The Investor Compensation Company Limited

THE INVESTOR COMPENSATION COMPANY LIMITED

ARRANGEMENTS FOR THE FUNDING OF THE INVESTOR COMPENSATION SCHEME OPERATED BY ICCL

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1. Introduction

Following consultation with Representative Bodies and contributors in the course of 2006 as part of a review of the funding of the Investor Compensation Scheme, the Investor Compensation Company Limited (the ICCL), with the support of the Financial Regulator, has now decided on certain revisions to its current funding arrangements as set out in its document of May 2004[1].

The ICCL is making these revisions in furtherance of its principal statutory objective to maintain a financially sound Scheme which provides statutory levels of compensation to eligible investors of failed authorised investment firms and insurance intermediaries. It is furthermore doing so in ways which seek progressively to improve the actual and perceived equity of the contribution burden on contributor firms.

In arriving at its decisions on these changes, the Board of the ICCL, on this occasion as in the past, took particular account of the views expressed in the consultation process. However, it has had to steer a course through sometimes conflicting views on particular aspects. The Board, which is fortunate in having broad industry and consumer representation, has endeavoured, in so far as possible, to achieve a timely and workable balance on such issues.

2. Legislative Background

The legislative background to the Scheme is set out in detail in Appendix 1.

The Investor Compensation Act, 1998 (the Act) provides that authorised investment firms and insurance intermediaries must become members of an investor compensation scheme[2] and contribute to its funding. Following industry consultation, the first detailed funding arrangements were published in 1999. Subsequent consultation processes were carried out in 2001 and 2003, which resulted in certain revisions to the classifications of contributors and to rates of contribution.

The Act also provides that compensation shall be paid to eligible investors (as defined in the Act) to the extent of 90% of an investor's net loss, as defined in the Act, or 20,000, whichever is the lesser. The right of eligible investors to claim compensation is triggered by

(a) a determination of the supervisory authority that an investment firm is unable, and has no reasonably foreseeable opportunity of being able, to meet its obligations arising from claims by clients, or

[1] The Investor Compensation Company Limited: Arrangements for Funding of the Investor Compensation Scheme operated by ICCL – May 2004.

[2] Such scheme will be one operated either by the Investor Compensation Company Limited or by an approved professional body for certified persons which is approved by the Financial Regulator under the Investor Compensation Act, 1998.

(b) a court ruling[3] made for reasons which are directly related to the financial circumstances of the investment firm which has the effect that clients of the firm are precluded for the time being from pursuing claims against the firm in relation to money or investment instruments owed to or belonging to them in connection with the provision of investment business services by the investment firm.

The Financial Regulator is the supervisory authority for the purpose of the Act. The Financial Regulator is a constituent part of the Central Bank and Financial Services Authority of Ireland (CBFSAI), which was established following the enactment of the Central Bank and Financial Services Authority of Ireland Act, 2003 on 1 May 2003.

The ICCL, having consulted with the Financial Regulator, sets the contributions to be paid by authorised investment firms to the fund(s) maintained by the ICCL and determines the appropriate size of the fund(s). The ICCL is required to "endeavour to ensure" that it is in a position to meet any reasonably foreseeable obligation under the Act and that it maintains a sufficient balance in the funds to enable it to meet such obligations. The ICCL is also obliged to have regard to the amount standing to the credit of the funds it maintains and the funding capacity of those authorised investment firms which are obliged to make contributions to the funds.

The Act also provides that the costs of administration and management of the ICCL shall be defrayed from the ICCL's resources, including the contributions paid to the funds maintained by the ICCL.

The ICCL's obligations to eligible clients of authorised investment firms under the Act date from 1 August 1998, i.e. the date the Investor Compensation Act came into law. However, the ICCL's obligations may extend to eligible clients who transacted business prior to this date under the provisions of the Investor Compensation Directive (the Directive). The Administrator appointed by the court or the Financial Regulator to manage the failed firm decides the eligibility of clients under the Act and the Directive.

3. Funding Year

Currently, the ICCL's funding year is 1 August to 31 July with the ninth funding year ending on 31 July 2007. The ICCL's funding year will continue to run from 1 August to 31 July. However, as the ICCL is engaged in ongoing discussions with the Financial Regulator to develop a co-ordinated billing and collections system for both the Financial Regulator levy and the ICCL contribution, the ICCL's funding year may change in the future.

[3] Other than a decision under the Companies Acts appointing an examiner or provisional liquidator.

4. Description of Funds and Contributor Categories

At inception, the ICCL, following consultation with industry, established two funds designated as Fund A and Fund B. The categories of firms which contribute to each of these Funds are derived directly from the Financial Regulator's authorisations and are adapted, as appropriate, where the Financial Regulator's categories of firms change. In this context, we will pay close attention to further developments arising from the implementation of the Insurance Mediation Directive and the Markets in Financial Instruments Directive.

Fund A

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

a) Investment Firms authorised under the European Communities (Markets in Financial Instruments) Regulation 2007;
b) 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;
c) Stockbrokers authorised under the European Communities (Markets in Financial Instruments) Regulation 2007[4];
d) Credit Institutions authorised to provide investment business services;
e) 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; and
f) UCITS management companies, authorised to undertake Individual Portfolio Management Services[5].

Fund B

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

a) Authorised Advisors authorised under the Investment Intermediaries Act, 1995;
b) Multi-Agency Intermediaries authorised under the Investment Intermediaries Act, 1995;
c) Insurance Intermediaries required to register with the Financial Regulator under the European Communities (Insurance Mediation) Regulations 2005[6];
d) 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.

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[4] At the time of publishing these Funding Arrangements, Stockbrokers were authorised under the Stock Exchange Act, 1995 (SEA). However, the Department of Finance was in the process of repealing the SEA.

[5] 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.

[6] At the time of publishing these Funding Arrangements, the Department of Finance was in the process of revising the 2005 Regulations. In that context, any reference in these Funding Arrangements to the 2005 Regulations will be superseded by the revised Regulations when they come into effect.

Determination of appropriate Fund for contribution purposes

(i) Fund A firms which are also registered under the Insurance Mediation Directive

Arising from the implementation of the European Communities (Insurance Mediation) Regulations 2005 (the Regulations) and the consequential impact of this on the Investment Intermediaries Act, 1995 (the IIA), a small number of firms are required to be authorised under the IIA in respect of their investment activities and to be separately registered under the Regulations in respect of their insurance mediation activities. Therefore, under the contributor categories set out above, such firms may simultaneously fall under the definition of firms which contribute to both Fund A and Fund B.

In such circumstances, the firm will only be liable to contribute to one Fund, namely Fund A. (Guidelines for assessing Fund A contributions are outlined in Appendix 4.)

Therefore, a firm, which is authorised under the IIA as a Fund A category firm and is also registered under the Regulations, will contribute to Fund A in respect of all its authorised and registered activities.

(ii) Fund B firms which are also registered under European Communities (Insurance Mediation) Regulations 2005

A firm, which is authorised under the IIA as a Fund B category firm and is also registered under the Regulation, will contribute to Fund B in respect of all its authorised and registered activities.

5. Responsibilities of Product Producers

In the event of a default by an investment product intermediary, and where the ICCL pays compensation to the eligible investors of that intermediary, a product producer from which the investment product intermediary held a valid written appointment is obliged to make payment to the ICCL. This payment is in respect of the same proportion of an eligible investor's compensatable loss as the money or investment instruments entrusted by that investor for transmission to that product producer, bears to that investor's net loss.

6. Section 25 Option for Certified Bodies

Certain approved professional bodies may apply to the Financial Regulator, under Section 25 of the Act, for approval of proposals for the establishment of an investor compensation scheme for a specified category or categories of certified person. Certified persons are obliged to participate in the scheme operated by the ICCL, until such time as an investor compensation scheme is approved under Section 25 in respect of their operation. As at the date of

publication of this document, no such scheme has been approved by the Financial Regulator.

7. Funding Targets and Projections

Background
When the Scheme was established in 1998 an overall target funding level of 10.16 million, was set, to be achieved by the end of a five year period, which was to be divided equally between Fund A and Fund B.

Annual contributions for Fund A consisted of a combination of a flat rate contribution and a variable rate contribution. The appropriate contribution rates were based on the number of eligible clients managed by the firm with reference to the ICCL's eligible client band structure. Following the 2001 consultation process, seven eligible client bands applied. The number of bands increased to eight following the implementation of the ICCL's 2004 Funding Arrangements.

Annual contributions for Fund B were based on two flat rates depending upon the type of business undertaken. Following the 2001 consultation process, in order to introduce an element of progressiveness, rates of contributions by certain Fund B contributors were related to income levels. Five income bands were established at that time. Following the implementation of the ICCL's 2004 Funding Arrangements, this number increased to eight in order to introduce further equity in the rates applied to contributing firms.

Provision was also made for additional "top up" funding in the event that any claim or claims on either Fund required it.

Impact of Claims on Funding Targets
Since the establishment of the Investor Compensation Scheme there have been two significant determinations made under the Act resulting in claims for compensation being made. Both relate to Stockbrokers covered by Fund A. There was one determination made under the Act in relation to Fund B resulting in a relatively modest amount of money (20,000) being paid.

The first claim on Fund A, in February 1999, arose out of the insolvency of Money Markets International Stockbrokers Limited (MMI) and has involved compensation payments, to the end of July 2006, of 772,294 out of Fund A. On the basis of estimates received from the Administrator for MMI in relation to the remaining outstanding claims, of which there are only three, it is expected that the total compensation payment would be approximately 775,000. The ICCL has paid a further 255,000 to date in relation to the costs and expenses of the Administrator.

The second claim on Fund A arose from the insolvency of W&R Morrogh Stockbrokers (Morrogh) and is, as yet, not fully resolved. At end-July 2006, the total estimate of compensation payable by the ICCL in this case was 10.3 million, which had been provided for in prior year accounts. 2,372 or

90% of claims had been dealt with in part or in full and compensation payments of some €7.1 million had been made.

Top-Up of Fund A

In the light of the substantial claim arising from the insolvency of Morrogh, the Board of the ICCL implemented a scheme for "top up" funding for Fund A in 2001 to ensure that, in so far as possible, it would be in a position to meet its obligations to pay compensation to claimants in accordance with the Act. Fund A firms with eligible clients were required to contribute some €5 million to the Morrogh top up. Stockbrokers contributed 50 per cent of the requirement with the other Fund A firms contributing the balance. It was determined that the "top up" payments would be phased over three years. Thus, in addition to the normal annual payments, additional "top up" payments to Fund A were invoiced in July 2002, April 2003 and April 2004.

General Adequacy of Funds

The claims history experienced by the Scheme to date has demonstrated that funds can be quickly absorbed when claims arise (both in payment of compensation and in meeting costs associated with the claims). Therefore, the Board of the ICCL continues to believe that neither Fund A nor Fund B could be regarded as adequately funded at present. As indicated in the November 2006 Consultation Paper, it is felt that the continued payment of annual contributions is the best way of building up the levels of funds available. The Board has agreed revised rates and bands of contribution which will apply with effect from the funding year commencing 1 August 2007. These are set out in Section 8 and appendices 2 and 3 of this document.

The following Tables set out the funding levels of Fund A and Fund B over the life of the scheme and the projected funding levels for the three-year funding cycle commencing 1 August 2007. The projected funding levels have been determined on the bases that (i) the revised contribution rates will apply during the relevant period, and (ii) no failures arise which would give rise to compensation payouts.

(i) Fund A

Year	Contributions/Interest Income € million	Top Up € million	Fund Reserve € million
2006 – actual	2.43	Nil	3.98
2007 – estimated	2.60	Nil	6.08
2008 – projected[7]	3.02	Nil	8.60
2009 – projected[7]	3.57	Nil	11.67
2010 – projected[7]	4.22	Nil	15.39

(ii) Fund B

Year	Contributions/Interest Income € million	Top Up € million	Fund Reserve € million
2006 – actual	1.85	Nil	9.60
2007 – estimated	1.90	Nil	11.00
2008 – projected[7]	1.79	Nil	12.30
2009 – projected[7]	1.87	Nil	13.67
2010 – projected[7]	1.95	Nil	15.12

[7] For the purposes of the projected figures for 2008, 2009 and 2010, interest income has been calculated at a conservative rate of 3% on the total reserves in the individual Funds. Administration costs have been factored in to arrive at the relevant Fund reserve figures presented in the final column of the Table.

8. Contributions by Participating Firms

Fund A

Rates of Contribution

The new annual contribution rates for Fund A firms for the year 1 August 2007 to 31 July 2008 are set out in Appendix 2. The rates shown in Appendix 2 will increase by 3 per cent for all firms with zero eligible clients and by 20 per cent for all other firms in each of the financial years ending 31 July 2009 and 2010.

Basis of Contribution

1. Fixed rate

All authorised Fund A firms are liable to pay a fixed rate of contribution. Reduced flat rates apply to firms with no, or fewer than 2,500, eligible clients.

2. Variable rate

All firms with eligible clients are also liable to pay a variable rate of contribution which is determined by the band of eligible client numbers into which they fall. No changes have been made to the number of bands, which had been expanded from seven to eight in the ICCL's 2004 Funding Arrangements document. The Board continues to believe that the use of eligible clients as a proxy for the potential level of exposure of participants remains the best method of allocating contributions for Fund A. However, other risk factors also affect exposure and the Board has agreed to commission research with a view to ascertaining if it is feasible to develop a more robust risk-based model of assessment.

3. Marginal relief

Marginal relief, which was introduced, with effect from the start of the financial year commencing 1 August 2004, has also been retained. The ICCL introduced this relief for participants who fall into the next highest band in circumstances where the number of their eligible clients that cause them to fall into that higher band is less than 10 per cent of the total number of eligible clients specified for the relevant band. Firms that fall within the marginal relief area of a band will not have to pay the higher contribution for the first year. However, firms that continue within the marginal relief area of a band in subsequent years must pay the higher contribution for subsequent years.

Such marginal relief must be availed of in the year in which it first arises. Firms may avail of marginal relief on more than one occasion.

These contribution rates are applicable unless unforeseen circumstances arise.

Determination of Appropriate Variable Rate Band for Fund A Firms

In determining which variable rate band applies to them, and, consequently, which contribution rate is payable by them, participating firms should make an annual assessment of the numbers of eligible clients, including execution-only clients, with whom they have done business in their previous financial year.

Guidelines for the Calculation of Eligible Client Numbers when Assessing the Appropriate Contribution Rate

The ICCL has updated its guidelines for the assessment of eligible client numbers and these are available on the 'Funding the Scheme' section of the ICCL's website in the form of 'Questions & Answers' (www.investorcompensation.ie). These guidelines are also included in Appendix 4 of this document.

The ICCL will continue to be available to give guidance to participants where there is any question of doubt or uncertainty.

There are certain firms that are authorised under Section 10 of the Investment Intermediaries Act, 1995 and which are required to contribute to the Scheme even though they have no eligible clients at present – although they could have such clients in the future. The nature of the authorisation of such firms brings them within the Directive and the Act. As a result of this, the ICCL has devised arrangements where such firms pay a flat rate fee. Such firms are not subject to any "top up" arrangements unless the failure arises from a firm reporting that it has no eligible clients.

Verification of Eligible Client Numbers

All Fund A firms will be required to confirm their number of eligible clients when contributing each year. The ICCL advises the Financial Regulator of the level of eligible clients as confirmed by Fund A firms. These figures may be subject to verification by the Financial Regulator as part of its ongoing supervisory process.

Fund B

Rates of Contribution

The new annual contribution rates for Fund B firms are set out in Appendix 3 for each of the three funding years which commence 1 August 2007, 2008 and 2009.

These contribution rates are applicable unless unforeseen circumstances arise.

Basis of Contribution

The Board of the ICCL believes that the continued building up of reserves in Fund B must be its objective for the next three-year period.

The previous contribution categories for Fund B intermediaries were Authorised Advisors, Multi Agency Intermediaries which were RAIPIs (MAI RAIPIs), Tied Agents and Multi Agency Intermediaries that were not RAIPIs (MAI non-RAIPIs). These contribution categories were derived directly from the Financial Regulator's authorisations which were notified to the ICCL.

As indicated by the ICCL, any changes which the Financial Regulator might introduce, in the future, in relation to the authorisation categories for intermediaries could have implications for the way in which the ICCL treated these entities for contribution purposes. In this context, following the Financial Regulator's implementation of the European Communities (Insurance Mediation) Regulations 2005, the above categorisations of Fund B firms may be replaced by a single category under the heading 'insurance intermediaries'. Consequently, the ICCL has amended its contributor categorisations in Fund B accordingly. This process led to a review of the contribution rates applied to the two previous categories of intermediaries in Fund B in order to arrive at a single contribution rate structure for all intermediaries going forward. This has, of necessity, resulted in relatively substantial increases for some intermediaries.

The single contribution rate structure will continue to consist of the eight income bands introduced in the 2004 Funding Arrangements. The total income, from investment business and insurance business, determines the band into which an intermediary falls and, consequently, the level at which the intermediary contributes to the ICCL. The Board has introduced further proportionality into the rates and intends to continue to ensure that an appropriate rate structure is applied. In this context, the Board intends to commission research with a view to ascertaining if it is feasible to develop a risk-based model of assessment.

9. Invoicing of Annual Contributions

Invoices for annual contributions will be issued in August each year i.e. the first month of the ICCL's financial year. Invoices issued by the ICCL are payable within 35 days. Contributors that fail to contribute in a timely manner will be reported to the Financial Regulator, under the Act, for failure to comply with their obligations. Failure to pay on time will result in the firm being assessed for interest on the outstanding amounts. Under Section 21(4) of the Act, an investment firm which does not comply with its obligations to pay its contribution to the Funds maintained by the ICCL may be liable to pay interest of 1.25 per cent per month to the ICCL on all or any part of a contribution which has not been paid by the specified date(s). Interest is calculated from the date upon which the contribution becomes due.

In 2004 the ICCL put forward its proposal to develop a co-ordinated billing and collections system for both the Financial Regulator levy and the ICCL contribution. While this has not yet been achieved, the development of an even more efficient levy collection system, preferably by joint collection with the Financial Regulator and / or the Financial Ombudsman, remains a strategic goal for the ICCL. This may give rise to some changes to the manner in which ICCL invoices are currently issued, and if so, contributors will be notified in a timely manner.

10. Annual Adjustment for Inflation

The Board has always reserved the right to adjust contribution rates in line with inflation. The contribution rates set out in Appendix 2 and 3 of this document take account of expected inflation over the three-year period commencing 1 August 2007.

11. Contributions by Newly Authorised / Registered Firms / Intermediaries

Investment firms and insurance intermediaries, which are authorised during the ICCL's funding year and subsequent to the ICCL's annual billing process (which takes place in August each year), will be required to pay the annual contribution in full.

As eligible client numbers or turnover figures will not be available at the time of raising the first invoice, the contribution rate for the first year may be agreed on a case by case basis with each firm.

12. Contributions by Firms whose Authorisation changes during the Funding Year

There will be no adjustment in contributions to reflect any changes in authorisation (including revocation) which occur during the funding year. The new rate of contribution will apply from the following funding year on the basis of the firm's authorisation status at that time.

13. Publication of Contributors

The ICCL's website contains a list of entities that fall within the scope of the Scheme at 31 July 2006. The ICCL updates the list of contributors annually after publication of its Annual Report. It should be noted that this is a static list of contributors to the scheme in a particular year and is not to be viewed as confirmation that a firm either is currently authorised or currently registered under the European Communities (Insurance Mediation) Regulations 2005.

The ICCL's database of contributors is updated on the basis of information supplied to the ICCL by the Financial Regulator and certain other bodies (e.g. Accountancy Bodies). It is not possible for the ICCL's database to be 'real-time' due to the fact that the lists, from which the ICCL's database is compiled, are maintained separately by these other bodies.

The Financial Regulator maintains the Register of Regulated Firms as well as the Register of Insurance Intermediaries on its website www.financialregulator.ie. In addition, the authorisation status of a regulated or registered firm may be checked by contacting the Financial Regulator by email at registers@financialregulator.ie or by contacting the lo-call telephone line: 1890-882090.

14. Contribution Obligation on Investment Firms

Section 21 of the Act provides that authorised investment firms and insurance intermediaries shall pay to the ICCL such contribution to the fund(s) as the ICCL may specify from time to time.

As set out previously, the Act also provides that, where an investment firm does not comply with its obligations under Section 21, the firm shall be liable to pay interest to the ICCL on all or any part of a contribution which has not been paid by the date or dates specified by the ICCL at a rate of 1.25 per cent per month (or part of a month) on and from the date on which the contribution becomes due or such other amount of interest as may be prescribed by the Minister for Finance.

Other consequences of failure by investment firms to comply with their obligations under Section 21 are set out in Sections 27 and 28 of the Act. Under the Act, the Financial Regulator may issue a direction requiring the firm to comply with its obligations and failure to comply with this direction could result in the firm being prohibited from engaging in investment or insurance business.

15. Handling of Claims on Funds

The ICCL proposes, without prejudice, that in the event of a determination or ruling, as described in Appendix 1, affecting an authorised investment firm or insurance intermediary, claims would be handled through some or all of the following methods:

- Payments would be made out of the reserves built up in Fund A or Fund B, as appropriate.

- Under Section 19 of the Act, inter-fund borrowing is permitted as stipulated. The Act does not prescribe a limit or a rate of interest which shall apply to such borrowings. The ICCL will determine the appropriate rate of interest applicable at the time that such borrowing occurs and will take account of the lending Fund's potential loss in

revenue in relation to amounts borrowed. As a guideline, borrowing should be up to a maximum of one third of the Funds in total, with a repayment schedule of not more than three years. As prescribed by Section 19(7) of the Act, the ICCL must consult with the Financial Regulator regarding any inter-fund borrowing.

- Utilisation may be made of borrowing facilities arranged under the ICCL's statutory borrowing powers. As prescribed by Section 13(1) of the Act, the Financial Regulator must approve any borrowing.

16. Top-Up Funding in the event of a Major Default

Contributors have expressed a wish that the Scheme's ability to meet its payment obligations be funded mainly by annual contributions, supplemented as appropriate by borrowings and that the liability burden be smoothed over time. This is a particular concern in the context of the small number of firms with eligible clients in Fund A. Contributors wished to avoid open-ended special top-up levies in the event of significant claims arising.

The Board recognises these legitimate concerns of contributors and the continued building of the Scheme's reserves is in response to this concern. The ICCL sought to address this issue as part of the work of the Morrogh Working Group established by the Department of Finance. The Morrogh Working Group report acknowledged the significant difficulties for the ICCL in gaining access to 'other borrowing facilities', e.g. borrowing from commercial banking institutions, from the Deposit Guarantee Scheme (DGS), etc. These difficulties could be summarised as follows:

Commercial Borrowing
Under current legislation, the ICCL is permitted to borrow[8] from commercial lending institutions. Such borrowing would be required in extreme circumstances where compensation payments could not be met through a combination of reserves, top-up contributions or inter-fund borrowing. Although commercial lenders have indicated that they would be prepared to lend to the ICCL, they have confirmed that they would require appropriate repayment assurances in the form of security[9], other than that derived from future income streams from contributors. (See 'State Guarantees' below.)

Borrowing from the Deposit Guarantee Scheme
The Board of the ICCL noted that some comparable investor compensation schemes, operated in other European Union (EU) Member States, are run and operated in conjunction with the relevant deposit protection scheme. The advantages appear to be efficiencies in the cost and administrative structures and consistency in the manner in which the whole compensation regime is operated. In some cases, it

[8] Subject to the approval of the Financial Regulator.
[9] Such as a State guarantee.

is permissible for a loan (up to specified limits) to be made between schemes on commercial arms' length terms.

However, under Article 101 of the European Communities (EC) Treaty, National Central Banks within the European System of Central Banks are prohibited from extending "overdraft facilities or any other type of credit facility in favour of …central governments…other public authorities, other bodies governed by public law, or public undertakings of Member States…." The Central Bank has indicated that it is possible that the ICCL could be defined either as a "public undertaking" or "a body governed by public law" and as such, any proposal to set up a credit facility between the Deposit Guarantee Scheme and the Investor Compensation Scheme could be considered by the European Central Bank as being ultra vires.

State Guarantees

The Investor Compensation Act, 1998, which governs the conduct of the ICCL, does not provide statutory authority for State guarantees. Furthermore, Article 86(1) of the EC Treaty prohibits the granting of State guarantees to a public undertaking to underwrite commercial borrowings. It would appear that any measure involving State support for the Investor Compensation Scheme would require EU Commission approval.

In light of these difficulties, the Morrogh Working Group report recommended that:

- in relation to commercial borrowing, the ICCL and the Department of Finance should further examine the international experience regarding the provision of repayment assurances sought by commercial lenders;
- in relation to borrowing from the DGS, the range of legislative, risk management and operational issues should be brought to the attention of the EU Commission; and
- in relation to State support for investor compensation, the legal position should also be brought to the attention of the EU Commission.

The ICCL considered that none of the above recommendations offered any real solution in relation to the core issue raised by the ICCL, namely, the need to put in place some form of last-resort borrowing arrangement or State guarantee.

The ICCL is 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 contributors in extreme circumstances. In this context, the ICCL is in discussion with the Financial Regulator, the Central Bank and Financial Services Authority of Ireland and the Department of Finance regarding satisfactory, last-resort funding arrangements and issues relating to borrowing from the Deposit Guarantee Scheme. The ICCL has also met with members of the EU Commission in order to progress the relevant issues. Furthermore, the ICCL has written to a number of credit institutions to ascertain the level and terms attaching to any amounts which

each institution would be prepared to extend to the ICCL without a State guarantee.

If appropriate arrangements can be put in place, the ICCL will seek to introduce a cap on the amount that may be raised in any one year in the event of a top-up call on contributors. Such a cap would be equal to twice the annual contribution rate.

Pending the implementation of such a cap, the existing arrangements will continue to apply. In the event of top-up funding:

- Should the default be attributable to a participating firm with declared eligible clients in Fund A, additional funding will be obtained through a special levy and/or increases in the annual contributions payable by participating firms in Fund A with eligible clients pro-rata to their annual contribution for the previous year.

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

- Should the default be attributable to a participating firm in Fund B, additional funding will be obtained through a special levy and/or increases in the annual contributions payable by participating firms in Fund B pro-rata to their annual contribution for the previous year.

Given its statutory obligations, the ICCL reserves the right to make alternative arrangements to those proposed above should the circumstances warrant it. Contributors will be consulted should such circumstances arise.

17. Procedures for making Compensation Payments to Eligible Investors

The procedures to be followed in relation to the payment of compensation are laid down in the Act. The following is a broad summary.

After the Financial Regulator has made a determination, or a court has made a ruling as described in Appendix 1 of this document, the ICCL is required to inform clients of the investment firm concerned of the determination or ruling and invite applications for compensation by a date which shall not be less than five months from the date of the determination or ruling.

The ICCL is also required to publish notices to the above effect in any of the newspapers circulating in the State or elsewhere or in Iris Oifigiúil.

Subsequent to a determination, the Financial Regulator may appoint an administrator to the investment firm, or, in the case of a liquidation or

bankruptcy, the liquidator or official assignee appointed by the court will be the administrator. The administrator shall give to the ICCL and to the Financial Regulator, as soon as is practicable, the names of eligible investors and a statement of the net loss of each such client. The ICCL is then required to make payment to those eligible investors. This has to be done as soon as practicable and, at the latest, within three months of receipt of the statement of net loss.
A client may appeal to the Courts against any refusal to make a payment or against the amount of any payment made.

With regard to the treatment of late claims, (claims which are received by the ICCL after the five month deadline), the ICCL operates within the provisions of the Directive and the Act.

> Article 9 of the Directive states:
> "*The fact that that*[10] *period has expired may not, however, be invoked by the scheme to deny cover to an investor who has been unable to assert his right to compensation in time*."
>
> Section 32(2) of the Investor Compensation Act, 1998 states:
> "*Where the supervisory authority is satisfied that an investor was unable for good reason to make an application for a payment under Section 34 within the period of time stipulated by the Company or compensation scheme, the supervisory authority shall direct the Company or compensation scheme to treat the application as if it were made within the period of time stipulated.*"

18. Subrogation

Under Section 35 of the Act, where the ICCL has paid compensation to a claimant, the ICCL shall be subrogated to the rights of that claimant in the liquidation proceedings for the amount of the compensation paid. This means that the ICCL steps into the shoes of the claimant in the liquidation proceedings and after compensating the claimant, awaits the payment of a dividend, if any, from the liquidation.

The Board of the ICCL will take a balanced approach bearing in mind the interests of claimants and contributors when assessing whether the ICCL will take any action to realise value under its subrogated position.

The Investor Compensation Company Limited
June 2007

[10] i.e. the period fixed during which investors shall be required to submit their claims.

APPENDIX 1

LEGISLATIVE BACKGROUND[11]

In March 1997 the European Council enacted a directive in relation to the establishment of investor compensation schemes in Member States. This directive, Council Directive 97/9/EC, is known as the Investor Compensation Scheme Directive (the Directive) and was seen as an integral part of the framework for the establishment of a single market in financial services.

The Directive had its genesis in another key directive, Council Directive 93/22/EC on investment services in the securities field, known as the Investment Services Directive. The Investment Services Directive laid down certain regulatory and prudential rules governing investment firms throughout the EU. These rules were aimed at protecting investors' money and securities. The Investment Services Directive did not, however, offer any protection to investors in circumstances where fraud or insolvency resulted in the inability of an investment firm to return securities or money to investors. The purpose of the Investor Compensation Directive is to provide a minimum level of protection for investors in these circumstances.

The Investor Compensation Directive applies to all investment firms (including Credit Institutions authorised to provide investment services) and is modelled on Council Directive 94/19/EU, known as the Deposit Guarantee Scheme Directive. The latter directive aims to give depositors a minimum level of compensation where a Credit Institution becomes insolvent.

The Investor Compensation Directive lays down certain basic requirements for investor compensation schemes in order to provide a harmonised minimum level of investor protection across the community. It is left to each individual Member State to implement an appropriate scheme and it is also left to each Member State to determine the most appropriate way of organising and financing such schemes.

Thus, the manner in which Member States have interpreted and applied the Directive varies quite considerably.

In Ireland, the Directive was given effect on 1 August 1998 through the introduction of the Investor Compensation Act, 1998. Under the Act, the ICCL was established as a company limited by guarantee. The number of directors of the ICCL is prescribed by the Minister for Finance. The Chairperson and Deputy Chairperson of the Board are appointed by the Governor of the Central Bank & Financial Services Authority of Ireland. The ten other directors represent either the interests of consumers (5) or the interests of the financial services industry (5) and are prescribed by the Minister for Finance.

[11] This is not a legal interpretation of the Act and other legislation referred to in this document.

APPENDIX 2

FUND A

ANNUAL CONTRIBUTION RATES[12 / 13]

FOR THE PERIOD COMMENCING 1 AUGUST 2007

Firms with fewer than 2,500 eligible clients

Band	***Number of eligible clients***	***Flat Rate €***	***Variable Rate €***	***Total Rate €***
0	Zero	3,650	0	3,650
A	1 – 9	6,070	610	6,680
B	10 – 499	9,150	1,530	10,680
C	500 – 2,499	13,220	8,570	21,790

Firms with 2,500 or more eligible clients

Band	***Number of eligible clients***	***Flat Rate €***	***Variable Rate €***	***Total Rate €***
D	2,500 – 4,999	15,250	30,500	45,750
E	5,000 – 24,999	15,250	57,650	72,900
F	25,000 – 49,999	15,250	61,130	76,380
G	over 50,000	15,250	106,870	122,120

[12] These rates apply to Fund A contributions in respect of the ICCL's funding year commencing 1 August 2007. In the two subsequent funding years, i.e. commencing 1 August 2008 and 2009, year-on-year increases to these rates of 20% will be applied to firms in Band A to G inclusive while year-on-year increases of 3% will apply to Band 0. All rates may be subject to change within the relevant three-year period in the event, for example, of a major default situation arising.

[13] Marginal relief is available for participants who fall into the next highest band in circumstances where the number of their eligible clients that cause them to fall into that higher band is less than 10 per cent of the total number of eligible clients specified for the relevant band. Firms that fall within the marginal relief area of a band will not have to pay the higher contribution for the first year. However, firms that continue within the marginal relief area of a band in subsequent years must pay the higher contribution for subsequent years. Such marginal relief must be availed of in the year in which it first arises. Firms may avail of marginal relief on more than one occasion.

A P P E N D I X 3

FUND B

ANNUAL CONTRIBUTION RATES

FOR EACH OF THE THREE FUNDING YEARS COMMENCING

1 AUGUST 2007, 2008 AND 2009

Level	***Income band €***	***2007/08 Rate €***	***2008/09 Rate €***	***2009/10 Rate €***
1	Up to €75,000	300	300	300
2	€75,001 – €150,000	350	350	350
3	€150,001 – €700,000	550	550	550
4	€700,001 – €1.5m	950	950	950
5	€1,500,001 – €3m	1,650	1,650	1,650
6	€3,000,001 – €6m	3,000	3,000	3,000
7	€6,000,001 – €15m	4,350	5,475	6,600
8	Over €15m	7,150	8,975	10,800

APPENDIX 4

THE ASSESSMENT OF 'ELIGIBLE CLIENT' NUMBERS

FOR 'FUND A' FIRMS

QUESTIONS & ANSWERS

The contribution rate for firms in Fund A has, since the establishment of the ICCL, been based on broad bands so as to minimise the need for detailed logging and verification of eligible client numbers.

The following guidelines and answers to frequently asked questions are intended to clarify certain issues in respect of which clarification has been requested by participating firms. These guidelines may be varied or added to in the future, as the ICCL considers necessary or desirable.

The following fundamental principles should be used when assessing if a client should be counted as "an eligible client":

A. *the assessment should be done annually*
B. *the 'period of assessment' should be the firm's own financial year which ends prior to the ICCL's funding year (which currently runs from 1 August to 31 July each year) i.e. the firm's previous financial year*
C. *the firm should count all clients who at any stage throughout the firm's financial year met the definition of eligible investor[14] under Article 2 of the Investor Compensation Act, 1998 (the Act). This will include execution-only clients.*

The answers to the frequently asked questions outlined below should be of further assistance to firms in determining if clients of the firm should be counted as "eligible clients" for the purposes of calculating the appropriate annual contribution to the ICCL. The ICCL will continue to be available to give guidance to participants where there is any question of doubt or uncertainty.

[14] In effect, the ICCL's definition of "eligible client" is a person, not being an excluded investor, who has entrusted money or investment instruments to an investment firm in connection with the provision of an investment business service by the investment firm.

APPENDIX 4

1. **Should execution-only clients be included?**
   YES

2. **What is the timeframe for including clients?**
   You should include all clients, who at any stage throughout the firm's financial year met the definition of eligible investor under the Act. The relevant firm's financial year is the financial year which ends immediately prior to the ICCL's funding year.

   For example, when calculating the appropriate annual contribution to pay the ICCL for the funding year commencing 1 August 2007 and where the firm's financial year runs from January to December, then the correct reference period to use is the 1 January 2006 to 31 December 2006 financial year.

3. **Should a client who invests a once-off lump sum with a product producer via a firm be included?**
   This client should be included in "eligible client" numbers in the year in which the lump sum is invested.

4. **Should Business Expansion Scheme (BES) clients be included?**
   You should include eligible clients who have entered or exited the BES scheme during the year in question.

5. **Should a client who deals with more than one entity within a group be included?**
   YES. You should include clients for whom a receipt and transmission service was provided by one group entity even if the order was passed to another group entity for execution.

6. **Why should clients covered for Deposit Protection Scheme purposes also be included in eligible clients for the Investor Compensation Scheme?**
   The number of different and separate interactions which entities within a group have with an eligible investor increases the overall risk profile of the group. Therefore, firms must include all relevant interactions with clients for the purposes of calculating eligible clients for the Investor Compensation Scheme.

7. **How should clients investing in Tracker bonds be dealt with?**
   Tracker bonds are investment instruments for the purposes of the Investment Intermediaries Act, 1995 and, therefore, clients who deal in these instruments would be "eligible investors" should that firm fail. On this basis these clients must be included when determining the number of eligible clients of each firm.

   Tracker Deposit Investors should be included in eligible client numbers at initial investment and at maturity stages.

8. Should Professional investors be included in eligible client numbers?

Professional and institutional investors are specifically excluded under Article 2 of the Act.

A professional investor is a client of an investment firm whom the investment firm can show has sufficient and appropriate expertise in investment instruments to be categorized as a professional investor.

- If the firm categorises investors as Professional investors, then these can be excluded from eligible client numbers only in the following circumstances:
    a) If the firm writes to the professional investor and makes them fully aware of the consequences of being designated professional i.e. they are not entitled to participate in the Investor Compensation Scheme; and
    b) If the investor acknowledges in writing to the investment firm that they have been made aware of the consequences of being categorized as a professional investor; and
    c) The investor must have met the criteria to be treated as a professional investor for the entire financial year, i.e. this acknowledgement must be in place for all such investors either from inception or from the commencement of the firm's relevant financial year, whichever is earlier.

9. Should Bed and Breakfast clients be included?

Bed and Breakfast clients must be included in eligible clients unless the firm does not at any time hold/control cash or investment instruments.

10. Should accountants be included in eligible client numbers?

YES. An accountant should be included unless:

a) the accountant is acting as a provider of investment business services, or
b) the accountant is a professional investor as referred to in 8 above.

11. Should clients which have been referred by an accountant be included?

YES. Clients, which are referred by accountants to brokers, do qualify to be treated as eligible investors by those brokers and should be included in the assessment of eligible client numbers by those brokers.

12. Should solicitors be included in eligible client numbers?

YES. A solicitor should be included unless:

a) the solicitor is acting as a provider of investment business services, or
b) the solicitor is a professional investor as referred to in 8 above.

13. Should clients which have been referred by a solicitor be included?

YES. Clients, which are referred by solicitors to brokers, do qualify to be treated as eligible investors by those brokers and should be included in the assessment of eligible client numbers by those brokers.

14. How should investment clubs be treated?
A club is an association or grouping without legal personality within the meaning of Section 37(3) of the Act. Therefore, each investment club should be treated as a single eligible client.

15. Are pension funds excluded investors and therefore should they be excluded from eligible client numbers?
In general, Pension Funds meet the definition of professional and institutional investors as referred to in 8 above.

However, for the purposes of calculating eligible client numbers, Pension Funds of individuals operating a personal retirement account should be included.

16. How should members of Employee Share Ownership Plans (ESOPs) be treated when determining eligible client numbers?

Due to the variety of ESOP arrangements which exist, firms should adopt a 'principles' based approach when deciding how to calculate eligible client numbers in relation to their ESOP arrangements. Firms should count all ESOP members who at any stage throughout the firm's financial year met the definition of eligible investor[15] under Article 2 of the Investor Compensation Act, 1998 (the Act), including execution-only clients.

In general, ESOPs comprise three elements:
1. an Employee Share Ownership Trust (ESOT - a trust),
2. an Approved Profit Sharing Scheme (APSS – a trust), and,
3. Beneficiaries.

When shares are transferred from an ESOT to an APSS, participants become beneficially entitled to the shares with immediate effect irrespective of any procedural delays which might occur in effecting the transfer of shares from the APSS to beneficiaries.

Therefore, the following bases should be used in determining the number of eligible clients a firm has in relation to an ESOP - unless the clients would otherwise fall to be 'excluded investors' under Section 2(1) of the Investor Compensation Act, 1998:

a) The Trustee(s) of the ESOT should be counted as a single eligible client.
b) The APSS Trustee(s) should be treated as a single eligible client if the Trust holds shares which are not attributable to particular beneficiaries.
c) Each beneficiary, either to whom the APSS has transferred shares or on behalf of whom the Trustee(s) of the APSS holds shares, should be counted as individual eligible clients.

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[15] In effect, the ICCL's definition of "eligible client" is a person, not being an excluded investor, who has entrusted money or investment instruments to an investment firm in connection with the provision of an investment business service by the investment firm.

A key issue with regard to whether an ESOP, or in particular an ESOT / APSS, constitutes one eligible client or whether some, or all, of their individual members constitute eligible clients depends on whether each such ESOP / ESOT / APSS / individual member meets the definition of eligible investor. Any such determination should be undertaken on a case by case basis for any given ESOP situation.

17. How should the firm treat insurance-only clients?

Insurance-only clients should be included in a firm's calculation of eligible client numbers except where the insurance-only client falls under the definition of an 'excluded investor' under Section 2(1) of the Investor Compensation Act, 1998.

18. How should the firm treat clients to whom the firm provides an investment business service and an insurance business service?

An eligible client whom a firm identifies as both an investment and insurance client should be counted only once for the purpose of calculating the firm's eligible client numbers.

19. Will the Markets in Financial Instruments Directive (MiFID) have an impact on the calculation of eligible clients?

The ICCL's understanding is that MiFID offers clarification with regard to a firm's classification and treatment of its clients.

Essentially, a different standard of service can be provided to the three classifications of client (retail, professional and eligible counterparty). A firm's systems must be able to identify and classify each client and each client's transactions in order to ensure that the relevant rules are met.

For the purposes of MiFID, some clients may be classified as professional in respect of specific investment services or transactions or products and be classified as non-professional in respect of other investment services or transactions or products. ICCL rules in respect of professional investors are outlined under Question 8 earlier.

For the purpose of determining the appropriate contribution to the ICCL, a firm should include all eligible clients, even those who are only eligible in respect of a certain investment service, transaction or product. The fact that the client is classified as professional in respect of all other services, transactions or products would not exclude them from the calculation of eligible client numbers.

APPENDIX 5

SOME RELEVANT DEFINITIONS

Investor Compensation Act, 1998

"Authorised investment firm" means –

- (a) an authorised investment business firm, or
- (b) an authorised member firm, or
- (c) a credit institution the authorisation of which by the Bank under Directive No. 77/780/EEC of 12 December 1977 and Directive No. 89/646/EEC of 15 December 1989 extends to one or more investment services listed in section A of the Annex to the Investment Services Directive, or
- (d) an insurance intermediary.

"Client" means a person who has entrusted money or investment instruments to an investment firm in connection with the provision of investment business services by the investment firm.

"Eligible investor" means a person, not being an excluded investor, who is a client of an investment firm and has made an application for payment under section 34 of the Act.

"Excluded investor" means a client of an investment firm which has been the subject of a determination by the supervisory authority under section 31 or a ruling and, in relation to that investment firm, is -

- (a) a professional or institutional client, including:
  - i. an investment firm;
  - ii. an investment firm for the purposes of the Investment Services Directive;
  - iii. a credit institution as defined in Article 1 of Council Directive No. 77/780/EEC;
  - iv. a financial institution as defined in Article 1(6) of Council Directive No. 89/646/EEC of 15 December 1989;
  - v. an insurance undertaking;
  - vi. an undertaking for collective investment; or
  - vii. a pension or retirement fund, or
- (b) a local authority, or
- (c) a director, manager or personally liable member of the investment firm, a holder of at least 5 per cent of the capital of the investment firm, a person responsible for carrying out the statutory audit of the investment firm or a client with similar status in a group undertaking, or
- (d) a close relative or a third party acting on behalf of a client referred to in paragraph (c), or
- (e) another firm in a group undertaking, or
- (f) a client who has any responsibility for, or has taken advantage of, facts relating to the investment firm which gave rise to the firm's

financial difficulties or contributed to the deterioration of its financial situation, or

(g) a company which is of such a size that it is not permitted to draw up abridged balance sheets under Article 11 of the Fourth Council Directive No. 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies, or

(h) a client specified by the supervisory authority as an excluded investor in accordance with section 35(8).

"Investment firm" means –

(a) an authorised investment business firm or a person (being a person who was an authorised investment business firm) whose authorisation has been revoked,

(b) an authorised member firm or a person (being a person who was an authorised member firm) whose authorisation has been revoked,

(c) a credit institution licensed in the State or a credit institution whose authorisation by the Bank under Council Directive 77/780/EEC of 12 December 1977 as amended by Council Directive 89/646/EEC of 15 December 1989 as amended and extended from time to time extends to one or more of the investment services listed in the Annex to the Investment Services Directive or a credit institution whose authorisation by the Bank under Council Directive 77/780/EEC of 12 December 1977 as amended by Council Directive 89/646/EEC of 15 December 1989 as amended and extended from time to time has been revoked or a credit institution whose authorisation by the Bank under Council Directive 77/780/EEC of 12 December 1977 as amended by Council Directive 89/646/EEC of 15 December 1989 as amended and extended from time to time no longer extends to one or more of the investment services listed in the Annex to the Investment Services Directive, or

(d) an insurance intermediary or a person who was formerly an insurance intermediary.

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