The Investor Compensation Company Limited

Consultation Paper

Funding the Investor Compensation Scheme

Responses are invited by 11 December 2015

Issue date 2 November 2015

List of abbreviations used in this paper

ICCL	Investor Compensation Company Limited
The Scheme	Investor Compensation Scheme
The Bank	Central Bank of Ireland
CHC	Custom House Capital Limited (in liquidation)
Board	The Board of the ICCL
The Act	Investor Compensation Act, 1998 (as amended)
ICSD	Investor Compensation Scheme Directive 97/9/EC
EU	European Union
EU ICS	EU National Investor Compensation Scheme
SEPA	Single Euro Payments Area
MiFID	Markets in Financial Instruments Directive
AIF	Alternative Investment Funds
UCITS	Undertakings for Collective Investments in Transferable Securities
CAR	Client Asset Regulations

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1 Introduction

1 The Investor Compensation Company Limited ["ICCL"] has an established policy of periodically consulting with industry regarding the bases and rates for levying participant firms to the Investor Compensation Scheme ["the Scheme"].

2 The ICCL published its most recent Consultation Paper in October 2012. Arising from that consultation process, the ICCL advised the Department of Finance and the Central Bank of Ireland ["the Bank"] on issues that affected the operation and sustainability of the Scheme.

3 This present consultation process arises following a period during which the ICCL has handled failures of investment firms at a higher frequency than forecast. However, with the exception of Custom House Capital Limited (in liquidation) ["CHC"], the compensation payable, in relation to each failure since 2011, has been within a range that has not materially impacted the reserves of the ICCL.

4 One of the objectives of this consultation paper is to summarise the outcome of internal deliberations on key issues affecting the funding of the Scheme and, consequently, to set out the ICCL's proposed future funding arrangements, with particular reference to the period 2016 – 2019 which the Board of the ICCL ["Board"] considers are necessary to ensure the continued viability of the Scheme in accordance with the requirements of the Investor Compensation Act, 1998, (as amended) ["the Act"].

5 In advance of preparing proposals for the future funding of the Scheme, the ICCL has considered the impact on firms of the current economic and regulatory climate including the effects of other existing and newly introduced levies. The Board has sought to strike a balance between the legislative requirement to have adequate funds available to pay claims and the capacity of firms to fund the Scheme.

6 This paper provides an opportunity for participants in the Scheme to make any focussed comments and observations that might be of assistance to the Board in determining what, if any, changes should be made to the manner in which the Scheme is funded, and specifically to the proposals put forward.

7 Respondents are requested to respond directly to each of the issues raised. Other comments or observations, relevant to the funding of the Scheme, may be returned under separate general headings. (A template to assist with the generation of focussed responses is provided at Section 7).

8 Respondents are requested to note that it is the policy of the ICCL to publish all responses to consultations on the ICCL's website, www.investorcompensation.ie.

Confidential information should not be included in consultation responses.

9 The ICCL will acknowledge all submissions received. A considered response to the submissions received will be made available on the Funding Publications section of our website www.investorcompensation.ie.

2 Key issues affecting the funding of the ICCL Scheme

(i) Background

10 The EU Investor Compensation Scheme Directive 97/9/EC [“ICSD”] laid down certain basic requirements for investor compensation schemes in order to provide a harmonised minimum level of investor protection across the European Union [“EU”]. It was left to each individual Member State to implement an appropriate scheme and to determine the most appropriate way of organising and financing such schemes within their own jurisdiction. Thus, while all current Member States have implemented the ICSD, the manner in which the ICSD has been interpreted and applied varies quite considerably.

11 The ICSD, under which the Scheme was established, states that the cost of financing investor compensation must, in principle, be borne by investment firms. In transposing the ICSD, the Irish Government placed an obligation on the ICCL to establish and maintain a fund or funds out of which compensation payments shall be made to clients of failed investment firms, in accordance with the provisions set out in the Act, as expeditiously as possible.

12 Revisions to the ICSD were under negotiation at an EU level during the ICCL’s previous funding consultation process in 2012/13. At that time, it was envisaged that a number of articles within the ICSD would be recast, in particular, the requirement to have an ex-ante fund in each Member State, an upward revision to the minimum harmonised compensation level, pre-defined minimum target fund levels and timelines for achieving those minimum funding target levels.

13 In June 2014, the EU Commission advised that it was withdrawing the proposal to amend the ICSD due to the absence of agreement on the proposals at both EU Council and EU Parliament level. This decision to withdraw was confirmed in the Commission’s Work Programme for 2015.

14 The importance of an ex-ante funded Investor Compensation Scheme was highlighted most recently in 2011 when the CHC case demonstrated how reserves may be quickly depleted. Furthermore, this case also emphasised the requirement for alternative funding options to enable the Scheme to swiftly access the funds required to meet the legislative requirements of the Compensation Scheme for future compensation cases. It should be noted that while the average compensation claim payment in the Morrogh case was relatively modest (circa €3,000), it is anticipated that the CHC case will result in a significantly higher average compensation claim payment (circa €10,000). In fact, the average compensation claim payment in CHC is currently circa €15,000.

15 The numbers of participant firms in both Fund A and Fund B have decreased significantly over the past number of funding years. Fund A has experienced a decrease in authorised investments firms of 12% during the past three years, while Fund B has seen a slightly greater decrease at 14%. The significance of the decrease in numbers of participant firms poses a challenge to the longer term funding of the Scheme's Fund Reserves, in particular, the Fund A reserves.

16 The current external borrowing arrangement that the ICCL negotiated with external bankers in 2007 expires in June 2017, during the next triennial funding period (August 2016 to July 2019). The ability and/or willingness of current lenders in the Irish market to provide a similar arrangement on comparable terms is being examined. It would appear extremely unlikely, particularly in the absence of a State Guarantee (which is not likely to be forthcoming) for any borrowings of the Scheme, that the ICCL will be in a position to put in place equivalent levels of external borrowing on an economic basis into the future.

17 With effect from 1 July 2015, the capacity of the ICCL cascade model was significantly enhanced with the addition of a secondary €50m Excess of Loss Insurance policy (further details are set out in paragraphs 19 to 26). This secondary policy was placed over the existing primary Excess of Loss Insurance policy which was first arranged in October 2010. This successful placement brought the combined Fund A Insurance layers to €100m while Fund B remained at €10m, each over an excess of €15m.

18 The ICCL's Excess of Loss Insurance policy is a "specie" insurance policy and the Board is conscious that successfully negotiating and renewing the policy requires a significant undertaking of resources by ICCL and our broker on an annual basis.

(ii) Cascade Model

19 ICCL operates a cascade model as the framework for funding the Scheme in the event of a default situation. The cascade represents the funding options available to the ICCL, depending on the seriousness of the failure, to access funds for the purpose of making compensation payments. This approach is supported by the finding in the EU Commission's study that the availability of multiple sources of funding, even if never activated, enhances the viability of the schemes.

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

Ex-ante levies [Annual Levies]

Ex-post levies [Top-up Levies]

Excess of Loss Insurance policy

Inter-fund borrowing

External borrowing

20 In addition to each of the elements, there are three important features to the cascade model:

- Capacity of the overall model;
- Mix of each element of the model;
- Implementation sequence of the individual elements of the model.

21 The implementation sequence of the individual elements of the cascade model has heretofore been determined by the Board depending on circumstances prevailing at that time.

22 The Board deployed the cascade model in the following manner in respect of the failure of CHC:

- €15 million will be paid directly from the ex-ante levies of Fund A;
- The potential additional €4.7 million to be met from the Excess of Loss Insurance policy.

23 The Board is giving consideration to setting a pre-determined implementation sequence for each of the individual elements of the cascade model (perhaps for failures at or above a certain level).

24 Ex-post levies may be applied when the ex-ante funded insurance excess and the available insurance policies are exhausted; external borrowing may be utilised when ex-ante funds and all available insurance policies are exhausted; inter-fund borrowing will remain at the discretion of the Board.

25 Cascade capacity has been determined separately for Fund A and Fund B in view of the differences between the Funds in respect of size, nature of participant firms, investment services offered and claims history.
Further details are available in paragraphs 29 and 38.

26 Cascade mix has been considered on the expectation that the Excess of Loss Insurance policy continues to be placed on acceptable terms of excess, coverage and renewal premium. A significant change to any of the above terms may lead the Board to reconsider the mix of how the cascade capacity target is funded for either Fund A and/or Fund B.

(iii) Reserves as at 31 July 2015

27 Tables 1 & 2 below set out the fund reserves of Fund A and Fund B over the life of the Scheme[1 / 2].

Table 1 - Fund A Reserves for the funding years ended 31 July 1999 to 2015 inclusive

Year	Levies / Interest Income	Top Up	Compensation & Related Costs	Administration Expenses	Fund Reserve (at end of period)
1999 – 2001	3,459,023	Nil	(1,190,293)	(415,119)	1,853,611
2002 - 2004	5,722,341	5,070,178	(11,544,239)	(717,093)	384,798
2005 - 2007	7,137,152	(144,948)	1,881,424	(984,639)	8,273,787
2008 - 2010	10,724,373	Nil	379,686	(1,299,767)	18,078,079
2011 – 2013	13,466,021	Nil	(17,764,525)	(2,469,751)	11,309,824
2014	4,370,475	Nil	2,568,669	(874,122)	17,374,846
2015	4,327,142	Nil	16,603	(852,633)	20,865,958

Table 2 - Fund B Reserves for the funding years ended 31 July 1999 to 2015 inclusive

Year	Levies / Interest Income	Top Up	Compensation & Related Costs	Administration Expenses	Fund Reserve (at end of period)
1999 - 2001	3,494,481	Nil	(40,289)	(1,073,756)	2,380,436
2002 - 2004	5,579,350	Nil	Nil	(967,126)	6,992,660
2005 – 2007	5,435,045	Nil	Nil	(1,290,994)	11,136,711
2008 – 2010	7,170,115	Nil	Nil	(1,957,332)	16,349,494
2011 – 2013	5,604,282	Nil	9,996	(1,636,231)	20,327,541
2014	1,594,391	Nil	Nil	(549,185)	21,372,747
2015	1,514,025	Nil	(1,269)	(495,984)	22,389,519

[1] Figures have been converted to Euro where appropriate.
[2] Figures for 2015 have been extracted from the draft Financial Statements for the year ended 31 July 2015.

28 The ICCL has sought to steadily build the reserves of the Scheme and the Board acknowledges the support given by participant firms as the Scheme builds towards those target funding levels identified in the 2013 Funding Arrangements.

Table 3 - Fund A Comparison of Target Fund Reserves against Actual/Forecast Reserves for funding years 31 July 2013 to 2016 inclusive

Year	Target Reserve	Fund Reserve at end of year	Cumulative Difference	Significant Item(s)
2013 - Actual	13,677,000	11,309,824	-2,367,176	Provision for IBRC failure claims.
2014 - Actual	16,931,000	17,374,846	+443,846	Release of provision for IBRC failure claims.
2015 – Actual	20,698,000	20,865,958	+167,958	Un-forecast withdrawal of a Band E firm and the impact of low interest rates on interest income. Release of remaining IBRC provision.
2016 – Forecast	24,868,000	24,429,952	-438,048	Additional Insurance premium, cumulative income foregone from Band E withdrawal and impact of low interest rates on interest income.

Table 4 - Fund B Comparison of Target Fund Reserves against Actual/Forecast Reserves for funding years 31 July 2013 to 2016 inclusive

Year	Target Reserve	Fund Reserve at end of year	Cumulative Difference	Significant Item(s)
2013 – Actual	20,318,000	20,327,541	+9,541	N/A
2014 – Actual	21,332,000	21,372,747	+40,747	N/A
2015 – Actual	22,344,000	22,389,519	+45,519	N/A
2016 –Forecast	23,352,000	23,271,833	-80,167	Impact of low interest rates on interest income.

(iv) Cascade Capacity & Mix

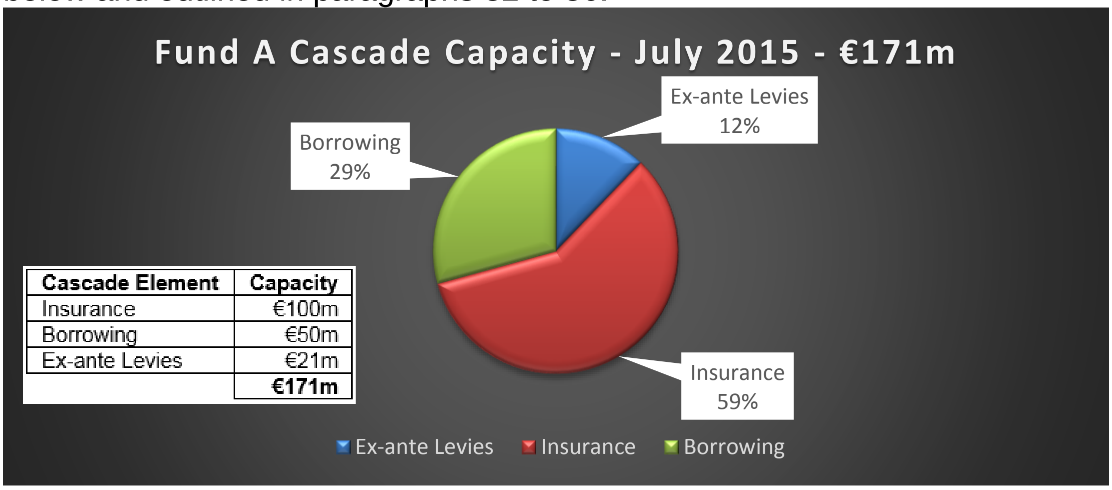
<u>FUND A</u>

29 The Board considers that an appropriate measure of cascade capacity for Fund A may be derived from past proposals in the ICSD to amend the funding criteria for each EU National Investor Compensation Scheme [“EU ICS”]. The core considerations are:

- the cost of financing is borne by participant firms;
- the EU ICS should be adequately financed,
- financing should be proportionate to potential liabilities;
- the target fund should be set, at least at, 0.5% of the value of all monies and financial instruments held, administered or managed by participant firms.

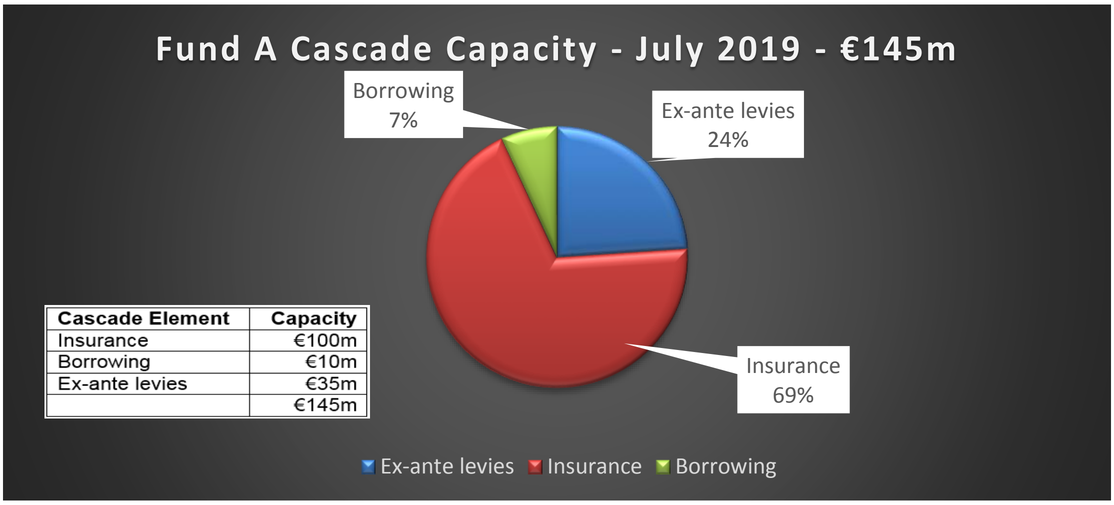
30 The Board has determined that the application of the ICSD criteria would require Fund A to have financing of €150m in place. This is based on the current value of monies and investment instruments held, administered or managed on behalf of retail investors by Fund A firms. Furthermore, the target incorporates compound growth of 5% per annum in the amount of such investments over each of the next 6 funding years.

31 At present the current capacity of the cascade model is €171 million. The Board recognises that the capacity will reduce (from €171 million to €145 million) during the lifetime of this funding arrangement due to the expiry of the external borrowing facility. In preparation for the expiry of the current €50 million facility, which is expected to be replaced with a €10 million facility due to the costs associated with borrowing facilities, the Board raised the level of insurance cover by an equivalent €50 million to €100 million (included in the €171 million above). Ex-ante levies are expected to contribute to the growth of reserves to €35 million without the need for significant rate increases (tables 6 to 9 in Section 4 refer). Beyond the lifetime of this funding arrangement, the continuing growth of ex-ante levy reserves should lead to the achievement of the €150 million cascade capacity target in 2021. The current mix and capacity of Fund A, in addition to forecasted positions, are detailed in the diagrams below and outlined in paragraphs 32 to 36.



32 The Board believes that the current cascade capacity of Fund A, while adequate at €171 million, needs to be re-calibrated in terms of mix to ensure that an over-reliance on alternative funding methods does not materialise. The current borrowing capacity of €50 million, which expires in 2017, will not be renewable on an economically viable basis in the longer term and is likely to be replaced with a borrowing facility of circa €10 million in the medium to long-term. *(Further detail is available at paragraph 44)* In the past, participants have expressed a preference for non-recourse sources of alternative funding to be utilised, where possible, and the Board will seek to utilise tools such as Excess of Loss Insurance where value can be achieved.

33 The Board proposes that the target cascade capacity of €150 million should be achieved by 2021 through a mix of ex-ante levies, insurance, and, external borrowing facility. The forecast mix and capacity of Fund A at July 2019 is detailed in the diagram below.



34 The proposed mix to achieve the €150m cascade capacity target is 26% ex-ante levies, 67% insurance and 7% external borrowing facility. The proposed mix and capacity of Fund A is expected to be achieved beyond the lifecycle of this funding arrangement when ex-ante levy reserves are forecast to reach €40m as at July 2021.

35 Important considerations when determining the mix for the cascade, in particular the percentage of the cascade capacity which should be provided by way of ex-ante levies, are the strength of the regulatory environment, the number of active participants in the Scheme and the ability of participant firms to fund the Scheme's reserves.

36 The Board has considered these factors and believes that the necessary mix for the Fund A target of €150m, could be achieved by July 2021 on the basis of implementing either proposal A:1 or A:2 which are set out in Section 4 *(please refer to paragraphs 59 to 67)*.

FUND B

37 The Board, after careful consideration, has determined that the previously identified target Fund Reserve of €30 million for Fund B should be revised to €35 million, subject to €10 million (circa 30%) of the target being provided by way of excess of loss insurance cover. The majority of the cascade capacity for Fund B (circa 70%) will continue to be provided by way of ex-ante levy reserves. The revised target has been set having due regard to various factors including previous claims experience.

38 In view of the revised cascade capacity target of €35 million for Fund B, and in particular the revised mix proposed by the Board, the need to build ex-ante levies to €30 million has been recast to €25 million. While it is still necessary to build the ex-ante levy reserves of Fund B to achieve the target cascade capacity and mix within the current cycle (Tables 13 and 14 in Section 5 refer), it is expected that the revised target will be achieved within this funding arrangement cycle. On this basis, once the Fund B cascade capacity of €35 million has been achieved, the Board has decided to recast levies at a rate which will broadly only cover operating costs.

Q1. Do you agree with the target cascade capacity for Fund A?

Q2. Do you agree with the target cascade mix for Fund A?

Q3. Do you agree with the target cascade capacity for Fund B?

Q4. Do you agree with the target cascade mix for Fund B?

(v) Excess of Loss Insurance Policy

39 Over the years, the ICCL regularly explored the option of purchasing insurance to cover compensation events as one method of capping the exposure of participants in the Scheme.

40 In October 2010, the Board announced that it had arranged an Excess of Loss Insurance policy to provide a further level of cover in cases where the costs of compensation exceeded €15 million in a policy year. The Board understands that globally only three national Investor Compensation Schemes have successfully negotiated and renewed such cover.

41 Successfully negotiating and renewing the policy requires a significant undertaking from both the ICCL and a specialist Irish brokering team. The ICCL, as part of the renewal process, is required, on an annual basis, to compile extensive data covering participant firms and claims events from the inception of the Scheme in 1998.

42 The Excess of Loss Insurance policy, which was first placed in October 2010, has been renewed annually. On 1 July 2015, as outlined earlier, the Board confirmed that cover for Fund A had been increased from €50 million above the €15 million excess, to €100 million. The Board considers that this is a significant achievement towards ensuring the Scheme is adequately funded to meet potential liabilities for claims that may arise in the future. The Fund B indemnity level continues to be renewed at €10 million above the €15 million excess.

Q5. Do you support the continued placement of Excess of Loss Insurance for Fund A at the current level of €100 million above an excess of €15 million?

Q6. Do you support the continued placement of Excess of Loss Insurance for Fund B at the current level of €10 million above an excess of €15 million?

(vi) Borrowing

Inter-fund Borrowing

43 In circumstances where the ICCL considers it necessary to make use of the inter-fund borrowing facility, the Board continues to believe that the following criteria should be applied:

- no margin rates should apply (i.e. the return to the lending fund should be revenue neutral);
- the amount available for borrowing should be a maximum of one third of the funds held in the Fund; and
- the maximum repayment timeframe should be three years.

Q7. Do you support the current Inter-fund borrowing arrangements?

External Borrowing

44 There are acknowledged difficulties for the ICCL in gaining access to 'other borrowing facilities'. These difficulties can be summarised as follows:

External Borrowing

i) Under current legislation, the ICCL is permitted to borrow[3] from commercial lending institutions. Such borrowing would be required in extreme circumstances where compensation payments could not be met through a combination of ex-ante levies, ex-post levies, the Excess of Loss insurance policy and/or inter-fund borrowing.

ii) Following a comprehensive tender process, in 2007, the ICCL negotiated and put in place a €50 million standby credit facility. The annual charge for this facility, which extends to 2017, is €65,000. Market conditions have changed significantly since 2007 and a recent examination of external borrowing options has identified that arranging a comparable borrowing facility of €50 million is not economically viable at present. It is considered desirable that some element of external borrowing should continue to form part of the cascade model. On the basis of negotiations undertaken to date, the Board will decide in the near future on whether to proceed with arranging a facility of €10 million, subject to satisfactory terms being achieved.

[3] Subject to the approval of the Bank in accordance with S.13(1) of the Act .

State Guarantees for ICCL borrowing

i) The Investor Compensation Act, 1998 (as amended), which governs the conduct of the ICCL, does not provide for a statutory State guarantee in relation to any borrowing of the ICCL. Recent discussions with the Department of Finance have confirmed that, at this time, there is no intention to review the legislation in this regard.

ii) The ICCL will continue to advocate the need for State or other guarantees for borrowing to enable the ICCL to manage the potentially unlimited liability of firms to fund the Scheme.

45 The ICCL remains committed to finding workable solutions to issues relating to establishing borrowing facilities which would allow the Scheme to manage the unlimited liability of the ICCL's participants in extreme circumstances.

Q8. Do you support external borrowing to supplement the cascade capacity?

Q9. Do you support the proposed quantum of borrowing?

(vii) Further efficiencies to the general operation of Funding

46 The ICCL remains committed to identifying and implementing appropriate measures that may facilitate the continuing efficient and effective operation of funding collection processes. The Board believes that it is appropriate to consider the following areas which are specifically related to the efficient collection of annual levies:

- E-Invoicing
  - With effect from August 2014, the ICCL implemented an E-invoicing solution to enable participants to receive levy invoices and related material electronically. To date, the uptake rate by participant firms has been particularly low. The ICCL acknowledges that not all participants may be well placed to engage with electronic invoicing. However, opportunities to achieve real savings in the operating costs are limited and the support from participant firms is essential to make such savings.

- Alternative payment methods
  - At present, a wide variety of payment methods are available to participant firms. The ICCL welcomes the continuing move by participants to avail of the online direct debit mandate and views this as the preferred payment method, particularly from the perspective of achieving operating efficiencies.
  - With effect from 1 August 2014, and in support of the National Payments Plan initiative to reduce businesses reliance on the usage of cheques, the Board incentivised Fund B firms that paid their annual levy using a SEPA online direct debit mandate. The uptake has been strong and is expected to continue.
  - The Board is proposing to apply a 5% surcharge to the standard levy for Fund A firms that pay by cheque and for Fund B firms that do not pay by the SEPA online direct debit mandate with effect from 1 August 2016. In effect, the Board will have offered participant firms a two year transition period, incentivised in the case of Fund B firms.

Q10. Do you support the penalisation of Fund A participant firms that continue to pay by cheque?

Q11. Do you support the penalisation of Fund B participant firms that do not avail of the efficient Direct Debit collection method?

47 The ICCL operates a self-assessment model for participant firms to determine their appropriate annual levy to be declared and paid. There is no proposal to change the self-assessment model.

48 The annual rate payable by Fund A firms is currently based upon their number of eligible clients while, for Fund B firms, the annual rate payable is based on their total income derived from authorised and regulated investment and insurance business. The ICCL advises the Bank of these client and income numbers. The Bank, as part of its ongoing supervisory process, may verify the returned figures of participant firms. While there is no proposal to change the basis for assessment for Fund B firms, one proposal for Fund A envisages a revised self-assessment basis. *(Please refer to paragraph 59 for further detail)*

49 The ICCL considers that, based on our experience to date, pro-rata invoicing for new entrant firms and firms exiting, which requires that participant firms pay their annual levy based upon the number of months for which they are authorised within the funding year, should remain in place for the forthcoming funding cycle. However, it is proposed that, in respect of pro-rata refunds for individual participant firms exiting the Scheme, refunds will only be payable by electronic transfer.

50 The ICCL continues to operate a general refund policy which is outlined in more detail on our website, www.investorcompenastion.ie. The ICCL will regularly review the appropriateness of the policy and make necessary amendments as deemed appropriate by the Board.

(viii) Regulatory and Economic Environment

51 The ICCL welcomes the recent introduction of revised regulations by the Bank to address the issues of Client Assets and Investor Money within regulated investment firms. The ICCL views the introduction of the revised regulations as a necessary strengthening of the overall regulatory environment around Client Assets and Investor Money.

52 In addition to an effective system for compensating covered losses where a participant firm fails, the Board acknowledges that the return of client assets and investor money, in a timely manner, is of paramount importance.

53 In this regard, the ICCL has strongly and consistently advocated for the Bank and the Department of Finance to implement a recommendation from the Department of Finance Morrogh Working Group report which seeks to provide a pre-determined basis for the returning of client assets and investor money where a shortfall arises.

54 In 2013, the Oireachtas introduced into the Act, the power for the Minister for Finance to make regulations providing for the return of investors' funds or investment instruments where a shortfall arises. Throughout 2014 and 2015, the ICCL participated in a working group, chaired by the Department of Finance. The terms of the working group were to codify, through a Statutory Instrument, past judgments in relation to the return of client assets and investor monies, while also seeking to introduce global initiatives which aim to improve outcomes for investors during an insolvency event. This matter was discussed more fully in the 2009 Funding Consultation process. The 2009 Funding Consultation document is available from our website at www.investorcompensation.ie.

55 The ICCL welcomes the recent introduction of S.I. 407 of 2015 – Investor Compensation Act, 1998 (Return of Investor Funds or Other Client Property) Regulations 2015. While the implementation of these regulations will improve the situation for certain clients, the current position where clients of CHC are waiting for their claims to be certified since 2011 is unacceptable.

3 Proposed Fund Reserve levels (effective 1 August 2016)

(i) Introduction

56 The Board of the ICCL believes that the current structure of the Scheme, divided into Fund A and Fund B, based on their authorised status and investment business services, provides an appropriate level of segmentation between participants and that any further sub-division would not be in the best interests of the Scheme as a whole.

(ii) Categorisation of Participant Firms

57 At present there are some 157 firms in Fund A, which is comprised of Section 10 firms (19), MIFID investment firms (95), Licensed Banks (30), AIF Managers (9) and UCITS Managers (4). Some 112 of the total number of Fund A firms (whose authorisation requires them to be a member of the Scheme because it permits them to have eligible clients) currently have no eligible clients and, therefore, pay a basic annual levy towards the ICCL administrative costs. As a result, the main obligation for financing Fund A falls on the remaining 45 Fund A participants.

58 Fund B currently comprises some 3,124 participants which are categorised based on the Bank's authorisation framework. These include Insurance Intermediaries (756), Tied Insurance Intermediaries (355), Authorised Advisors (364), Multi-Agency Intermediaries (1,403) and members of Accountancy Bodies (246).

4 Fund A - Funding criteria and proposals

(i) Basis for levying

59 The ICCL has commenced a process of collecting more detailed data from participant firms in relation to eligible investors and the value of their investments that may be subject to coverage. At this time, the purpose of collecting this data is to better inform the Board of the potential exposures of the Scheme and not for use as a basis for levy calculations. The Board does not currently envisage a scenario whereby a move to risk based or exposure based levying is imminent. However, proposal A:2 does introduce a supplementary levy for firms subject to the Bank's Client Asset Regulations ["CAR"]. At present, the Board considers that the collection and analysis of such data from participant firms will support the cascade capacity setting process and the verification of self-assessed returns.

60 The Board of the ICCL continues to believe that the best basis of allocating levies for Fund A firms is the use of eligible client numbers. Furthermore, in respect of Fund A firms which have self-assessed themselves as having zero eligible clients, a basic levy and special ex-post levy rules[4] will continue to apply. Therefore, no amendment to the levy basis is envisaged. Table 5 below sets out the existing band structure and rates for Fund A participants.

Table 5 - Fund A: Existing levy band and rate structures for the funding year commencing 1 August 2015

Band	No. of Eligible Clients	Total Rate (€)
0	Zero	5,400
A	1 - 9	18,670
B	10 - 499	29,840
C	500 - 2,499	60,890
D	2,500 - 4,999	127,820
E	5,000 - 24,999	203,680
F	25,000 - 49,999	213,410
G	Over 50,000	341,190

(ii) Band structure

61 The eligible client ranges, which determine the levy rates applicable to Fund A firms, appear to have the support of participants and have not given rise to any material issues in the interim. In the circumstances, the Board does not intend to make any amendment to the current ranges.

(iii) Cap on levies

62 In light of the relatively small number of Fund A participants who are required to contribute the majority of the funding, the Board of the ICCL recognises the potential benefit (both from a financial planning and a cash flow

[4] For details refer to page 16 of the Funding Arrangements (May 2013) available on www. investorcompensation.ie

point of view) of a cap on the maximum level of additional 'ex-post' funding to Fund A, that can be required in any one year. In this context, the ICCL policy would be to introduce a cap on the amount that may be raised in any one year, in the event of the need for an ex-post levy call on Fund A participants, which would be equal to twice the annual levy rate. However, the position of the Board remains unchanged from prior consultations. The Board considers that a cap could only be introduced if, for example:

- The Excess of Loss Insurance policy continues to be placed on acceptable terms with adequate reserves in place to meet initial claims;
- A watertight, last resort borrowing arrangement is in place that would guarantee the ability of the Scheme to make its statutory compensation payments on time.

(iv) Funding Reserve level

63 The Board acknowledges the support of Fund A participants in rebuilding Fund A reserves following the failure of CHC, a Band C firm, in October 2011. As signalled by the Board in the 2013 consultation, it was considered, that the actual level of reserves, required to ensure that Fund A was adequately funded, would need to be considerably in excess of the then projected €30 million. The Board considers that, in order to achieve the cascade capacity of €150 million, it is necessary in the medium term to maintain a sizeable level of other funding in the form of insurance, while the ex-ante levies build gradually to re-balance the mix of cascade capacity.

Having regard to the Excess of Loss Insurance policy coverage of €100m, the €50 million standby credit facility, which expires in 2017, and which due to market conditions is likely to be replaced with a more economically viable €10 million facility, the Board considers that the funding targets as set out in paragraphs 29 to 36 are reasonable and achievable within a five to six year period commencing 1 August 2016.

64 Notwithstanding the ICCL's established policy of consulting on levy rates over a 3-year cycle, the Board will carry out an interim review should the need arise. Circumstances that could arise and which could lead to a review include:

- a further significant failure(s),
- significant changes to the structure of the market, and/or,
- significant legislative changes particularly arising from changes at EU level.

65 The proposed levy rates for the 3-year funding cycle commencing 1 August 2016, given the economic conditions, seek to strike a balance between the requirement to have funds available to pay claims and the improving financial position of most firms funding the Scheme.

66 Tables 6 & 7 below set out the ICCL's proposals for consideration. Proposal A:1 and A:2 respectively target ex-ante levy reserves of €40 million by end July 2021.

The assumptions underlying the projections are:

- No significant new failures arise;
- No material change to the existing CHC provision for compensation;
- Continuing ability to renew the excess of loss insurance on broadly the same terms at a €100 million indemnity;
- €10 million external borrowing facility is successfully placed from 2017 on terms considered acceptable by the Board;
- No material reduction in the number of authorised firms is experienced annually beyond the withdrawal of the following number of firms:
    - 2 Band Zero firms;
    - 1 Band A firm;
    - 1 Band B firm;
    - 1 Band C firm;
- Operating costs allocated to Fund A to remain relatively consistent at circa €1.2 million per annum;
- Interest income on reserves will be 0% due to the low interest rate environment and legislative constraints on investment policy;
- Bad debts are not experienced at a material level.

Q12. Do you believe the assumptions set out in paragraph 66 are reasonable? – Please state your reasons.

PROPOSAL A:1 - €150m Cascade Capacity

€150 million cascade capacity;
Cascade mix – Insurance 67%; Ex-ante levies 27%; Borrowing facilities 6%
Ex-ante levies target equates to €40 million reserves;
Ex-ante levies target to be achieved by July 2021
Ex-ante levies target to be achieved without the need for an annual levy increase;

Table 6 - Fund A: Proposed levy rates for the 3-year funding cycle commencing 1 August 2016/2017/2018 (Proposal A:1)

Band	Number of eligible clients	Existing Rates (€)	Proposed Rates August 2016 to July 2019 (€)
0	Zero	5,400	5,400
A	1 – 9	18,670	18,670
B	10 – 499	29,840	29,840
C	500 – 2,499	60,890	60,890
D	2,500 – 4,999	127,820	127,820
E	5,000 – 24,999	203,680	203,680
F	25,000 – 49,999	213,410	213,410
G	Over 50,000	341,190	341,190

<u>PROPOSAL A:2 - €150m Cascade Capacity</u>

€150 million cascade capacity;
Cascade mix – Insurance 67%; Ex-ante levies 27%; Borrowing facilities 6%
Ex-ante levies target equates to €40 million reserves;
Ex-ante levies target to be achieved by July 2021
Ex-ante annual levies **<u>will not</u>** increase for firms that **<u>are not</u>** subject to the Central Bank's Client Asset Regulations ["CAR"];
Ex-ante annual levies **<u>will</u>** increase by 10% in August 2016 for firms that **<u>are</u>** subject to the Central Bank's Client Asset Regulations ["CAR"] **<u>and</u>** that have eligible clients.

Table 7 - Fund A: Proposed levy rates for the 3-year funding cycle commencing 1 August 2016/2017/2018 (Proposal A:2)

Band	Number of eligible clients	<u>Existing</u> Rate (€)	<u>Proposed Rates</u> August 2016 to July 2019 Not subject to "CAR" (€)	<u>Proposed Rates</u> August 2016 to July 2019 Subject to "CAR" (€)
0	Zero	5,400	5,400	5,400
A	1 – 9	18,670	18,670	20,540
B	10 – 499	29,840	29,840	32,820
C	500 – 2,499	60,890	60,890	66,980
D	2,500 – 4,999	127,820	127,820	140,600
E	5,000 – 24,999	203,680	203,680	224,050
F	25,000 – 49,999	213,410	213,410	234,750
G	Over 50,000	341,190	341,190	375,310

Q13. Do you support the implementation of Proposal A:1 or A:2?

67 Tables 8 & 9 below set out the projected Fund Reserve levels for Fund A under proposal A:1 and proposal A:2.

Table 8 - Fund A: Projected Fund Reserve levels under funding proposal A:1

Year	Levies (€ million)	Interest Income (€ million)	Fund Reserve (€ million)
2015*	4.232	0.95	20.865
2016	4.653	0.00	24.430
2017	4.532	0.00	27.783
2018	4.540	0.00	31.051
2019	4.438	0.00	34.194

*** reference made to actual year-end fund reserve**

Table 9 - Fund A: Projected Fund Reserve levels under funding proposal A:2

Year	Levies (€ million)	Interest Income (€ million)	Fund Reserve (€ million)
2015*	4.232	0.95	20.865
2016	4.653	0.00	24.430
2017	4.709	0.00	27.958
2018	4.718	0.00	31.405
2019	4.587	0.00	34.695

*** reference made to actual year-end fund reserve**

5 Fund B - Funding criteria and proposals

(i) Basis for levying

68 The Board of the ICCL believes that the use of income (total income of a firm from authorised and regulated investment and insurance business) continues to be the most appropriate basis upon which annual levies are allocated to Fund B participants.

Therefore, no amendment to the levy basis is envisaged. Table 10 below sets out the existing level structure and rates for Fund B participants.

Table 10 - Fund B: Existing levy band and rate structures for the funding year commencing 1 August 2015

Level	Existing income band structure (€)	Total Rate (€)
1	< 75,000	200
2	75,001 - 150,000	250
3	150,001 - 400,000	400
4	400,001 – 700,000	550
5	700,001 - 1.5m	1,040
6	1,500,001 - 3m	1,800
7	3,000,001 - 6m	3,280
8	6,000,001 - 15m	12,630
9	15,000,001 - 25m	20,650
10	> 25,000,000	24,940

(ii) Band structure

69 As the current band structure has been broadly supported by participants, the ICCL considers that significant changes to the current band structure are not required. Please note that **one** Fund B scenario under consideration involves changes to the lower income bands and levy rates.

(iii) Fund Reserve level

70 Fund B compensation experience, is quite different from Fund A experience. The frequency and impact of compensation events to date has been significantly less. Therefore, after a prolonged period of ex-ante levies reserve building and the strengthening of the Fund B cascade model and mix, the ICCL Board, after careful consideration, believes that €35 million is an appropriate target for the Fund B cascade model.

71 The Board has determined that the target should be comprised of ex-ante levies of €25 million and €10 million excess of loss insurance indemnity. It is therefore necessary to continue to build up the ex-ante levy reserves of Fund B to achieve the target cascade capacity and mix within the current cycle. Once the revised target has been achieved, the Board has decided to recast levies at a rate which will at least maintain the Fund B cascade capacity at €35 million.

72 The proposed levy rates for the 3-year funding cycle commencing 1 August 2016, seek to strike a balance between the requirement to have funds available to pay claims and the continuing financial pressures on the majority of firms funding the Scheme, while also trying to retain proportionality within the rate structure.

<u>(iv) Rate structure</u>

73 The ICCL has reviewed the rate structure on the basis of continuing to provide an appropriate basis upon which to levy firms, provide an appropriate level of proportionality between bands and ensure that, for the majority of firms, any changes from existing rates do not appear to create an unreasonable burden for firms. Two proposals, B:1 and B:2 are put forward for consideration. It will be noted that, under proposal B:1 no changes are proposed. On the basis that target levels are achieved by July 2018, participant firms' levies thereafter would seek to recoup Fund B's share of the administrative costs of operating the Scheme. (Refer to Table 11)

74 Under proposal B:2 below, levies for all participant firms with income levels between €150k and €6 million will remain unchanged. The existing level 1 and level 2 categories would be merged resulting in the withdrawal of the "Up to €75,000" and "€75k to €150k" categories and the introduction of a new level 1 category of "Up to €150k". The levy rate for the new category would be set at a level which would not envisage any additional income from the merged grouping. The existing levels 8, 9 and 10 would incur a one-off levy increase of between 3% and 4% in August 2016. (Refer to Table 12)

75 Notwithstanding the ICCL's established policy of consulting on, and agreeing, levy rates over a 3-year cycle, the Board proposes to extend the Fund B consultation period to a 6-year cycle in the absence of any material failure, subject to an interim review in year 3.

Circumstances that could arise which may necessitate a full consultation, rather than an interim review, include:

- a further significant failure(s),
- significant changes to the structure of the market, and/or,
- significant legislative changes, including a revised Insurance Mediation Directive.

76 Tables 11 & 12 on pages 31 and 32 set out the ICCL's proposals for consideration. Proposal B:1 and B:2 both target Fund Reserves of circa €25 million by end July 2018. B:1 does not propose any change to the existing annual rates or income bands until the €25 million is achieved, thereafter, a 50% levy (approximately) would apply to cover operating costs and to maintain the ex-ante fund reserves at or above €25 million. B:2 proposes to further enhance proportionality within the Fund.

The assumptions underlying the above projections are:

- No significant new failures arise;
- Continuing ability to renew the excess of loss insurance on broadly the same terms at a €10 million indemnity;
- No material reduction in the number of authorised firms is experienced annually beyond the withdrawal of the following number of firms:
    - 80 Level 1 firms;
    - 20 Level 2 firms;
- Operating costs allocated to Fund B to remain relatively consistent at circa €0.7 million per annum;
- Interest income on reserves will be 0% due to the low interest rate environment and legislative constraints on investment policy;
- Bad debts are not experienced at a level above €20k per annum.
- Participant firms that do not pay by direct debit will pay an additional 5% levy surcharge;

Q14. Do you believe the assumptions set out in paragraph 76 are reasonable? – Please state your reasons.

PROPOSAL B:1

Proposal B:1 – Maintain levy rates at 1 August 2015 levels until target fund of €25 million is achieved. Apply a revised levy to cover the administrative costs of operating the Fund once the target fund level of €25 million is achieved.

Table 11 - Fund B: Proposed levy rates for the 3-year funding cycle commencing 1 August 2016/2017/2018 (Proposal B:1)

Level	Existing income band structure (€)	Existing Rate (€)	Proposed Rate effective 01/08/2016 (€)	Proposed Rate effective 01/08/2017 (€)	Proposed Rate effective 01/08/2018[5] (€)
1	< 75,000	200	200	200	100
2	75,001 - 150,000	250	250	250	125
3	150,001 - 400,000	400	400	400	200
4	400,001 – 700,000	550	550	550	270
5	700,001 - 1.5m	1,040	1,040	1,040	500
6	1,500,001 - 3m	1,800	1,800	1,800	900
7	3,000,001 - 6m	3,280	3,280	3,280	1,600
8	6,000,001 - 15m	12,630	12,630	12,630	6,500
9	15,000,001 - 25m	20,650	20,650	20,650	10,500
10	> 25,000,000	24,940	24,940	24,940	13,000

[5] Assumes ex-ante levy fund reserves have reached €25 million target.

PROPOSAL B:2

Proposal B:2 Amalgamate the existing levels 1 & 2; increase annual levy rates by between 3% and 4% for existing levels 8,9 and 10. Apply a revised levy to cover the administrative costs of operating the Fund once the target fund level of €25 million is achieved.

Table 12 - Fund B: Proposed levy rates for the 3-year funding cycle commencing 1 August 2016/2017/2018 (Proposal B:2)

Band	Existing income band structure (€)	Existing Rate (€)	Proposed income band structure effective 01/08/2016 (€)	Proposed Rate - effective 01/08/2016 (€)	Proposed Rate - effective 01/08/2017 (€)	Proposed Rate - effective 01/08/2018[6] (€)
1	< 75,000	200	***< 150,000***	210	210	100
2	75,001 - 150,000	250				
3	150,001 - 400,000	400	150,001 - 400,000	400	400	200
4	400,001 – 700,000	550	400,001 - 700,000	550	550	270
5	700,001 - 1.5m	1,040	700,001 - 1.5m	1,040	1,040	500
6	1,500,001 - 3m	1,800	1,500,001 - 3m	1,800	1,800	900
7	3,000,001 - 6m	3,280	3,000,001 - 6m	3,280	3,280	1,600
8	6,000,001 - 15m	12,630	6,000,001 - 15m	13,000	13,000	6,500
9	15,000,001 - 25m	20,650	15m – 25m	21,500	21,500	10,500
10	> 25,000,000	24,940	> 25m	26,000	26,000	13,000

Q15. Do you support the implementation of Proposal B:1 or B:2?

[6] Assumes ex-ante levy fund reserves have reached €25 million target.

77 Tables 13 & 14 below set out the projected Fund Reserve levels for Fund B under proposal B:1 and proposal B:2.

Table 13 - Fund B: Projected Fund Reserve levels under funding proposal B:1

Year	Levies (€ million)	Interest Income (€ million)	Fund Reserve (€ million)
2015*	1.437	0.77	22.390
2016	1.434	-	23.272
2017	1.413	-	24.118
2018	1.392	-	24.963
2019	0.690	-	25.100

*** reference made to actual year-end fund reserve**

Table 14 - Fund B: Projected Fund Reserve levels under funding proposal B:2

Year	Levies (€ million)	Interest Income (€ million)	Fund Reserve (€ million)
2015*	1.437	0.77	22.390
2016	1.434	-	23.272
2017	1.431	-	24.136
2018	1.410	-	25.001
2019	0.679	-	25.126

*** reference made to actual year-end fund reserve**

6 Request to participants for comments

78 The Board of the ICCL invites participants to consider the contents of this paper and to respond, to the issues and proposals set out, by ***11 December 2015*** at the latest. 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 in a position 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.

79 All responses should be clearly marked 'Funding Consultation' and made in writing, so as to be received by ***11 December 2015***.

Responses should be sent to:

Funding Consultation Team
The Investor Compensation Company Limited,
c/o: Central Bank of Ireland,
P.O. Box 11517
North Wall Quay
Spencer Dock
Dublin 1

Or

by e-mail to info@investorcompensation.ie

It would assist the ICCL greatly if, where appropriate, respondents utilised the template provided at Section 7 and any comments or observations provided were cross-referenced with the relevant question or section number which precedes each paragraph of this Consultation Paper.

80 Respondents are requested to note that it is the policy of the ICCL to publish all responses to consultations on the ICCL's website, www.investorcompensation.ie.

Confidential information should not be included in consultation responses.

81 If it is felt to be helpful, representatives from the ICCL will be available for meetings with relevant representative parties on foot of submissions received.

82 The ICCL will consider the submissions and representations and decide upon any changes that it believes are appropriate to the manner in which the Scheme is operated and any alterations to the funding structures. As a number of 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 agreement and co-operation of these parties. Consequently, the ICCL may, where it has sole responsibility for the areas affected, seek to "fast track" certain changes arising from this review to make them effective as soon as possible. The ICCL will then pursue the implementation of other changes as quickly and effectively as possible within the time constraints necessary to reach agreement with other parties on the relevant issues.

83 The Board intends to complete the consultation element of the review of its funding arrangements by February 2016 and to commence the process of preparing a revised funding arrangements document. Subsequently, the revised funding arrangements will be drafted for approval by the ICCL Board (The Board will consult with the Central Bank of Ireland prior to approving the revised funding arrangements). In these circumstances, it is planned to publish new funding arrangements by 31 May 2016. These arrangements will take effect from 1 August 2016.

84 This consultation document is also available on the ICCL website at www.investorcompensation.ie.

31 October 2015

7 Template to assist with the generation of focussed responses

Name of Respondent Firm/ Body/Organisation:				
Question No.	**Question**	**Yes / No**	**Comment**	**Paragraphs no.'s referenced in your response:**
1	Do you agree with the target Cascade Capacity for Fund A?			
2	Do you agree with the target Cascade Mix for Fund A?			
3	Do you agree with the target Cascade Capacity for Fund B?			
4	Do you agree with the target Cascade Mix for Fund B?			

Name of Respondent Firm/ Body/Organisation:				
Question No.	**Question**	**Yes / No**	**Comment**	**Paragraphs no.'s referenced in your response:**
5	Do you support the continued placement of Excess of Loss Insurance for Fund A at the current level of €100 million above an excess of €15 million?			
6	Do you support the continued placement of Excess of Loss Insurance for Fund B at the current level of €10 million above an excess of €15 million?			
7	Do you support the current Inter-fund borrowing arrangements?			
8	Do you support external borrowing to supplement the cascade capacity?			

Name of Respondent Firm/ Body/Organisation:				
Question No.	**Question**	**Yes / No**	**Comment**	**Paragraphs no.'s referenced in your response:**
9	Do you support the proposed quantum of borrowing?			
10	Do you support the penalisation of Fund A participant firms that continue to pay by cheque?			
11	Do you support the penalisation of Fund B participant firms that do not avail of the efficient Direct Debit collection method?			
12	Do you believe the assumptions set out in paragraph 66 are reasonable? – Please state your reasons.			

Name of Respondent Firm/ Body/Organisation:				
Question No.	**Question**	**Yes / No**	**Comment**	**Paragraphs no.'s referenced in your response:**
13	Do you support the implementation of Proposal A:1 or A:2?			
14	Do you believe the assumptions set out in paragraph 76 are reasonable? – Please state your reasons.			
15	Do you support the implementation of Proposal B:1 or B:2?			

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