) and amounts due to market counterparties (which is not client money) in the Firm's daily calculation.

The Firm has previously investigated whether this activity could be segregated by the Firm's custodian banks into specific accounts on their books opened for this purpose but they have advised that they do not have the ability to perform the above and that at most, all dividend amounts received on behalf of both clients and market counterparties can be held in a dedicated account.

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This creates two difficulties in complying with Regulation 49(6). Firstly, this would involve the receipt of both client monies and non-client monies into this account. Secondly, the fact that those monies, once received into the Firm's CSD account, will need to be transferred to the CSD account of the correct recipient, which is again automatically arranged by the CSD. This means that the non-client monies cannot be moved out of the client money account for fear of unnecessarily blocking the transfer being carried out by the CSD to those other counterparties.

In response to these two difficulties, and to ensure compliance with Regulation 49(6), the Firm completes a daily calculation of the monies held with the CSD that are due to clients, and transfer company funds equal to those amounts into the Firm's client money account. This occurs on the day following the actual receipt of those funds in the CSD.

As only the Firm has the records as to whether the intended recipients are clients or not, and because the CSD dividend compensation process requires the presence of the relevant funds with the CSD, it is not possible for the relevant monies to be initially received directly into a client money account.

The above scenario represents the most frequent circumstance by which the Firm holds client money.

The Firm understands that other investment firms in the market subject to the current requirements experience similar challenges.

Question 23: Do you agree with the Central Bank's proposal to require investment firms to perform an 'internal' client financial instrument reconciliation?

The Firm agrees with this proposal.

Question 24: Do you agree with the proposed frequency (i.e. monthly) for performing the 'internal' client financial instrument reconciliation? In responding, please refer to instrument types, e.g. those that could be checked more or less frequently than on a monthly basis, and set out the applicable rationale.

The Firm agrees with this proposal. In the case of equity and equity-like instruments, daily reconciliation would be feasible as daily account reporting by custodians is common practice.

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Question 35: Do you agree with the Central Bank's proposal to enhance the CAR to require investment firms to develop and maintain a Client Asset Applicability Matrix within the CAMP?

The Firm agrees with this proposal.

Question 36: Do you agree with the Central Bank's proposal to enhance existing requirements to include a section in the CAMP that identifies all entities to which an investment firm outsources any activity relating to the safeguarding of client assets and details of how the investment firm proposes to exercise oversight of the activities? If not, please explain why.

The Firm has no objection to the proposal but is concerned that the phrase *"any activity relating to the safeguarding of client assets"* could be interpreted to include the role of third parties with whom client assets are held (which is clearly not an example of outsourcing). The Firm therefore suggests that an appropriate level of clarity is provided either within the revised regulations or the supporting guidance.

Question 37: Do you agree with the Central Bank's proposal for investment firms to include a reference to the location of its internal client asset breach and incident log in the CAMP?

The Firm agrees with this proposal.

Question 39: Do you agree with the proposed enhancements to the CAR guidance as set out above […]

In a general sense, the Firm agrees with the proposed enhancements. Given the breadth of these proposals, any associated guidance that the CBI is minded to provide would be beneficial. The Firm would also welcome if the guidance notes gave more consideration to how the regulations apply to assets as they are in the process of being transferred/sold to new owners as opposed to those assets being held in custody for their current owners. Please see our response to question 44 on this topic.

Question 40: In your opinion, is there any additional information which should be included in the CAMP?

Regulation 63(1) obliges investment firms to ensure that the HCAO is supported by adequately trained staff to discharge their responsibilities under the regulations. However, there is no specific guidance regarding the level or sufficiency of the training to be provided, e.g. format (i.e. "on-the-job", computer-based, classroom-based, etc.), frequency or scope (i.e. training required for staff involved in the daily reconciliation or calculation versus the training required for other staff). Having this information set out in the CAMP would enable the Firm and its Board to identify a training plan suitable to its business

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model/structure and would allow auditors to opine on a firm's adherence to the requirement to have staff appropriately trained.

Question 41: Do you agree with the Central Bank's proposed approach for the CAR guidance on the structure of the CAMP?

The Firm agrees with this proposal.

Question 42: Do you agree with the Central Bank's proposal to grant a 12-month transitional period following the publication of the third edition of the Investment Firms Regulations for investment firms to comply with the revised CAR?

The Firm agrees with this proposal.

Question 43: Do you foresee any challenges in reporting the information referenced in the paragraph 171, on a monthly basis?

The Firm does not foresee any challenges.

Question 44: Have you identified areas of the client asset regime that warrant consideration, in particular in light of new or evolving business practices, financial innovation or advancements in technology?

The Firm primarily provides stockbroking services to large institutional clients and does not offer services to clients which directly require the client to deposit monies with the Firm in advance of service provision. However, the Firm falls within the scope of the regulations due to the fact that, on occasion, the Firm receives monies on behalf of clients into our custodian accounts as part of the international trade clearing process. This primarily relates to dividends accruing to shareholdings which have been recently purchased by the Firm for a client. These monies are, by and large, automatically disbursed or passed on to the client without our intervention by the settlement systems in respective jurisdictions.

In some cases, this disbursement to clients is pre-determined and will automatically occur in the settlement system, even in the event of the Firm's insolvency. In other cases, the disbursement will automatically occur only whilst the Firm's custodian account is operational (which would not be the case in an insolvency scenario).

This scenario, whereby client monies are received into the Firm's bank accounts on behalf of those clients through external processes and then disbursed to that client through pre-determined external processes, is not directly considered by the regulations nor by the associated guidance notes.

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The Firm therefore believes further clarity is required as to how monies received (and passed on) as part of the trade settlement process are treated in the context of the Client Asset Requirements.

Finally, by virtue of the current regulations, occasionally the Firm finds itself segregating and protecting very small amounts (e.g. €10.00 or less) for very large institutional clients. The Firm believes that the regulations and/or guidance notes could provide scope for professional clients to waive their right to protection under the regulations where de minimis values are being segregated.

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