



# **The Investor Compensation Company Limited**

## **Funding Arrangements of the Investor Compensation Scheme**

**August 2016 to July 2019**

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**Issue date 22 April 2016**

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# 1 Introduction

## 1.1. *Background*

In November 2015, the Investor Compensation Company Limited [“ICCL” or “Company”] consulted with Industry and Representative Bodies regarding the bases and rates for levying participants to the Investor Compensation Scheme [“Scheme”] for the period 1 August 2016 to 31 July 2019.

Four submissions were made by both firms and Representative Bodies during the consultation phase. Each of the submissions was considered by the Board of the ICCL [“the Board”] and a response document was published by the Company on 21<sup>st</sup> April 2016.

The ICCL remains aware of the challenging economic and regulatory climate for the majority of firms. The Board has sought to strike a balance between the legislative requirement to have adequate funds available to pay claims and the capacity of participant firms to fund the Scheme.

The ICCL, having consulted with the Central Bank of Ireland [“the Bank”], has now agreed the bases and rates which will apply for each of the three funding years to 31 July 2019. Specific details are provided in section 2 of this document for Fund A and Fund B firms.

This document also provides other information which the ICCL considers relevant and useful to participant firms in understanding the funding operations of the Scheme.

## 1.2. *Cascade Capacity, Mix and Projections*

The ICCL has sought to steadily build the reserves of the Scheme and the Board acknowledges the support given by participant firms. The Funding Consultation paper issued in November 2015 highlighted the potential future challenges that a continuing decrease in the number of participant firms may pose to the longer term funding of the Scheme’s Fund Reserves. Over the past three years, the number of authorised investment firms required to contribute to Fund A has fallen by 12% while the number required to contribute to Fund B has fallen by 14%.

The significance of the decrease in the number of participant firms poses a particular challenge to the longer term funding of Fund A given the small population of participant firms and the longer term intent of the ICCL to rebalance the cascade capacity mix.

Past cases have demonstrated how reserves can be quickly depleted and emphasise the need for alternative liquidity options to enable the Scheme to swiftly put in place the funds required to meet the legislative requirements of the Compensation Scheme.

The Cascade model capacity and mix have 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 throughout the duration of these Funding Arrangements.

The ICCL has an established policy of consulting on, and agreeing, levy rates over a 3-year cycle. There is no proposal to change this approach for Fund A, however, in respect of Fund B, *the ICCL will now consult on a 6-year cycle, subject to a 3 year interim review.*

**Participant firms of both Fund A and B should be aware that circumstances could arise which would require the ICCL to carry out a review at an earlier stage.**

The circumstances which could arise include:

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

### ***Cascade Capacity and Mix***

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.

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.

### ***Fund A***

In its current Funding Arrangements, agreed in 2013, the ICCL had targeted a minimum Fund Reserve of €24.9 million for Fund A, to be achieved by 31 July 2016. The ICCL is satisfied that this target will be broadly achieved and the Fund Reserve is projected to be €24.5 million at 31 July 2016.

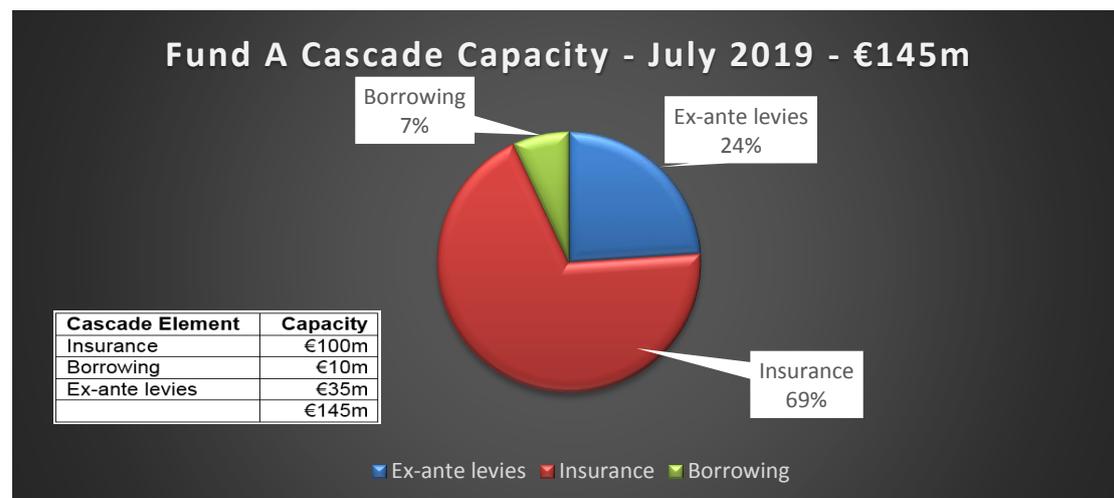
The ICCL has now determined that funding capacity should be addressed in the context of the overall cascade capacity. An appropriate measure of cascade capacity for Fund A can be derived from past proposals in the Investor Compensation Scheme Directive ["ICSD"] to amend the funding criteria for each 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.

The ICCL 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.

The mix of the target cascade capacity is based on €40 million of ex-ante reserves, €100 million of excess of loss insurance and a €10 million external borrowing arrangement.

On the basis of the target cascade capacity being set at €150 million, the ICCL believe that this should be achieved by 2021 through a mix of ex-ante levies, insurance, and, external borrowing facility. The target mix and capacity of Fund A at July 2019 is detailed in the diagram below.



Accordingly, the ICCL, having consulted with the Bank, has agreed that the ICCL should seek to build Fund A Reserves by circa €10 million, from their current level of €24.5 million to a target level of €35 million over the three year life of these Funding Arrangements, based on the assumptions outlined in the Funding Consultation paper.

The assumptions underlying the projections are:

- No significant new failures arise;
- No material change to the existing Custom House Capital Limited (In Liquidation) ["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 no lower than 0% due to the low interest rate environment and legislative constraints on investment policy, and there is no loss of capital;
- Bad debts are not experienced at a material level;
- Participant firms that:
  - pay by direct debit will receive a discount of 5% of their levy, subject to a €25 cap;
  - elect to receive their invoice by e-invoicing will receive a discount of 5% of their levy, subject to a €25 cap;
- Participants firms that pay by direct debit, and, elect to receive their invoice by e-invoicing will receive a discount of 10% of their levy, subject to a €50 cap.

## ***Fund B***

In its current Funding Arrangements, agreed in 2013, the ICCL had targeted a Fund Reserve of €23.3 million for Fund B to be achieved by 31 July 2016. The ICCL is satisfied that this target will be achieved at 31 July 2016.

The ICCL has now determined that funding capacity should be addressed in the context of the overall cascade capacity. The ICCL, having consulted with the Bank, has agreed a cascade capacity of €35 million for Fund B, comprised of €10 million of excess of loss insurance cover and €25 million of ex-ante reserves. The achievement of the €25 million target for ex-ante reserves is based on the assumptions outlined in the Funding Consultation paper.

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 no lower than 0% due to the low interest rate environment and legislative constraints on investment policy, and there is no loss of capital;
- Bad debts are not experienced at a level above €20k per annum;
- Participant firms that:
  - pay by direct debit will receive a discount of 5% of their levy, subject to a €25 cap;
  - elect to receive their invoice by e-invoicing will receive a discount of 5% of their levy, subject to a €25 cap;
- Participants firms that pay by direct debit, and, elect to receive their invoice by e-invoicing will receive a discount of 10% of their levy, subject to a €50 cap.

Section 2 of this document sets out the agreed levy rates and bases to enable an adequate level of funding reserves to be achieved.

### **1.3. Related documents**

1.3.1. [Funding Consultation Paper – November 2015](#)

1.3.2. *Responses to Consultation Paper – April 2016*

## **2 Fund Specific Information**

### **2.1. Fund A**

#### *2.1.1. Basis of Assessment*

The ICCL will continue to operate a self-assessment model for participant firms to determine the appropriate individual annual levy. The annual levy payable by a Fund A firm will be based upon two criteria:

- 2.1.1.1. Whether the firm is subject to the Bank's Client Asset Regulations ["CAR"];*
- 2.1.1.2. Its number of eligible clients. (Guidance in relation to the assessment of eligible clients will be published on the ICCL website and may be subject to update)*

*Firms subject to the CAR are required to meet a minimum additional regulatory requirement. While the ICCL is aware that firms subject to the CAR undertake additional internal compliance and are subject to additional supervision from the Central Bank of Ireland, it is clear that these firms pose the greatest risk to the operation of the Scheme. In circumstances where a firm is subject to the CAR, and, it also has eligible clients, the firm will be required to pay an additional levy of 10% to reflect this increased risk.*

*The ICCL advises the Bank of the number of eligible clients returned by participant firms to the ICCL and these figures which may then be subject to verification by the Bank as part of its ongoing supervisory process. (Refer to 3.6 and 3.7.2 below)*

#### *2.1.2. Period of Assessment*

The period of assessment will continue to be the participant firm's financial year which ended immediately prior to the commencement of the ICCL funding year. (e.g. where a participant firm's financial year ends on 31 March, this financial data should be used for the ICCL Funding Year commencing 1 August.)

### 2.1.3. Levy Rates

The levy rates for participant firms are set out in Table 1 below.

**Table 1 – Fund A rates effective 1 August 2016 to 31 July 2019**

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

### 2.1.4. Section 2(5) Exemption

Certain Fund A firms may be exempt from the ICCL Scheme if they satisfy both of the criteria set out in section 2(5) of the Investor Compensation Act, 1998, (as amended) [“the Act”].

Section 2(5)(a) is satisfied where a firm does not meet the definition of an authorised investment business firm under the Markets in Financial Instruments Directive 2004/39/EC (MiFID) i.e. the firm is exempt from regulation under MiFID by virtue of Article 2 of MiFID.

Section 2(5)(b) is satisfied where the **only** activities that the firm is authorised to carry on under the Investment Intermediaries Act 1995 (as amended) are either:

- Administration of collective investment schemes, or,
- Undertaking custodial responsibilities involving the safekeeping and administration of investment instruments of or relating to collective investment schemes.

It is the responsibility of the investment firm to apply for the exemption for each funding year. Where a firm no longer meets the criteria to avail of the exemption during any funding year, it is the responsibility of the firm to notify the ICCL and to pay the appropriate levy on a pro-rata basis from the date the change take effects. Where a firm meets the criteria for the first time during a funding year and has paid an ICCL annual levy in respect of that funding year, the firm may be eligible to a pro-rata refund (*refer to 3.8*).

A guidance note in relation to the exemption is available from the ICCL Payments Team on request.

## 2.2. Fund B

### 2.2.1. Basis of Assessment

The ICCL will continue to operate a self-assessment model for participant firms to determine the appropriate individual annual levy. The annual levy payable by a Fund B firm is based on its income derived from regulated investment and insurance business. The ICCL advises the Bank of these figures, as returned by participant firms to the ICCL, which may then be subject to verification by the Bank as part of its ongoing supervisory process. (Refer to 3.6 and 3.7.2 below)

### 2.2.2. Period of Assessment

The period of assessment will continue to be the participant firm's financial year which ended immediately prior to the commencement of the ICCL funding year. (e.g. where a participant firm's financial year ends on 31 March, this financial data should be used for ICCL Funding Year commencing 1 August.)

### 2.2.3. Levy Rates

The levy rates for participant firms are set out in Tables 4 to 6 below.

#### **Important Note:**

Firms are requested to note the following changes from the May 2013 Funding Arrangements when self-assessing their levy and making the necessary annual return to the ICCL:

- The old Level 1 (€0 - €75,000) and Level 2 (€75,001 – 150,000) bands have been merged to form a single band with an income range of €0 to €150,000;
- There are no other changes to the income bands.
- The administration only rate proposed to take effect from 1 August 2018 (refer to table 4), **will only** be implemented if the Board is satisfied that the Fund B reserves have reached the adequate level.

**Table 2 – Fund B rates effective 1 August 2016 to 31 July 2017**

Band	Income band structure (€)	Levy Rate (€)
1	< 150,000	210
2	150,001 - 400,000	400
3	400,001 - 700,000	550
4	700,001 - 1.5m	1,040
5	1,500,001 - 3m	1,800
6	3,000,001 - 6m	3,280
7	6,000,001 - 15m	13,000
8	15m – 25m	21,500
9	> 25m	26,000

**Table 3 – Fund B rates effective 1 August 2017 to 31 July 2018**

<b>Band</b>	<b>Income band structure (€)</b>	<b>Levy Rate (€)</b>
1	< 150,000	210
2	150,001 - 400,000	400
3	400,001 - 700,000	550
4	700,001 - 1.5m	1,040
5	1,500,001 - 3m	1,800
6	3,000,001 - 6m	3,280
7	6,000,001 - 15m	13,000
8	15m – 25m	21,500
9	> 25m	26,000

**Table 4 – Fund B rates effective 1 August 2018 to 31 July 2019**

<b>Band</b>	<b>Income band structure (€)</b>	<b>Levy Rate<sup>1</sup> (€)</b>
1	< 150,000	100
2	150,001 - 400,000	200
3	400,001 - 700,000	270
4	700,001 - 1.5m	500
5	1,500,001 - 3m	900
6	3,000,001 - 6m	1,600
7	6,000,001 - 15m	6,500
8	15m – 25m	10,500
9	> 25m	13,000

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<sup>1</sup> Assumes ex-ante levy fund reserves have reached €25 million target.

### **3 General Information for all Firms**

#### **3.1. *Obligation to pay a levy***

Section 21 of the Act provides that authorised investment firms, including insurance intermediaries, ["firms"] shall pay to the ICCL, such contribution ["levy"] as the ICCL may specify from time to time.

(The annual levy amounts for the period 1 August 2016 to 31 July 2019 are specified in Tables 1 to 4 of this document)

Firms are required to comply with section 21 of the Investor Compensation Act, 1998, (as amended). Firms that do not comply with section 21 and fail to pay their due levy will be referred by the ICCL to the Bank. The ICCL may take legal recovery proceedings against such firms. (Refer to section 3.8.1 below) The Bank may also take additional regulatory action against firms reported to it by the ICCL.

#### **3.2. *Authorisation Change***

There will be no adjustment of levy to reflect any changes in authorisation (excluding firms availing of the exemption documented at section 2.1.4) which occur during the funding year. The new rate of levy will apply from the following funding year on the basis of the firm's authorisation status at that time.

#### **3.3. *Newly Authorised Firms***

Firms which are authorised during the ICCL's funding year (i.e. subsequent to the ICCL's annual invoicing process which takes place in August each year), will be required to pay the annual levy calculated on a pro-rata basis.

Where eligible client numbers or income figures are not available at the time of raising the first invoice, the first invoice will be raised at the lowest band/level of the appropriate Fund. In other circumstances, where eligible client numbers or income figures are available, the levy rate should be self-assessed by the firm on a case by case basis.

### **3.4. Invoicing process**

Annual levy invoices are normally issued in August each year (i.e. the first month of the ICCL's financial year). Invoices will be issued in hardcopy format to the principal business address as registered by the firm with the Bank. However, if the participant firm has elected to receive communications by email, the invoice and other associated correspondence will issue by email to the address details supplied by the firm through the *myICCL* section of the ICCL website.

The preferred issuing method is email and a **discount** is available for firms that utilise this facility.

### **3.5. Payment & Invoicing Methods**

The ICCL offers a number of payment methods to facilitate the payment of the annual levy in a timely and efficient method and these are communicated on the annual invoice. Firms can avail of a discount of up to 10%, capped at €50, if they pay by direct debit and receive e-invoices. (*See details below*)

The preferred payment method is single direct debit.

**Where a participant firm pays by single direct debit, an annual discount equivalent to the lower of 5% of the gross annual levy or €25 is available.**

The ICCL issues invoices in hardcopy format by post. Alternatively, where a firm so elects, it can have invoices issued electronically. However, it is the responsibility of the firm to ensure that the correct email address is provided through the *myICCL* section of the ICCL website at all times.

**Where a participant firm avails of e-invoicing, an annual discount equivalent to the lower of 5% of the gross annual levy or €25 is available.**

### **3.6. Verification of self-assessed returns**

All firms will be required to self-assess and return their eligible client numbers or income level for each funding year. In circumstances where a firm fails to submit the self-assessed return of their eligible client numbers or income figures, payment will be deemed to constitute a return. (Refer to 3.7.2 below)

### **3.7. Non-compliance**

#### *3.7.1. Unpaid annual levies*

##### Penalty Interest

Section 21(4) of the Act, provides that interest at a rate of 1.25% per month shall apply to overdue balances.

##### Reporting to the Central Bank of Ireland

Firms that fail to pay their annual levy, will be reported to the Bank for failing to comply with their obligations under the Act. The Bank may initiate a number of actions against firms that fail to pay the ICCL levy in a timely manner.

##### Legal Recovery of unpaid annual levies

Section 21(5) of the Act provides that any sums due to the Scheme are recoverable as a simple contract debt in any court of competent jurisdiction. The ICCL has successfully taken legal action to recover unpaid levies. Details of judgments obtained are published in Stubbs Gazette, notified to the Bank and published on the ICCL website. Published judgments can be viewed at <http://www.investorcompensation.ie/funding/enforcement-actions.233.html>

#### *3.7.2. Incorrect self-assessed returns*

Section 43(7) of the Act provides that any person who provides misleading information, (e.g. in relation to a self-assessed return of eligible client numbers or total investment and insurance income), in purported compliance with its obligations under the Act will be committing an offence. In circumstances where a firm fails to submit the self-assessed return of their eligible client numbers or income figures, payment will be deemed to constitute a return. Summary proceedings in relation to an offence under section 47 may be brought and prosecuted by the Director of Public Prosecutions or by the Bank.

### **3.8. Refund Policy**

The ICCL continues to operate a refund policy which is set out in more detail on our website, [www.investorcompensation.ie](http://www.investorcompensation.ie). The ICCL will regularly review the appropriateness of the policy and make necessary amendments as deemed appropriate by the Board.

The amount of annual levy to be paid in any year to the ICCL is calculated by the participant firm on a self-assessment basis by reference to the agreed funding categories and number of eligible clients, and, authorisation under the CAR as appropriate, in the case of Fund A participant firms (refer to section 2.1 above) or income bands in the case of Fund B participant firms (refer to section 2.2 above).

Firms may submit a request for a refund of overpaid levies on the basis that they have overstated eligible client numbers or income. The ICCL will process such refund requests where they are made within the same funding year as the relevant annual levy fell due for payment. Refunds requests in respect of previous years will only be considered in exceptional circumstances.

The main justifications for this approach are:

- The ICCL is acting on trust and in good faith on information supplied to it by professional firms with regard to their eligible client numbers or income.
- The ICCL predicates its funding position and requirements on this data and pays out compensation in failure cases on the basis that those funds are available to it.
- Once levies are credited to a particular Fund, the Act (section 19) places restrictions on the extent to which payments, other than compensation payments, may be made from such funds.

### **3.9. *Revocation of Authorisation***

Firms that have paid the annual levy in full and whose authorisation is revoked during the ICCL's funding year (i.e. subsequent to the ICCL's annual billing process which takes place in August each year), will be invited to claim a pro-rata refund of the annual levy they have paid.

The refund will be calculated on a pro-rata basis for each calendar month during which the firm was no longer authorised. On receipt of notification from the Bank that the firm is no longer authorised, the ICCL will initiate the refund request. The refund application must be received within six months of:

- The date of revocation of the firm, or,
- The date the application form is issued by the ICCL, whichever is the later.

### **3.10. *A Branch joining the Investor Compensation Scheme of a Host Member State***

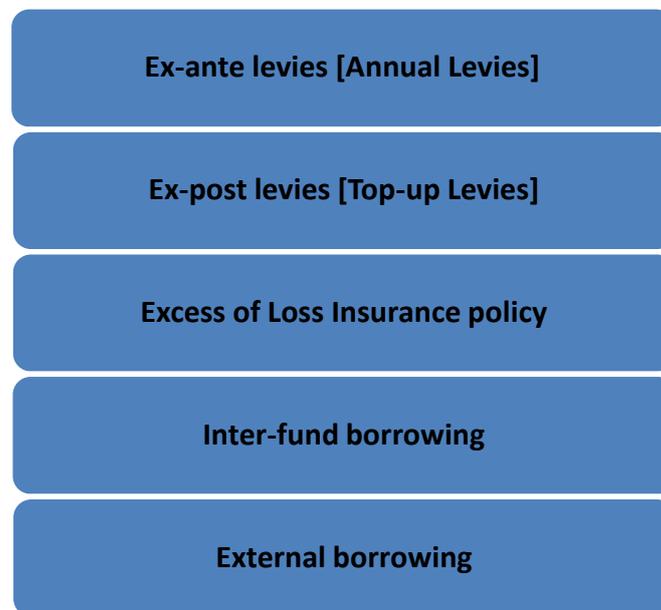
Investment firms should note that, in accordance with the requirements of the ICSD (Article 7, para. 1), an investment firm which establishes a branch in a host Member State may join the local investor compensation scheme where the level or scope of that scheme exceeds the minimum provided in the investment firm's home Member State. An investment firm seeking to avail of this provision should inform the ICCL in advance as failure to do so may delay the application process preventing the firm from commencing trading in the host Member State.

## 4 Appendices

### 4.1. *Appendix 1 – Funding of Compensation Payments – Cascade Model*

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):



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.

The implementation sequence of the individual elements of the cascade model is determined by the Board depending on circumstances prevailing at the time of the failure.

## Recent Use of the Cascade Model

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.

The decision of the Board not to require additional ex-post levies was based on the following criteria:

- Sufficient reserves were available to meet the Excess of Loss Insurance policy excess of €15 million;
- No new failures had arisen that would have given rise to significant claims for compensation;
- The timely restoration of the Fund A reserves.

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

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.

Cascade mix has been determined 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.

## Reserved Funds of Fund A and Fund B

**Table 5 - Fund A: Projected Fund Reserve levels**

<b>Year</b>	<b>Levies (€ million)</b>	<b>Interest Income (€ million)</b>	<b>Fund Reserve (€ million)</b>
2015*	4.232	0.95	20.865
2016	4.945	0.20	24.726
2017	4.618	0.00	28.118
2018	4.630	0.00	31.435
2019	4.519	0.00	34.623

\* reference made to actual year-end fund reserve

**Table 6 - Fund B Projected Fund Reserve levels**

<b>Year</b>	<b>Levies (€ million)</b>	<b>Interest Income (€ million)</b>	<b>Fund Reserve (€ million)</b>
2015*	1.437	0.77	22.390
2016	1.423	0.20	23.278
2017	1.324	0.00	24.008
2018	1.305	0.00	24.740
2019	0.624	0.00	24.787

\* reference made to actual year-end fund reserve

### **Ex-post Levy Payments**

It is generally agreed that the Scheme's ability to meet its payment obligations should be funded mainly by ex-ante annual levies, supplemented as appropriate by the Excess of Loss Insurance policy and borrowings, such that the liability burden can be smoothed over time.

In the event of the failure of a firm which gives rise to a very substantial liability to the Company and which would place an unacceptable strain on the other elements of the Cascade Model, as described above, the ICCL may have no practical alternative other than to require firms to pay an additional ex-post levy payment.

The arrangements which will apply in the event of an ex-post levy being required are as follows:

- Should the default be attributable to a participating firm with declared eligible clients in Fund A, additional funding will be obtained through an ex-post levy and/or increases in the annual levies payable by participating firms in Fund A with eligible clients pro-rata to their annual levy for the previous year.
- Should the default be attributable to a participating firm in Fund A, which had declared no eligible clients, additional funding will be obtained through an ex-post levy and/or increases in the annual levies payable by all participating firms in Fund A, including firms with no eligible clients, pro-rata to their annual levy for the previous year.
- Should the default be attributable to a participating firm in Fund B, additional funding will be obtained through an ex-post levy and/or increases in the annual levies payable by all participating firms in fund B pro-rata to their annual levy for the previous year.

In such a scenario the ICCL would seek to cap any ex-post levy to twice the annual levy rate. However, given the legislative obligations<sup>2</sup> placed upon it, 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.

Given its statutory obligations, the ICCL reserves the right to make alternative arrangements to those proposed above should the circumstances warrant it. Participant firms would be consulted if such circumstances were to arise.

### **Excess of Loss Insurance policy**

In October 2010, an Excess of Loss Insurance policy was successfully arranged through the Lloyds market which provided €50 million indemnity for Fund A and €10 million indemnity for Fund B in cases where the aggregate level of compensation on the relevant Fund exceeded €15 million in a policy year.

The Excess of Loss Insurance policy, which was first placed in October 2010, has been renewed annually. On 1 July 2015, 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.

Successfully negotiating and renewing the policies requires a significant undertaking from both the ICCL and a specialist Irish brokering team. The ICCL and the Broking Team compile extensive data covering participant firms and claims events annually, together with an actuarial assessment and a detailed analysis of the firms covered by the Scheme. The Excess of Loss Insurance policies are renewed annually.

The failure of CHC which is expected to lead to the first claim under the policy, is expected to cost the ICCL €15 million (anticipated claims compensation cost of €19.7 million less insurance recovery of €4.7 million from that Excess of Loss Insurance policy) based on the Administrator's latest estimates.

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<sup>2</sup> Section 22(3) of the Act requires the Company to ensure that it is in a position to meet any reasonably foreseeable obligations under the Act and that it maintains a sufficient balance in all funds maintained by it which will enable it to meet such obligations.

## **Inter-fund Borrowing**

In circumstances where the ICCL considers it necessary to make use of the inter-fund borrowing facility, the Board of the ICCL 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.

## **External Borrowing**

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<sup>3</sup> 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.

### State Guarantees for ICCL borrowing

- i) The Investor Compensation Act, 1998 (as amended), which governs the conduct of the ICCL, does not provide statutory State guarantee in relation to any borrowing of the ICCL. In discussions with the Department of Finance and the Central Bank, Article 86 (1) of the EC Treaty was highlighted as potentially prohibiting the granting of State guarantees to a public undertaking to underwrite commercial borrowings.

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<sup>3</sup> Subject to the approval of the Bank in accordance with S.13(1) of the Act .

- 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.

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.

## **4.2. Appendix 2 – Description of Funds and Participant Firm Categories**

At inception and following consultation with industry, the ICCL established two funds designated as Fund A and Fund B. The categories of firms which pay levies into each of these Funds are derived directly from the Bank's authorisations/registrations and are adapted, as appropriate, where the Bank's categorisation of firms changes.

### **Fund A**

Fund A is intended to meet claims from eligible investors of:

- Investment Firms authorised under the European Communities (Markets in Financial Instruments) Regulations 2007.
- Investment Firms authorised under Section 10 of the Investment Intermediaries Act, 1995 ["IIA"] that are not exempt under Section 2(5) of the Investor Compensation Act, 1998.
- Stockbrokers authorised under the European Communities (Markets in Financial Instruments) Regulations 2007.
- Credit Institutions authorised to provide investment business services.
- Certain certified persons who provide investment business services, which are similar to services provided by Fund A firms, in a manner which is incidental to their main professional activities.
- UCITS management companies, authorised to undertake Individual Portfolio Management Services<sup>4</sup>.
- AIF Managers, authorised to undertake Individual Portfolio Management Services<sup>5&6</sup>.

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<sup>4</sup> Individual Portfolio Management Services refers to the management of portfolios of investments and discretionary portfolio management services as well as non-core services such as investment advice, safekeeping and administration services.

<sup>5</sup> Article 12(2) of Directive 2011/61/EU – Alternative Investment Fund Managers Directive (AIFMD) – which has a transposition date of 22 July 2013, requires that for each AIFM, the authorisation of which also covers discretionary portfolio management services as referred to in Article 6(4)(a), shall be subject to the provisions of Directive 97/9/EC – Investor Compensation Directive for the services referred to in Article 6(4) of AIFMD.

<sup>6</sup> Individual Portfolio Management Services refers to the management of portfolios of investments and discretionary portfolio management services as well as non-core services such as investment advice, safekeeping and administration services, and receipt and transmission of orders in relation to financial instruments.

## **Fund B**

Fund B is intended to meet the claims of eligible investors of:

- Investment Intermediaries<sup>7</sup> authorised under the IIA.
- Insurance Intermediaries registered with the Central Bank of Ireland under the European Communities (Insurance Mediation) Regulations 2005.
- Certain certified persons who provide investment business services, which are similar to services provided by Fund B firms, in a manner which is incidental to their main professional activities.

## **Determination of appropriate Fund for levy purposes**

When establishing the correct fund to which a firm is required to pay a levy, the authorisation of the firm will take precedence over the registration of the firm. (e.g. An authorised MiFID investment firm that is also registered under the European Communities (Insurance Mediation) Regulations 2005 (the IMD Regulations), as an insurance intermediary, will be assessed as a Fund A firm for the purposes of levies to the Scheme.)

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<sup>7</sup> At the time of publication, the Central Bank of Ireland was in the process of updating the authorised status of firms previously recorded as “Authorised Advisor”, “Multi-agency Intermediary” and “Deemed-RAIP” to “Investment Intermediary”.

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