The Investor Compensation Company DAC

Consultation Paper

Review of the Risk Equalisation Rule

Responses are invited before 12 January 2024

Issue date 24 November 2023

List of abbreviations used in this paper

AIF	Alternative Investment Funds
BBIL	Blackbee Investments Limited (in liquidation)
EU	European Union
ICCL	The Investor Compensation Company DAC
ICSD	Investor Compensation Scheme Directive 97/9/EC
MiFID	Markets in Financial Instruments Directive
RER	Risk Equalisation Rule
The Act	Investor Compensation Act, 1998 (as amended)
The Bank	Central Bank of Ireland
The Board	The Board of the ICCL
The Scheme / ICS	Investor Compensation Scheme
UCITS	Undertakings for Collective Investments in Transferable Securities

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1 Objective

This is the first review of the Risk Equalisation Rule ('the RER') since it was introduced on 1 March 2020 (refer to section 8 for a copy of the current RER). The aim of this consultation is to provide participant firms with an opportunity to submit their considered views on proposed revisions to the RER. This consultation paper should be read in the context of the overall approach to funding the Investor Compensation Scheme ('the Scheme' or 'ICS') which is set-out in the published triennial Funding Arrangements document (August 2022 to July 2025), which were consulted on by The Investor Compensation Company DAC ('ICCL') between October 2021 and December 2021. This RER consultation paper outlines and seeks views on four proposals to amend the RER in the context of the experience of operating the RER since 1 March 2020.

This paper is of relevance to current and prospective member firms of Fund A of the ICS. Such firms include licenced credit institutions, authorised MiFID investment firms, some UCITS and AIFM firms[1]. This paper may also be of interest to various financial services representative bodies. This paper is particularly relevant to current or prospective member firms of Fund A:

- that cause the aggregate level of assets covered by the ICS to increase by €250 million or more upon authorisation by the Bank or at any point in the three-year period following authorisation by the Bank; and/or

- that acquire a book of business or enter into any transaction, restructuring, or other arrangement that causes the aggregate level of assets covered by the ICS to increase by €250 million or more upon the completion of a transfer, restructuring, transaction or other arrangement or at any point in the three-year period following the completion of the transfer, restructuring, transaction or other arrangement.

[1] UCITS and AIFMs authorised to provide individual portfolio management (IPM)

2 Introduction

The ICCL's total funding requirement for investor compensation matters is generally, determined on a triennial basis. Section 21 of the Investor Compensation Act, 1998, as amended ('the Act') provides that investment firms shall pay to the funds maintained by the ICCL the relevant levy that the ICCL specifies. Section 22(3) of the Act provides that the ICCL should endeavour to ensure that it is in a position on an ex-ante[2] basis, to meet any reasonably foreseeable obligations that may arise under the Act.

In advance of issuing this Funding Consultation document, the ICCL has consulted with the Central Bank of Ireland (the 'Bank'), as the Competent Authority in Ireland for the Investor Compensation Directive (97/9/EC) ('the Directive' or 'ICSD').

The Board of the ICCL ('the Board') seeks to ensure that its cascade model is sufficiently resilient and flexible to meet reasonably foreseeable claims events using various funding layers of the cascade model with associated capacity. The RER is a constituent part of the ex-ante reserve layer of the cascade model.

The ICCL published its recent Funding Arrangements Document in May 2022. In that document, the ICCL advised participant firms that it would review the RER.

In February 2020, the RER was introduced to address situations where the quantum of assets covered by the ICS and the ICS Cascade Model could be significantly increased following, for example, the authorisation of a new investment firm in the jurisdiction and/or the transfer of a book of business to an existing investment firm by any transfer, restructuring, transaction, or other arrangement.

This present consultation process arises immediately following the failure of a MiFID investment firm, Blackbee Investments Limited ('BBIL'). At this time, it is unclear what the impact from this failure may be for the reserves of Fund A, however, ICCL in accordance with relevant provisions of the Act has invited claims for compensation from more than 2,000 clients of BBIL.

This consultation provides an opportunity for participants in the Scheme to make any considered comments and observations on the proposals put

[2] Ex-ante means "before the event" or a pre-funding approach

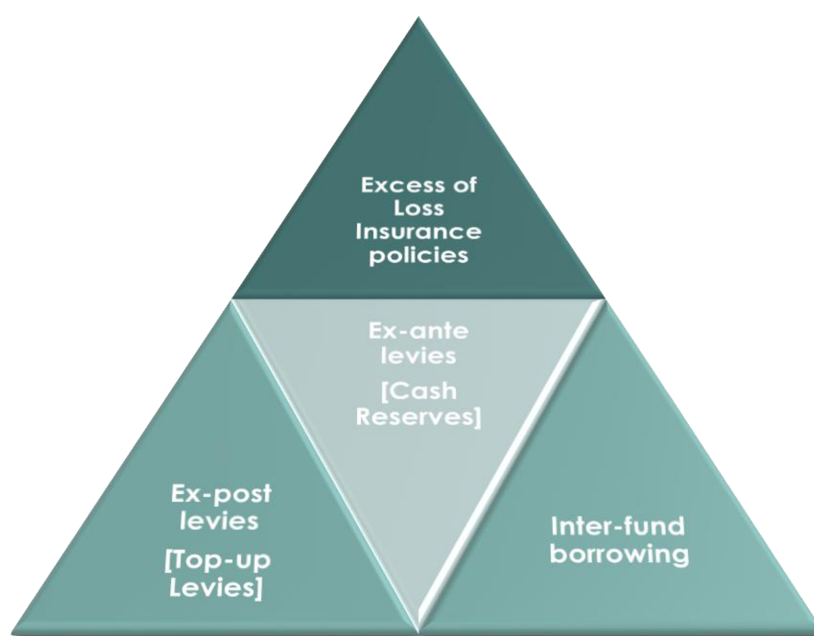
forward. Such comments and observations may be of assistance to the Board in determining what, if any, changes should be made to the way the RER is formulated and interacts with the other components of the cascade model (further below in section 3) which determine how the Scheme is funded.

Section 3 outlines the current cascade model in place while the proposals being put forward are presented in Section 4, with the formula to be applied, should all proposals be adopted, listed in Section 5. Further details pertaining to the format and timeframe for the making of submissions to this Funding Consultation are contained in sections 6 and 7.

3 Fund A – Cascade Model

ICCL operates a cascade model as the framework for funding the Scheme in the event of a failure or failures of investment firm(s) that give rise to compensation payments under the Act. The cascade model represents the funding sources available to the ICCL. The deployment of those funding sources for the purpose of making compensation payments will depend on the extent of the failure of the participating investment firm(s). This approach is supported by the finding in the EU Commission's study[3] that the availability of multiple sources of funding, even if never activated, enhances the viability of such compensation schemes. In the view of the ICCL, this model materially contributes to the maintenance of investor confidence, a core objective of an Investor Compensation Scheme.

The ICCL cascade model currently consists of the following elements:



[3] Oxera report prepared for the EU Commission (January 2005)

In addition to each of the above elements, there are three important features to be considered in terms of the operation of the cascade model:

- Capacity of the overall model;
- Mix of each element of the model;
- Timeframe for capacity of each element to be achieved.

The Cascade mix for 2022 to 2025 has been set on the expectation that Alternative Funding sources[4] continue to be available and renewed on terms acceptable to the Board of the ICCL.

A significant change to the current terms for Alternative Funding sources may require the Board to reconsider the mix, and/or capacity target, and/or timeframe for achievement of the cascade targets for Fund A.

[4] Examples include Excess of loss insurance policies and/or commercial borrowing facilities

4 Proposals to amend the Risk Equalisation Rule (“RER”)

This section of the consultation document contains four proposals, each of which should be considered independently of each other, and on their own merits. The responses to the proposals and consideration by the ICCL will inform whether any, one or a combination of proposals will be adopted. Each proposal relates to the calculation of the levy amount that may be payable by a firm that would be subject to the RER. For illustrative purposes only, section 5 of the consultation paper contains a proposed formula (incorporating proposals 1, 2 and 4) for the calculation of the RER levy.

Respondents to this consultation document should note that proposal 3 does not amend the RER. Instead, it would alter the annual levying basis of assessment for a firm that is subject to the RER. It should be considered an addendum to the existing triennial Funding Arrangements 2022 – 2025, if adopted.

(I) PROPOSAL (1) – AMENDMENT TO THE THRESHOLD AT WHICH THE RER BECOMES APPLICABLE

Following the consultation process leading to the introduction of the RER in 2020 a threshold to trigger a payment of a levy pursuant to the RER was adopted.

At present, the migration of <€250m of client assets over a three-year period in respect of a transaction, does not attract the application of the RER. However, if an entity exceeds the €250m threshold, the RER is applied to the full amount of retail client assets migrated. The ICCL, drawing on its experience of having operated the RER for over three years, considers that an alternative approach to the application of the threshold may be merited.

It is proposed that the participants of Fund A consider and share their thoughts on a proposal to amend the threshold such that the €250m level of the threshold would remain unchanged, however, for any RER transaction(s) that exceed the €250m threshold, the first €250m of client assets would not count towards the calculation of the RER levy itself. In effect, this would create a one-time credit for firms subject to the RER to ensure an even application of the RER to all firms.

The impact for Fund A is clear and would translate into a one-off reduction of €416,250 in the RER levy payable by firms subject to the RER based on the 33.3% “RM” factor applied to date.

Alternatively, if proposal 1 (as set out above) and proposal 4 (as set out on page 15) were both adopted as outlined in this paper, the impact for Fund A, would be calculated as €350,000 per firm based on the proposed 28% "RM" factor.

A revised version of the RER, incorporating only proposal 1 (the application of a credit for the first, and only the first €250m of client assets migrated) is set-out in appendix 1.

For the avoidance of doubt, the €250m credit being proposed is a one-time or lifetime credit. It would not apply to a second or subsequent RER transaction.

Q1. Views are sought in respect of the proposal:

- **to retain the threshold at €250 million, and,**
- **to provide a one-off credit against the first €250 million that is subject to an RER transaction.**

(II) PROPOSAL (2) AMENDMENT TO THE TIMELINE FOR PAYMENT OF THE RER AND THE LOOKBACK TIMEFRAME

The current RER, under section 3.5 (refer to section 8 of this document), in effect requires that the levy is paid within 30 days of "…all or any part of the relevant transfer, restructuring, transaction or other arrangement has been completed."

At the time of the introduction of the RER, it was considered more likely than not, that the majority of RER transactions would be substantially completed up-front, or, within a very short timeframe from the date of initiation of the first asset migration. However, with experience of operating the RER since 1 March 2020, the ICCL has learnt that the asset migrations that trigger the RER may not be substantially completed in a single event.

Arising from a variety of reasons, including regulatory or internal control system requirements, we have learned for example that a firm may undertake small batch migrations to test and validate processes. It may only be when the firm is satisfied that processes are operating as intended and required to safeguard client assets, that client assets are then migrated in larger value batches. Other factors such as high-risk operational periods for firms may also delay/defer a proposed asset migration plan.

A consequence of such real-life factors could lead to the ICCL being "in-funds" before the matching client assets have transferred and come fully in-scope. While this could be considered a prudent approach for the financing of the Scheme and mitigation of moral hazard risks, there may be other approaches to payment timeframes that could be explored for firms subject to the RER, which could still deliver an acceptable outcome to the ICCL and Fund A.

ICCL considers that it could lead to administrative inefficiencies if it tried to directly align RER-related payments with actual transfers.

It may be appropriate to consider staggering the payment of the RER to smoothen the payment of the RER over the lookback period. Proposal 2 envisages an <u>optional alternative payment mechanism</u> being considered for introduction whereby, <u>at the request of the firm subject to the RER</u>, a minimum initial RER payment of 25% of the estimated asset migration is required within 30 days of the initial transfer (RER_0). Additional payments would arise at each 12-month lookback date, potentially on an equal basis if the amount of migrated assets remains unchanged from the initial estimate. This proposal could in theory result in a firm subject to the RER, if it elected to stagger its payments

equally, discharging it's RER liability over up to four payment dates (broadly speaking, over a three-year period).

Proposal 2, from a payment mechanism perspective, would be considered optional, and would set a minimum payment amount and frequency. However, if not exercised as an option, a firm would continue to make the full payment at RER_0 and continue to pay any additional lookback amounts arising at RER_1, RER_2 and RER_3.

Proposal 2 would also adjust the first lookback date (RER_1) (and subsequent lookbacks) from the date of the firm's financial year-end immediately after the first RER event (RER_0) to the initial date of migration plus 12 months (24 months and 36 months respectively) resulting in a full 3-year lookback period. This would help mitigate any risk of an abridged lookback period arising due to the proximity or otherwise of a firm's financial year end to RER_0. It is not intended for the proposed changes to the lookback timeframe to be optional, instead, it is proposed that these would become the default timeframes.

A revised version of the RER, incorporating only proposal 2 is set-out in appendix 1.

Q2. Views are sought in respect of the proposal to:

- **provide an option to discharge the RER liability in four payments, and,**
- **align the lookback periods with the initial date of migration.**

(III) PROPOSAL (3) AMENDMENT TO ADDRESS THE INTERACTION BETWEEN THE RER AND THE ANNUAL LEVY PAYMENT

The purpose of the RER is to seek to mitigate the impact on the funding ratio (cash reserves as a percentage of target reserves) arising from a significant migration of assets into the scope of the scheme cover. In effect, the RER only contributes to the reserves of Fund A and is not applied against the ICCL's operating costs.

On the other hand, the annual levy addresses the following two funding requirements:

1. to build reserves from an existing base in line with projected changes in client assets held (and replenish reserves after a claim event) over a three-year timeframe; and
2. to meet the operating costs of the ICCL arising over that three-year timeframe.

The operating costs of the ICCL include, for example, the alternative funding costs that are incurred to maintain alternative sources of funding so that in the event of a failure of an investment firm, the potential costs for the participants in Fund A are better managed. The alternative funding sources and related amounts are deemed necessary given existing and projected changes in the quantum of retail client assets held by the participating investment firms, in addition to those retail client assets held that arise from RER in-scope transactions.

At present the RER provides a one-off relief from the annual levy for firms that are both newly authorised and initiating an RER in-scope transfer within the same ICCL funding year within which they are authorised (e.g., between 1 August and 31 July). In such circumstances, the firm is exempted from an annual levy in year 1 and pays an annual levy in year 2 with effect from its date of authorisation (+1 year) on a pro-rata basis for that ICCL funding year. No relief was included for an existing firm that became subject to the RER.

While the design and application of a relief could be achieved in more than one way, it would seem appropriate to maintain a construct that is both easy to understand and balanced for any firm subject to the RER, other participant firms, and the overall Fund.

The ICCL is considering a relief that can be provided on an equal basis to newly established firms and existing firms, that are subject to an RER levy, and that would apply to clients whose assets transferred as part of an in-scope RER

transaction during the period between RER_0 and RER_3, and not solely in year one.

The proposal under consideration is to provide a credit in respect of eligible client numbers that are included within the "CA" value migrated by the firm subject to the RER against the annual levy of the firm, for a maximum of three funding years during the application of the RER and related lookback period.

It is proposed that where a firm is subject to the RER, the existing annual levy relief for newly authorised firms would be removed. Instead in calculating its annual levy a firm's total number of eligible clients would be adjusted down as appropriate to exclude RER related clients over the subsequent 3 years. This could be applied as follows:

- For each ICCL funding year during which a firm is subject to the RER, when submitting the value of "CA" to enable calculation of the Initial Risk Equalisation Levy (RER_0) (and/or) the Lookback Risk Equalisation Levy 1 (RER_1) and/or 2 (RER_2) and/or 3 (RER_3), the firm will advise the ICCL of the number of eligible clients to which the "CA" projected or known covered assets related to.

- When submitting the ICCL Return 1 (Self-assessment for annual levy) which currently requires a firm to identify the band within which its eligible client numbers arise, in order to avail of the RER annual levy relief, it would be necessary for the firm to undertake enhanced reporting to ICCL.

- Enhanced reporting would require the firm to report both its total eligible client number and the number of eligible clients that were in-scope for the RER during the firm's financial year which ended immediately prior to the commencement of the ICCL's funding year. This period will not align with the RER periods (unless the RER initial transfer was on the first date of the firm's financial year) so it will create an additional reporting requirement for firms.

- This control is necessary to ensure, on completion of the RER lookback periods, that the number of excluded RER clients from the annual levy process aligns with the number of clients returned during the RER process.

- The proposed relief could only be claimed in <u>three consecutive</u> funding years during the application of the RER. This is to prevent a firm obtaining four years of relief which could otherwise occur due to the timing of an

RER transaction whereby a firms RER transaction could straddle four funding years. It is proposed that in such circumstances, a schedule of funding years to which the Annual Levy relief can be claimed will be considered and the firm will be notified by the ICCL which three years relief will be applied against.

Q3. Views are sought in respect of the proposal to alter the Fund A basis of assessment contained in the Annual Funding arrangements to exclude the number of eligible clients that are included in the RER calculation from the total number of eligible clients for annual levy purposes subject to the three year limit as set out above.

(IV) PROPOSAL (4) AMENDMENT TO ADJUST THE LEVEL OF THE RESERVES PERCENTAGE APPLIED IN THE RER FORMULA

When the RER was introduced, the Reserves Percentage of the cascade model "RM" for the corresponding Funding Arrangements in place at that time between 2019 – 2022 was 33.3%. The triennial review of the Funding Arrangements which introduced the 2022 – 2025 Funding Arrangements, amended the RM such that it **may** consider reducing to a targeted 28% during the cycle to 31 July 2025. It is noted that the RM percentage could be impacted by a number of variables including, the change in value to total retail client asset values which are affected by inflows/outflows and asset price changes arising from market fluctuations.

The ICCL will consider aligning the RM factor for the RER with the relevant RM factor established in the triennial funding arrangements of the ICCL for the cascade model. As stated above, the RM factor set out in the current funding arrangements document which is in operation from 1 August 2022 to 31 July 2025 is targeted at 28%.

In terms of the current funding arrangements for August 2022 to July 2025, proposal 4 would represent a decrease of almost 16% in the RM factor from 33.3% to 28%.

The proposal to align the RM factor for any RER transaction commencing within a triennial funding cycle poses the question of how to deal with RER transactions that straddle the end of a triennial funding cycle. The ICCL has considered such 'in-flight' RER transactions and recognises that the RM target-setting process for the second triennial funding cycle for Fund A would most likely incorporate those RER 'in-flight' transactions. It is proposed that the RM factor for RER transactions that straddle two triennial funding cycles would also have the aligned RM factor applied to them. This would be the RM factor in operation for the triennial funding cycle at the lookback date Y_1, Y_2, or Y_3.

A revised version of the RER, incorporating only proposal 4 is set-out in appendix 1.

Q4. Views are sought in respect of the proposal to align the RM factor for RER transactions with the relevant target RM factor for the triennial funding arrangements period.

5 Proposed Formula for the RER incorporating proposals 1, 2 & 4.

Participant firms should be aware that the proposed formula below is for illustrative purposes only. It assumes the adoption of proposals 1, 2 & 4 as set out in the consultation document. However, as explained at the start of section 4, the proposals, and consideration of same by the ICCL, will inform whether any one or a combination of these proposals will be adopted.

Definitions

_CA_ Greater of the estimated covered assets migrated or actual covered assets migrated

_RM_ is the reserves percentage of cascade model at the start of the current triennial funding cycle ***(proposed as 28%)***

RER_0 is the Initial Risk Equalisation Levy amount

RER_1 is the 1st Risk Equalisation Levy lookback amount

RER_2 is the 2nd Risk Equalisation Levy lookback amount

RER_3 is the 3rd Risk Equalisation Levy lookback amount

Y_0 Initial transfer date

P_0 Initial payment (due 30 days from Y_0)

Y_1 Initial transfer date + 12 months

P_1 Look-back payment 1 (due 30 days from Y_1)

Y_2 Initial transfer date + 24 months

P_2 Look-back payment 2 (due 30 days from Y_2)

Y_3 Initial transfer date + 36 months

P_3 Look-back payment 3 (due 30 days from Y_3)

RER incorporating proposals 1, 2 & 4

$RER_0 = \{\{\{ CA^{Y0} \text{ minus } €250mn^{5} \} * 0.5\% \} * RM \} * 25\%$

$RER_1 = \{\{\{\{ CA^{Y1} \text{ minus } €250mn \} * 0.5\% \} * RM \} * 50\% \} \text{ minus } \sum RER_0$

$RER_2 = \{\{\{\{ CA^{Y2} \text{ minus } €250mn \} * 0.5\% \} * RM \} * 75\% \} \text{ minus } \sum \{ RER_0 + RER_1 \}$

$RER_3 = \{\{\{\{ CA^{Y3} \text{ minus } €250mn \} * 0.5\% \} * RM \} * 100\% \} \text{ minus } \sum \{ RER_0 + RER_1 + RER_2 \}$

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[5] €250 million credit is a one-time credit and as such can only be claimed once by a member firm of Fund A

6 Submissions sought

The Board of the ICCL invites participants to consider the contents of this paper and to respond to the issues and proposals set out. Please make your submission electronically as a pdf document by email, on or before ***15 January 2024*** at the latest.

Submissions should be marked "RER Consultation 2023" and sent by email to info@investorcompensation.ie .

When addressing the questions raised in this Consultation Paper, please identify the question number you are referring to and clearly set out the basis for your views.

Q1. Views are sought in respect of the proposal:

- **to retain the threshold at €250 million, and,**
- **to provide a one-off credit against the first €250 million that is subject to an RER transaction?**

Q2. Views are sought in respect of the proposal to:

- **provide an option to discharge the RER liability in four payments, and,**
- **align the lookback periods with the initial date of migration?**

Q3. Views are sought in respect of the proposal to alter the Fund A basis of assessment contained in the Annual Funding arrangements to exclude the number of eligible clients that are included in the RER calculation from the total number of eligible clients for annual levy purposes subject to the three year limit as set out above.

Q4. Views are sought in respect of the proposal to align the RM factor for RER transactions with the relevant target RM factor for the triennial funding arrangements period.

In responding, participants are requested to bear in mind the statutory responsibilities which are imposed upon the ICCL by the Investor Compensation Directive and the Investor Compensation Act. Accordingly, the Board of the ICCL will only be able to give serious consideration to suggestions and proposals that will not compromise its ability to operate a viable pre-funded Scheme in accordance with its statutory obligations.

It is the policy of the ICCL to publish all responses to its consultations on the ICCL website (www.investorcompensation.ie). As all responses will be made available on the ICCL website, commercially confidential information should not be included in consultation responses.

The ICCL can clarify directly for firms, the levies arising from the proposals on an RER transaction that is at present, or that may in the future, be subject to the RER. Should a firm wish to obtain this clarification, please contact us by email at info@investorcompensation.ie and provide us with details of the proposed or actual transaction.

7 Proposed timelines

The ICCL will consider all submissions and representations received and subsequently decide upon any changes put forward that it believes are appropriate to the way the Scheme is operated and any alterations to the funding structures.

As several issues relating to the funding of the Scheme have an impact on other organisations, it may only be possible to implement certain changes with the co-operation and/or agreement of these parties.

The Board provisionally intends to complete its analysis of the consultation element of this review and to propose any necessary amendments to the RER to the Bank by the end of March 2024. In these circumstances, it is planned to publish the outcome of the RER review (subject to any updates) on or before 31 May 2024. In the event that adjustments are made to the RER following the completion of the review process, such adjustments would provisionally be intended to take effect from 1 June 2024.

24 November 2023

8 Current Risk Equalisation Rule (effective from 1 March 2020[6])

Why is the rule needed?

1.1. The rule is required to address situations where the quantum of assets covered by the Investor Compensation Scheme (‘**ICS’**) and the ICCL Cascade Model is significantly increased following the authorisation of a new investment firm in the jurisdiction and/or the transfer of a book of business to an existing investment firm or any transfer, restructuring, transaction or other arrangement leading to such an increase.

1.2. ICCL Cascade Model – The Investor Compensation Company DAC (**‘ICCL’**) is charged with implementing and operating the ICS, through the Investor Compensation Act, 1998, (**‘Act’**) which transposes the Investor Compensation Schemes Directive (**‘ICSD’**) 97/9/EC. Both the ICSD and the Act require that the cost of financing an ICS must be borne by investment firms.

The ICCL operates a cascade model as the framework for funding the ICS in the event of a default or failure of a participating investment firm(s). The cascade represents the funding options available to the ICCL, depending on the extent of the failure, to access funds for the purpose of making compensation payments. This approach is supported by the finding from the EU Commission’s study that the availability of several sources of funding, even if never activated, enhances the viability of investor compensation schemes.

The ICCL model consists of the following capital and other funding elements (not necessarily in the order presented below):

- Ex-ante levies;
- Ex-post levies;
- Excess of loss insurance policy;
- Inter-fund borrowing between Funds A and B.

A 2010 EU Commission proposal for recasting of the ICSD contained, among many other matters, a key proposal with regard to the target fund size for investor compensation schemes. While the revised ICSD did not ultimately progress to the final stages, the Board of the ICCL (the '**Board**') has taken guidance from the target fund size proposal which provided that *“at least 0.5% of the value of monies and financial instruments that are held, administered or*

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[6] This document relating to the Risk Equalisation Rule is without prejudice to all other ICCL rules, levies, documents, policies and procedures relating to the Investor Compensation Scheme save to the extent expressly stated in this document.

managed by investment firms…are covered by the protection of the investor compensation scheme."

During the 2018/19 triennial funding consultation process, a calibration of the target fund size for the ICS was undertaken, utilising this approach. The most recent data available regarding MiFID retail client assets held by investment firms participating in the ICS enabled the Board to determine that, in order to meet the requirements of section 22(3) of the Act, the ICS should have financing capacity of circa €150mn in place by 2024 (equivalent to €30bn of covered funds).

This triennial process established the funding rules and levy rates for firms participating in the ICS, and followed consultation with key stakeholders, resulting in the ICCL's Funding Arrangements publication.

The ICCL legitimately expected, having consulted with industry and the Central Bank of Ireland (**'Bank'**) in November 2018, that no new authorisations or transfers of covered assets from other jurisdictions were likely to occur that would fundamentally challenge the assumptions applied in the Funding Arrangements that were subsequently published by the ICCL in April 2019.

1.3. Changing risk profile – The ICCL regularly engages with the Bank, as supervisory authority for the ICCL, and competent authority in Ireland for the ICSD. Through this engagement, an emerging risk was subsequently identified relating to the potential transfer of significant amounts of ICS covered assets into the Irish jurisdiction from other jurisdictions, either through newly authorised entities, or, to existing authorised entities (through an acquisition, restructuring, or other such arrangement) without an equivalent transfer of matching ICS funding.

New start-up investment firms with no or immaterial initial exposures may join the ICS and grow organically within the fund without any consequent material effect on the ratio of actual funding capacity to target funding capacity ('funding ratio'). The ICCL, in developing its triennial Funding Arrangements makes provision for such situations. The ICCL does not make provision in its Funding Arrangements for the transfer of significant amounts of covered assets from other jurisdictions as this has the potential to unnecessarily burden the participant firms with additional levy costs. As a consequence of this, if a large firm with covered assets of a very significant scale, or multiple firms, with covered assets of significant scale were to join the ICS, the funding ratio of the ICCL would be negatively impacted.

This is best illustrated through the example of a firm seeking to join the ICS in 2024, with covered assets of €4bn, when the ICS is expected to be fully funded at €150mn (€50mn reserves and €100mn insurance) based on aggregate covered assets of €30bn. The funding ratio of Fund A of the ICS would be 100% and the effect of an additional €4bn of covered assets being introduced

without any matching funds would be to increase the target fund to €170mn[7] with the effect that the funding ratio for Fund A of the ICS would fall to circa 88% (€150mn divided by the revised target fund of €170mn). That would be the equivalent of setting the funding ratio of the ICS back to that which prevailed at 31 July 2018 or six full years of claims free funding for the entire industry.

1.4. Adjustment of the existing funding rules to manage new and evolving risks – the transfer of a significant amount of ICS covered assets into the Irish jurisdiction from other jurisdictions, either to a newly authorised entity, or, to an existing authorised entity (through an acquisition, restructuring, or other such arrangement) without an equivalent transfer of matching ICS funding - would require an adjustment to the ICCL cascade target. The Funding Arrangements of the ICS set out the ICCL's accepted cascade mix, that being the ratio of reserves to excess of loss insurance required to meet the overall cascade target for the ICS (**'Cascade Ratio'**). The Cascade Ratio was set at 1:2 in the Funding Arrangements and the Board has determined that this will be maintained, subject to the availability of additional insurance, when addressing additional cascade target requirements arising from such covered asset increases. A worked example is provided under part 7 of the rule (below).

1.5. New funding rule necessary to manage the new and evolving risks – The new and evolving risks identified subsequent to the publication of the Funding Arrangements, were not anticipated in the setting of the levy rates for the period August 2019 to July 2022. While the Board's initial preferred approach would be to apply the existing Fund A basis of assessment, it was clear on review that the ICCL could not achieve its statutory funding objective on such a basis.

The Board has considered the matter in detail, and having consulted with the Bank in accordance with section 22(2) of the Act, has determined that the most appropriate approach is to introduce a new funding rule that would seek to ensure that the funding and cascade ratios of the ICS are not impacted to such a degree as would prevent the ICCL from demonstrating that it is achieving its statutory objectives, with a relevant firm being required to contribute to the maintenance of the existing ratios through a "risk equalisation" levy.

[7] Revised target of €170mn calculated as €34bn * 0.5% resulting in a funding shortfall of €20mn.

Who will the rule apply to?

2.1. The rule will apply to:

2.1.1. Any newly authorised investment firm[8] that causes the aggregate level of assets covered by the ICS to increase by €250 million or more upon authorisation by the Bank or at any point in the three-year period following authorisation by the Bank; and/or

2.1.2. Any existing authorised investment firm that acquires a book of business or enters into any transaction, restructuring, or other arrangement that causes the aggregate level of assets covered by the ICS to increase by €250 million or more upon the completion of a transfer, restructuring, transaction or other arrangement or at any point in the three-year period following the completion of the transfer, restructuring, transaction or other arrangement.

How will the risk equalisation levy be collected?

3.1. The risk equalisation levy will be initially calculated by the ICCL on notification by the Bank of:

3.1.1. a new firm applying to become an authorised investment firm, or,

3.1.2. an application for approval of a proposed transfer, restructuring, transaction or other arrangement by an authorised investment firm

where the projected or known value of covered assets that will come within the scope of the ICS upon the issuance of the authorisation by the Bank or upon completion of the transfer, restructuring, transaction or other arrangement or at any point in the three-year period following the issuance of the authorisation by the Bank or completion of the transfer, restructuring, transaction or other arrangement amounts to €250 million or more.

3.2. The initial calculations of the risk equalisation levy (the "**Initial Risk Equalisation Levy**") will be based on the estimated, projected or known amounts of additional covered assets as advised by the relevant firm to the Bank that will come within the scope of the ICS upon issuance of the authorisation by the Bank, the completion of a transfer, restructuring, transaction or other arrangement or at any point in the three year period following the issuance of the authorisation by the Bank or the completion of the transfer, restructuring, transaction or other arrangement.

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[8] Authorised investment firm has the same meaning as given in the Investor Compensation Act, 1998.

3.3. Once the Initial Risk Equalisation Levy has been calculated for the relevant firm, the ICCL will advise the Bank of the outcome so that the applicant and/or firm can incorporate the impact of the levy into its projections for the Bank's authorisation process and/or acquiring transaction approval process and/or other applicable approval process.

3.4. The Initial Risk Equalisation Levy may be re-calculated by the ICCL (the "**Revised Initial Risk Equalisation Levy**") at any point up to five business days before the issuance of an authorisation by the Bank or five business days before the completion of the transfer, restructuring, transaction or other arrangement on the basis of updated estimates, projections or known amounts of additional covered assets as advised by the relevant firm to the Bank that will come within the scope of the ICS upon the issuance of the authorisation by the Bank or upon completion of a transfer, restructuring, transaction or other arrangement or at any point in the three year period following the issuance of the authorisation by the Bank or the completion of the transfer, restructuring, transaction or other arrangement.

3.5. The relevant firm must discharge the Initial Risk Equalisation Levy (or the Revised Initial Risk Equalisation Levy if applicable) by no later than thirty calendar days after:

3.5.1. the Bank has issued an authorisation to the firm; and/or

3.5.2. all or any part of the relevant transfer, restructuring, transaction or other arrangement has been completed.

Will the risk equalisation levy be subject to a look-back review?

4.1. The risk equalisation levy is being introduced to ensure that the ICS can meet its funding obligations arising from additional covered assets without materially impacting the ICCL's ability to fulfil its statutory mandate of discharging potential compensation liabilities following the authorisation of a new investment firm or the completion of any transfer, restructuring, transaction or other arrangement involving an existing authorised investment firm that leads to a substantial increase in the amount of covered assets.

4.2. Consequently, the ICCL shall re-calculate the risk equalisation levy for the relevant firm, on the first, second and third anniversary of the application of the Initial Risk Equalisation Levy (or the Revised Initial Risk Equalisation Levy if applicable) based on the amount of covered assets of the firm as at 31 December of the preceding year.

4.3. Should any re-calculation result in a higher risk equalisation levy applying to the firm at any point, the firm shall pay the balancing amount to the ICCL within thirty calendar days of notification by the ICCL.

4.4. Should the re-calculation result in a lower risk equalisation levy, a risk equalisation levy refund situation will only arise in circumstances where the actual value of covered assets transferred has not exceeded the value used to calculate the Initial Risk Equalisation Levy / Revised Risk Equalisation Levy at any time from the date at 3.5.1 / 3.5.2 through to the reporting date for anniversary 3.

Would the annual funding levy rules also apply to the firm?

5.1. Where the risk equalisation levy applies to an investment firm upon its authorisation the funding rules applicable to Fund A firms or Fund B firms to pay an annual levy will only be applied to that newly authorised investment firm after the first anniversary of the application of the Initial Risk Equalisation Levy (or the Revised Initial Risk Equalisation Levy if applicable)).

5.2. Where the risk equalisation levy applies to an existing investment firm it will remain subject to the funding rules applicable to Fund A firms or Fund B firms to pay an annual levy without interruption or deduction.

5.3. In both cases, the obligation to discharge annual contribution levies will be in addition to the liability for any additional risk equalisation levy balancing payments due following the re-calculation on the first, second and third anniversary of the application of the Initial Risk Equalisation Levy (or the Revised Initial Risk Equalisation Levy if applicable)).

Would the ex-post funding rules also apply to the firm?

6.1. Yes, in the event that the ICS experienced compensation claims of such scale that the Board has determined a requirement to apply ex-post levies to firms, those rules would also apply to the relevant firm (in addition to its obligations to discharge the risk equalisation levy and annual levy).

How will the risk equalisation levy be calculated?

7.1. The formula to calculate the risk equalisation levy is as follows[9]:

Risk Equalisation levy =
"REL"

Reserves percentage of cascade model =
"RM"
as at 1 August 2019 (33.3%)

Projected or Known Additional Covered Assets =
"CA"

Covered Assets is calculated by adding the value of:

- Client assets held for MiFID retail clients[10] (client funds and financial instruments) as returned to the Bank in accordance with the Monthly Client Assets Report, and,
- Client assets held for Other clients for whom the firm provides regulated services other than MiFID[11] (client funds and financial instruments) as returned to the Bank in accordance with the Monthly Client Assets Report, and,
- Assets under management as returned to the Bank in accordance with the Monthly Metrics Report, but excluding assets under management for MiFID professional clients.

[CA * 0.5%] * RM = REL

[9] The ICCL may apply some rounding to the calculations

[10] In circumstances where a firm has entered into a tripartite arrangement, for ICCL purposes, the relevant firm is required to return to the ICCL the value of client assets held by the custodian.

[11] In circumstances where a firm has entered into a tripartite arrangement, for ICCL purposes, the relevant firm is required to return to the ICCL the value of client assets held by the custodian.

7.2. Example of Initial Risk Equalisation Levy:

7.2.1. If a relevant firm was proposing to introduce into the ICS, additional covered assets estimated, projected or known to be in the amount of €600 million, the Initial Risk Equalisation Levy (or the Revised Risk Equalisation Levy) would be calculated as:

[CA * 0.5%] * RM = REL

[€600mn * 0.5%] * 33.3% = €1.00mn

7.3. Example of Look-Back Review

7.3.1. A relevant firm is assessed with an Initial Risk Equalisation Levy (or the Revised Risk Equalisation Levy) of €1 million on 13 September 2020, based on estimated covered assets to be transferred of €600 million.

7.3.2. **Anniversary 1 –** On 13 September 2021, the firm is reassessed on the basis of actual covered assets as at 31 December 2020 of €595 million – no additional liability or repayment arises as a Risk Equalisation Levy refund situation can only arise at the third anniversary reassessment.

7.3.3. **Anniversary 2 –** On 13 September 2022, the firm is reassessed on the basis of actual covered assets as at 31 December 2021 of €625 million. An additional liability of €41.6k arises and is levied.

[CA * 0.5%] * RM = REL

[€625mn * 0.5%] * 33.3%] = €1.0416mn

[€1.0416mn - €1.0000mn] = €0.0416mn

7.3.4. **Anniversary 3 –** On 13 September 2023, the firm is reassessed on the basis of actual covered assets as at 31 December 2022 of €610 million. No additional liability arises as the actual amount of covered assets in year 3 is less than the actual amount of covered assets reassessed in year 2. No risk equalisation levy refund arises due to the application of rule 4.4.

9 Appendix 1

Proposal (1) – Amendment to the threshold at which the RER becomes applicable

Definitions

CA Greater of the estimated covered assets migrated or actual covered assets migrated

RM is the reserves percentage of cascade model at the start of the current triennial funding cycle

RER_0 is the Initial Risk Equalisation Levy amount

RER_1 is the 1st Risk Equalisation Levy lookback amount

RER_2 is the 2nd Risk Equalisation Levy lookback amount

RER_3 is the 3rd Risk Equalisation Levy lookback amount

Y_0 Initial transfer date

P_0 Initial payment (due 30 days from Y_0)

Y_1 Firms next financial year end immediately after Y_0

P_1 Look-back payment 1 (due 30 days from Y_1)

Y_2 Firms next financial year end immediately after Y_1

P_2 Look-back payment 2 (due 30 days from Y_2)

Y_3 Firms next financial year end immediately after Y_2

P_3 Look-back payment 3 (due 30 days from Y_3)

RER formula incorporating only proposal 1 - €250m threshold credit

$\mathbf{RER_0} = \{ \{ \{ CA^{Y0} \text{ minus €250mn}^{12} \} * 0.5\% \} * RM \}$

$\mathbf{RER_1} = \{ \{ \{ CA^{Y1} \text{ minus €250mn} \} * 0.5\% \} * RM \} \text{ minus } \sum \mathbf{RER_0}$

$\mathbf{RER_2} = \{ \{ \{ CA^{Y2} \text{ minus €250mn} \} * 0.5\% \} * RM \} \text{ minus } \sum \{ \mathbf{RER_0} + \mathbf{RER_1} \}$

$\mathbf{RER_3} = \{ \{ \{ CA^{Y3} \text{ minus €250mn} \} * 0.5\% \} * RM \} \text{ minus } \sum \{ \mathbf{RER_0} + \mathbf{RER_1} + \mathbf{RER_2} \}$

[12] €250 million credit is a one-time credit and as such can only be claimed once by a member firm of Fund A

Proposal (2) Amendment to the timeline for payment of the RER and the lookback timeframe

Definitions

CA Greater of the estimated covered assets migrated or actual covered assets migrated

RM is the reserves percentage of cascade model at the start of the current triennial funding cycle

RER_0 is the Initial Risk Equalisation Levy amount

RER_1 is the 1st Risk Equalisation Levy lookback amount

RER_2 is the 2nd Risk Equalisation Levy lookback amount

RER_3 is the 3rd Risk Equalisation Levy lookback amount

Y_0 Initial transfer date

P_0 Initial payment (due 30 days from Y_0)

Y_1 Initial transfer date + 12 months

P_1 Look-back payment 1 (due 30 days from Y_1)

Y_2 Initial transfer date + 24 months

P_2 Look-back payment 2 (due 30 days from Y_2)

Y_3 Initial transfer date + 36 months

P_3 Look-back payment 3 (due 30 days from Y_3)

RER formula incorporating only proposal 2 – Payment timeframe and Lookback timeframe

$\mathbf{RER_0} = \{ \{ CA^{Y0} * 0.5\% \} * RM \} * 25\%$

$\mathbf{RER_1} = \{ \{ \{ CA^{Y1} * 0.5\% \} * RM \} * 50\% \} \text{ minus } \sum \mathbf{RER_0}$

$\mathbf{RER_2} = \{ \{ \{ CA^{Y2} * 0.5\% \} * RM \} * 75\% \} \text{ minus } \sum \mathbf{\{ RER_0 + RER_1 \}}$

$\mathbf{RER_3} = \{ \{ \{ CA^{Y3} * 0.5\% \} * RM \} * 100\% \} \text{ minus } \sum \mathbf{\{ RER_0 + RER_1 + RER_2 \}}$

Proposal (4) Amendment to adjust the level of the Reserves Percentage applied in the RER

Definitions

CA Greater of the estimated covered assets migrated or actual covered assets migrated

RM is the reserves percentage of cascade model at the start of the current triennial funding cycle ***(proposed as 28%)***

RER_0 is the Initial Risk Equalisation Levy amount

RER_1 is the 1st Risk Equalisation Levy lookback amount

RER_2 is the 2nd Risk Equalisation Levy lookback amount

RER_3 is the 3rd Risk Equalisation Levy lookback amount

Y_0 Initial transfer date

P_0 Initial payment (due 30 days from Y_0)

Y_1 Firms next financial year end immediately after Y_0

P_1 Look-back payment 1 (due 30 days from Y_1)

Y_2 Firms next financial year end immediately after Y_1

P_2 Look-back payment 2 (due 30 days from Y_2)

Y_3 Firms next financial year end immediately after Y_2

P_3 Look-back payment 3 (due 30 days from Y_3)

RER formula incorporating only proposal 4 – Adjust the level of the Reserves Percentage

$RER_0 = \{ \{ CA^{Y0} * 0.5\% \} * RM \}$

$RER_1 = \{ \{ CA^{Y1} * 0.5\% \} * RM \}$ minus $\sum RER_0$

$RER_2 = \{ \{ CA^{Y2} * 0.5\% \} * RM \}$ minus $\sum \{ RER_0 + RER_1 \}$

$RER_3 = \{ \{ CA^{Y3} * 0.5\% \} * RM \}$ minus $\sum \{ RER_0 + RER_1 + RER_2 \}$

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