

Oireachtas Joint Committee on European Scrutiny

4 November 2010

Opening Statement

Anne Troy, Chief Operations Officer

Investor Compensation Company Limited

Good morning

I propose to make a brief statement about the role of the ICCL in investor compensation, our interaction with the EU Commission while they were developing the new Investor Compensation Directive and about some of the provisions of the draft Directive.

In March 1997, the European Council adopted a Directive providing a minimum level of protection for investors in circumstances where fraud or insolvency results in the inability of an investment firm to return investment instruments or money to investors. The Investor Compensation Directive laid down certain basic requirements for investor compensation schemes in order to provide a harmonised minimum level of investor protection across the European Union. It was left to each individual Member State to implement a scheme and to determine the most appropriate way of organising and financing such schemes. In Ireland, the Directive was implemented through the Investor Compensation Act, 1998.

Under the Act, the Investor Compensation Company Ltd – the ICCL - was established as a company limited by guarantee and having a share capital. There are three shareholders – the Central Bank of Ireland (Central Bank), the Irish Stock Exchange and the Irish Association of Investment Managers. A principal objective of the ICCL is the putting in place of arrangements (for example, funding and payment procedures) to ensure that eligible clients of a failed firm receive compensation, within the parameters set down in the Act, as quickly as possible.

The structure adopted in Ireland (that is, the establishment of a specialist company to put compensation arrangements in place) is one which has also been used in a number of other Member States of the European Union.

The Investor Compensation Directive applies to all authorised investment firms (including Credit Institutions authorised to provide investment services). In addition to transposing the Directive into Irish Law, the Investor Compensation Act, 1998 also provides for compensation arrangements to apply to a large number of authorised intermediary firms, most of whom are insurance intermediaries, which were not covered by the Directive.

The ICCL, after consultation with stakeholders, established two Funds. Fund A relates to investment firms authorised under the Markets in Financial Instruments Directive, 2004 and certain IIA firms and Fund B relates to retail intermediaries authorised either under the Investment Intermediaries Act, 1995 or the Insurance Mediation Regulations, 2005.

The Scheme is funded by contributions from firms in Fund A and B. The rates of contribution are set every three years, following a consultation process. Current contribution rates vary depending on the membership category and are based either on the number of eligible clients of the firm or on the firm's income from investment and insurance business.

The Scheme will pay compensation where an authorised firm is unable, due to its financial circumstances, to return money or investment instruments owed to a client. Investors will be compensated if they are eligible investors and have dealt with a firm that has been authorised to conduct business. The Scheme will not pay compensation where a loss to the client arises as a result of poor advice or where the value of a client's investment declines because of market or other economic forces.

Once a determination has been made that a firm is unable to return investments to its clients, an Administrator will be appointed either by the Court or by the Central Bank. Investors will be given at least five months, from the date of the court ruling or determination by the Central Bank of Ireland, to make a claim. The Administrator is charged with examining all claims and certifying them for payment. This process can take a significant period of time. Once a claim has been certified by the Administrator, the ICCL's role is to make payments as quickly as possible and is obliged to do so within three months of the date of certification. To date the average time for the ICCL to pay a claim after it has been certified is 10 days.

Since its establishment in 1998, the ICCL has had experience of three failures, two in 1999 and one in 2001. We have paid out a total of €8.3m in compensation to investors. At present, the amount of compensation payable to each eligible investor is limited to 90 per cent of the amount lost subject to a maximum payout of €20,000. This amount reflects the obligations imposed under the Investor Compensation Directive and is generally consistent with the levels of payment available in most other Member States of the European Union.

Turning to the proposed Directive, in early 2009, in the wake of the financial crisis, the EU Commission undertook a review of compensation arrangements, including the Investor Compensation Directive. The objectives of the review were to ensure a sufficient level of protection to consumers, to improve the functioning of the Directive, to remedy any regulatory gaps and to provide for greater co-operation between member states' schemes. As part of the review, the Commission consulted a range of stakeholders, including investor compensation schemes. The ICCL took part in that process, responding to questionnaires and participating in meetings. The main issues to arise from that process related to the funding of the schemes, the coverage of compensation, the minimum level of compensation and how to deal with delays in paying compensation to consumers.

The outcome of that process is the draft Directive, which proposes to amend the original Directive of 1997. The major changes proposed are set out in the Explanatory Memorandum to the Directive. We note that the draft Directive is being discussed by Council Working Groups in Brussels. In due course the proposal will be subject to scrutiny by the European Parliament. In the course of this work, the provisions may change. The ICCL has examined these proposals from an operational point of view. The consideration of the policy issues involved is primarily a matter for the Department of Finance, which has sought the views of the ICCL in developing their approach to the negotiations in Brussels.

Broadly speaking, the ICCL welcomes the Directive. We share the Commission's aim to update existing provisions so as to provide greater security and confidence for investors. We note that some of the proposals may result in somewhat higher compensation costs, which may have implications for the rate of contribution from the firms covered by the ICCL.

The Directive proposes that each compensation scheme should have a minimum target fund of 0.5% of liabilities. This proposal is particularly welcome because it provides useful guidance to compensation schemes as to the appropriate total level of funding to be maintained. We note that further work may be needed to clarify how to calculate the level of the target fund.

The draft Directive extends the cover provided to include UCITS¹ investors. The ICCL does not cover UCITs, but would be prepared to make the necessary arrangements to administer any such extension of the scheme.

The proposal to provide cover for the failure of a third party custodian would certainly improve protection for investors but greater clarity is needed both as to how this would work in the context of existing insolvency law and how this cover would be funded.

At present, compensation payments are limited to 90% of the loss. The Directive of 1997 explains the rationale for this provision as follows: *“in order to encourage investors to take due care in their choice of investment firms it is reasonable ... to require investors to bear a proportion of any loss”*. The new draft Directive proposes to remove this restriction, so that claimants will be compensated for 100% of their loss, subject to a maximum payout. This is an improvement in the cover available to claimants, which may have some implications in relation to the funding of the compensation scheme.

The Directive also envisages a fixed maximum payout of €50,000 per investor. The maximum level in Ireland at present is €20,000. An increase in the maximum payout is certainly warranted, if only to take account of inflation. An increase to €50,000 appears to be reasonable, when compared with the maximum payout under the DGS of €100,000, and taking into account the need to provide confidence to investors. On the other hand, indications are that the number of claimants that would benefit from an increase to €50,000 would be relatively small. The experience of the ICCL and the more recent experience of compensation schemes in other member states suggest that more than 95% of claimants would be fully compensated within the €20,000 maximum.

¹ Undertakings in Collective Investment in Transferable Securities

The increase in the maximum payout will certainly have an impact on the funding of the compensation scheme.

The Directive proposes to provide for early payment of part of an investor's losses. One third of the initial assessment of a claim would be paid by the compensation scheme not later than one year after a firm has been determined to be unable to return money and instruments. The balance would be paid out later once the claim had been fully certified. It usually takes some time to calculate accurately the losses sustained by claimants when an investment firm fails. In the first instance, clients are given time to make claims. The Administrator then has to determine the value of individual claims, notably the applicable value of financial instruments. It may be that there are client assets available, however, until they have been allocated to individual clients, the losses of the claimants cannot be known and certified by the Administrator. For these reasons, it can take a period of years to pay compensation. The Directive rightly highlights this as an area for improvement. The ICCL supports that objective. However, we are conscious that, in the absence of certification by the Administrator, there will always be a danger of overpayment and subsequent claw-back from claimants.

The Directive makes provision for inter-scheme borrowing. This is the Commission's response to the need for lender of last resort facilities for investor compensation schemes. While these provisions are to be welcomed, the short payback time of 5 years does not address the core issues.

To conclude, the ICCL welcomes the Directive, notes the improvements it provides for claimants and will closely follow the negotiation of the Directive, to be conducted by the Department of Finance.

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