The Investor Compensation Company Limited

Consultation Paper

Funding the Investor Compensation Scheme

Responses are invited by 7 December 2012

Issue date 31 October 2012

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1 Introduction

1 The Investor Compensation Company Limited ["ICCL"] has an established policy of periodically consulting with industry regarding the bases and rates for levying contributors to the Investor Compensation Scheme ["Scheme"]. This is the sixth consultation process.

2 The ICCL published its most recent Consultation Paper in October 2009. Arising from that consultation process, the ICCL made a number of submissions to the Department of Finance, the Central Bank of Ireland ["the Bank"] and the European Commission on issues that affect the operation and sustainability of the Scheme.

3 This present consultation process coincides with two recent failures, Custom House Capital Limited ["CHC"] in October 2011 and Bloxham in June 2012. The Board of the ICCL ["Board"] understands, from discussions held with the Bank and the Administrator of Bloxham, that the failure of Bloxham will not require the ICCL to make claims compensation payments. Each of these firms were contributors to Fund A of the Scheme. (Further detail is provided in paragraph 22 of this document)

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

5 The ICCL is very much aware of the impact on firms of the current economic and regulatory climate. The Board have sought to strike a balance between the legislative requirement to have adequate funds available to pay claims and the capacity of firms to fund the Scheme.

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

7 Respondents are requested to respond directly to each of the issues raised. Other comments or observations, relevant to the funding of the Scheme, may be returned under separate general headings. (A template to assist with the generation of focussed responses is provided at Section 5 - page 30)

8 Respondents are requested to note that the ICCL intends to publish all submissions received on the Funding Section of our website www.investorcompensation.ie – However, the ICCL reserves the right not to publish any content that it deems inappropriate or defamatory. Any confidential or commercially sensitive information which the respondents wish to supply in support of their views and which the respondents do not wish to be published should be provided separately and should be clearly marked “Not for publication”. The ICCL shall not be liable nor have any liability whatsoever in respect of any information provided by a respondent which is subsequently released by the ICCL whether marked “Not for publication” or otherwise or in respect of any consequential damage suffered as a result.

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

2 Key issues affecting the funding of the ICCL Scheme

(i) Background

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

11 The ICSD, under which the Scheme was established, states that the cost of financing investor compensation must, in principle, be borne by investment firms. In transposing the ICSD, the Irish Government placed an obligation on the ICCL to establish and maintain a fund or funds out of which compensation payments shall be made to clients of failed investment firms as expeditiously as possible and in accordance with the provisions set out in the Act. The ICSD is currently under review at EU level. Further detail concerning the review of the ICSD is contained at paragraph 35.

12 The W&R Morrogh and Custom House Capital Limited cases have demonstrated how reserves can be quickly depleted and emphasise the requirement for alternative funding options to enable the Scheme to swiftly put in place the funds required to meet the legislative requirements of the Compensation Scheme. It should be noted that while the average compensation claim payment in the Morrogh case was relatively modest (circa €3,000), it is anticipated that the Custom House Capital Limited case will have a significantly higher average compensation claim payment (circa €10,000).

13 The number of participant firms in both Fund A and Fund B has decreased significantly over the past three funding years. Fund A has experienced a decrease in authorised investments firms of 18% while Fund B has a slightly greater decrease at 20%. The decreased number of participant firms poses a challenge to the longer term funding of the Scheme's Fund Reserves, in particular, the Fund A reserves, following the failure of Custom House Capital Limited.

(ii) Cascade Model

14 ICCL developed a 'cascade' model as the framework for funding the Scheme in the event of a default situation. The 'cascade' represents a prioritised approach to be taken by 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 synthetic funding elements (not necessarily in the order presented below):

Reserved funds of Fund A or Fund B

Additional Top-up payments

Excess of Loss Insurance policy

Inter-fund borrowing

External borrowing

15 The implementation sequence of the individual elements of the cascade model would be determined by the Board depending on circumstances prevailing at that time.

16 The Board has deployed the Cascade model in the following manner in respect of the failure of Custom House Capital Limited:

- €15 million will be paid directly from the reserved funds of Fund A;
- The potential additional €4.7 million will be met from the Excess of Loss Insurance policy;

The decision of the Board not to require additional top-up payments is based on the following criteria:

- Sufficient reserves are available to meet the policy excess;
- No new failures have yet arisen that will give rise to significant claims for compensation;
- A focus on the restoration of the Fund A reserves to the previously identified minimum target fund of €30 million.

17 The ICCL Cascade model has been significantly strengthened with the addition of the Excess of Loss Insurance policy which has enabled the Board not to seek an additional top-up payment in the current challenging environment. The Board is aware of the difficulties that may be encountered in renewing this policy on an annual basis. The ICCL's Excess of Loss Insurance policy is a "specie" insurance policy with annual renewal subject to detailed preparations by the Company and lengthy negotiations and discussions with our brokers and Lloyds Underwriters. Significant difficulties were experienced in the current renewal cycle due to perceived increased underwriting risks following the failure of investment firms, not only in Ireland, but internationally e.g. MF Global and Phoenix. Target fund reserves 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. Any significant change to the above may lead the Board to reconsider the target fund reserve for either Fund A and/or Fund B.

(iii) Reserves as at 31 July 2012

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

Table 1 - Fund A Reserves for the funding years ended 31 July 1999 to 2012 inclusive

Year	Contributions / Interest Income	Top Up	Compensation & Related Costs	Administration Expenses[2]	Fund Reserve (at end of period)
1999 – 2001	€3,459,023	Nil	(€1,190,293)	(€415,119)	€1,853,611
2002 – 2004	€5,722,341	€5,070,178	(€11,544,239)	(€717,093)	€384,798
2005 – 2007	€7,137,152	(€144,948)	€1,881,424	(€984,639)	€8,273,787
2008 – 2010	€10,724,373	Nil	€379,686	(€1,299,767)	€18,078,079
2011	€3,715,817	Nil	(€31,045)	(€735,292)	€21,027,559
2012[3]	€5,350,390	Nil	(€15,072,131)	(€910,617)	€10,395,201

[1] All figures have been converted, where appropriate, and, are expressed in Euro.
[2] Administration expenses include personnel costs, insurance renewal premiums, bad debt costs and other general administration overheads - further detail is available from our Annual Report.
[3] Extracted from the draft Financial Statements for the year ended 31 July 2012.

Table 2 - Fund B Reserves for the funding years ended 31 July 1999 to 2012 inclusive

Year	Contributions / Interest Income	Top Up	Compensation & Related Costs	Administration Expenses[4]	Fund Reserve (at end of period)
1999 – 2001	€3,494,481	Nil	(€40,289)	(€1,073,756)	€2,380,436
2002 – 2004	€5,579,350	Nil	Nil	(€967,126)	€6,992,660
2005 – 2007	€5,435,045	Nil	Nil	(€1,290,994)	€11,136,711
2008 – 2010	€7,170,115	Nil	Nil	(€1,957,332)	€16,349,494
2011	€1,922,774	Nil	Nil	(€586,347)	€17,685,921
2012[5]	€1,911,759	Nil	Nil	(€546,290)	€19,051,390

19 The ICCL has sought to steadily build the reserves of the Scheme and the Board acknowledges the support given by participant firms as the Scheme builds towards those target funding levels identified in the 2010 Funding Arrangements.

20 It should be noted that the failure of CHC in October 2011 and the consequent charge of €15 million (anticipated claims compensation cost of €19.7 million less insurance recovery of €4.7 million) against Fund A reserves, coupled with the decline in the number of contributor firms, both in Fund A and B, has led to the 2010 – 2013 target Fund Reserves not being achieved. Tables 3 & 4 below display a comparison up to the end of July 2013 of the target Fund Reserves for Fund A and B respectively against the actual and forecast Fund Reserves of the Scheme.

[4] Administration expenses include personnel costs, insurance renewal premiums, bad debt costs and other general administration overheads - further detail is available from our Annual Report.
[5] Extracted from the draft Financial Statements for the year ended 31 July 2012.

Table 3 - Fund A Comparison of Target Fund Reserves against Actual/ Forecast Reserves for funding years 31 July 2009 to 2013 inclusive

Year	Target Reserve	Fund Reserve at end of year	Difference	Significant Items
2009 – Actual	€14,754,118	€14,754,118	NIL	N/A
2010 – Actual	€17,947,000	€18,078,079	+€131,079	Investment Interest return greater than forecast.
2011 – Actual	€21,383,000	€21,027,559	-€355,441	Excess of Loss Insurance Contract premium cost and decreased contributor numbers
2012 – Actual	€25,161,000	€10,395,201	-€14,765,799	As 2011 above and CHC Claims Compensation cost of €15 million (up to €19.7 million before €4.7 million insurance recovery) and subrogated income recovery from W&R Morrogh of €1.5 million.
2013 – Forecast	€29,488,000	€13,280,187	-€16,207,813	As 2011 & 2012 above on a cumulative basis

Table 4 - Fund B Comparison of Target Fund Reserves against Actual/Forecast Reserves for funding years 31 July 2009 to 2013 inclusive

Year	Target Reserve	Fund Reserve at end of year	Difference	Significant Items
2009 – Actual	€14,773,395	€14,773,395	NIL	N/A
2010 – Actual	€16,355,000	€16,349,494	-€5,506	N/A
2011 – Actual	€17,886,000	€17,685,921	-€200,079	Decreased number of authorised firms / Excess of Loss Insurance Contract premium cost / bad debt charges from revoking firms
2012 – Actual	€19,474,000	€19,051,390	-€422,610	As 2011 above – cumulative basis
2013 – Forecast	€21,128,000	€20,353,714	-€774,286	As 2011 & 2012 above on a cumulative basis

(iv) Impact of Current Failures on Reserves

21 The Board considers that the claims history experienced by the Scheme has demonstrated that funds are quickly absorbed when claims arise (both in the payment of compensation and in meeting costs associated with the claims). Therefore, the Board continues to believe that the current level of reserves in Fund A is inadequate and needs to be increased to provide acceptable levels of cover in the event of any future defaults. The current reserves of Fund B have yet to reach the previously identified target.

22 As may be seen from Table 3, the cost of the failure of Custom House Capital Limited ["CHC"] in October 2011, has had a significant impact on the current reserves of the Scheme. The ICCL has, on the advice of the Administrator of the case, Mr Kieran Wallace of KPMG, provided for claims compensation costs that will not exceed €19.7 million. Compensation claims paid, that in the aggregate exceed €15 million, are recoverable from the ICCL's Excess of Loss Insurance policy. In relation to the failure of Bloxham, the Bank and the Administrator of Bloxham, Mr Kieran Wallace of KPMG, have to date, not identified any case which would lead them to conclude that the winding down of Bloxham will result in compensatable losses for eligible clients of the firm.

23 The Board proposes that the continued payment of annual contributions is the best way of building up the level of funds available. Section 3 of this document sets out proposals to enable an adequate level of funding reserves to be restored.

24 The Board is proposing to maintain its previously identified minimum target Fund Reserve of €30 million for Fund A which has been set having due regard to various factors including previous claims experience. An adequate long-term target Fund Reserve for Fund A remains under active consideration by the Board and is expected to be directly affected by any increase to the minimum compensation threshold on amendment of the ICSD (see paragraph 35). Other factors that may affect the calculation of a longer term target Fund Reserve include measures to strengthen the regulatory environment, the number of active participants in the Scheme and the ability of participant firms to fund the Scheme's reserves.

25 The Board considers it is prudent that Fund B continues to build its reserves further over time while achieving greater proportionality between the income levels of contributors and the annual amount payable. The short-term target fund for Fund B is proposed at €24 million. The longer term target for Fund B has been set at €30 million.

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

Q2. Do you agree with the target Fund Reserves for Fund B?

(v) Excess of Loss Insurance Contract

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

27 In October 2010, the Board announced that it had arranged an Excess of Loss Insurance policy to provide a further level of cover in cases where the costs of compensation exceeded €15 million in a policy year. The Board understands that the ICCL is the only EU Investor Compensation Scheme to successfully negotiate and maintain such cover.

28 Successfully negotiating the policy required a significant undertaking from both the ICCL and a specialist Irish brokering team. The ICCL was required to compile extensive data covering participant firms and claims events from the inception of the Scheme in 1998. Furthermore, an actuarial assessment was completed and a detailed analysis of the firms covered by the Scheme was collated. The achievement of this objective in an efficient and cost effective manner was significantly supported by an appropriate investment in the ICCL's IT infrastructure and core applications in 2009.

29 The Excess of Loss Insurance policy, which was placed in October 2010, was renewed on 1 October 2011 and again on 1 October 2012.

30 As outlined earlier, the failure of Custom House Capital Limited, 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. Tables 5 & 6 below provide some quantitative detail on the Excess of Loss Insurance policy for Fund A & B respectively.

Table 5 – Fund A: Quantitative detail regarding the ICCL Excess of Loss Insurance policy

Policy Year	Policy Excess	Coverage over excess	Claims	Estimated Recovery	Premium (incl. government levy)
Oct '10 – Sep '11	€15,000,000	€50,000,000	1	€4,700,000	€330,880
Oct '11 – Sep '12	€15,000,000	€50,000,000	0	0	€330,880
Oct '12 – Sep '13	€15,000,000	€50,000,000	0	0	€404,923

Table 6 - Fund B: Quantitative detail regarding the ICCL Excess of Loss Insurance policy

Policy Year	Policy Excess	Coverage over excess	Claims	Estimated Recovery	Premium (incl. government levy)
Oct '10 – Sep '11	€15,000,000	€10,000,000	0	0	€49,650
Oct '11 – Sep '12	€15,000,000	€10,000,000	0	0	€49,650
Oct '12 – Sep '13	€15,000,000	€10,000,000	0	0	€53,827

31 It is clear from the above tables that the negotiation and placing of the Excess of Loss Insurance policy has already proved extremely beneficial to participant firms of Fund A in helping to meet the compensation costs associated with the failure of Custom House Capital Limited. While no claim has been experienced on Fund B, similar benefits would accrue in the event of a large claim on that Fund.

Q3. Do you support the continued placement of Excess of Loss Insurance for Fund A?

Q4. Do you support the continued placement of Excess of Loss Insurance for Fund B?

(vi) Borrowing

Inter-fund Borrowing

32 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

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

Commercial Borrowing

i) Under current legislation, the ICCL is permitted to borrow[6] 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, 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. The ICCL carries out regular reviews of this facility to ensure that it continues to meet ICCL's requirements.

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.

ii) Since 2006, the ICCL has raised with the EU Commission the problems posed for Investor Compensation Schemes in relation to the management of the open-ended liability of firms to fund schemes especially schemes with small numbers of contributor firms. Specifically, in January 2007, the ICCL sought clarification from the Commission on whether restrictions apply to investor compensation schemes establishing back-stop borrowing facilities[7], in extreme cases, which would allow schemes to spread the funding burden for firms over reasonable timeframes. The response of the Commission, in July 2007, indicated that State guarantees might contravene articles 87 and 88 of the EC Treaty but suggested that the specific circumstances of each case would have to be looked at before making a final determination.

iii) The unprecedented turmoil in financial markets witnessed between 2008 and 2012 worldwide, resulted in numerous failures in the UK. This, in turn, led the UK Financial Services Compensation Scheme ["FSCS"] to pay substantial amounts of compensation during the period. This extraordinary level of compensation was funded by borrowing from the Bank of England and was subsequently refinanced by HM Treasury.

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

[7] Underpinned by State guarantee

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

34 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 contributors in extreme circumstances.

Q5. Do you support the current borrowing arrangements?

(vii) Amending the EU Investor Compensation Scheme Directive ["ICSD"]

35 On 12 July 2010, the European Commission published a proposal to amend the current Investor Compensation Scheme Directive (Directive 97/9/EC). However, priority is currently given by the Council Presidency to the Deposit Guarantee Schemes and the Resolution proposals for which an agreement may be expected by June 2013. The ICCL anticipates that the negotiation of the amended ICSD may come before the Irish Presidency of the EU in 2013. The implementation deadline would likely be set for 18 months following agreement.

The Commission's amending proposals aim to:

- Increase the protection provided under the ICSD and strengthen confidence in the use of investment services;
- Address regulatory loopholes and problems experienced in the operation of some national schemes; and
- Reflect changes in the regulatory framework. The original ICSD was modelled on the Deposit Guarantee Schemes Directive ["DGSD"] and linked to the Investment Services Directive ["ISD"]. The DGSD has since been amended with further significant changes anticipated shortly. The ISD has been replaced by the Markets in Financial Instruments Directive ["MiFID"] and MiFID has itself been subject to significant changes with further amendments expected.

The key changes from the Commission's proposal to amend the Directive are:

- Increasing the compensation limit in each Member State to €50,000. Member States will not be permitted to exceed this limit;
- Requiring compensation schemes to provide partial payment if final payment has not been made within nine months of a formal determination that the firm is 'in default';
- Requiring Member States to establish an ex ante fund of 0.5% of cover of the values of monies and instruments held or administered by firms to be built up over 10 years;

- Introducing a mandatory mutual borrowing facility between investor compensation schemes in different Member States;
- Alignment of the directive with the definitions, services and activities in MiFID. The ICSD currently relates to the investment firms and activities set out in the ISD the predecessor to MiFID.
- Extending compensation to investors who incur a loss due to the financial failure of third party custodians, UCITS depositaries and UCITS sub-custodians;
- Increasing the requirements for investment firms to disclose information about the compensation available under the terms of the Directive.

The European Parliament's report differs from the Commission's proposals on the following points:

- Compensation levels: The report proposes raising the compensation limit in each Member State to €100,000;
- Coverage: The report proposes that investors should be able to claim compensation where a court has determined that there has been bad advice;
- Ex ante funding: The report proposes to halve the time allowed to establish the target fund from 10 years to 5 years;
- The European Parliament's report recommends that the extension should only be made to third party custodians at this time not to UCITS depositaries and sub-custodians;
- Funding: The report recommends that investment firms' financial contributions to the compensation scheme should be risk weighted.

The General Approach agreed in Council under the Polish Presidency of the EU Council differs from the Commission's proposal on the following points:

- Compensation levels: The compromise proposal raises the minimum level of compensation payable to investors to €30,000 and also sets an upper limit of €100,000.
- Ex ante funding: It does not require pre-funding to ensure schemes are properly funded.
- Coverage of third party custodians: No provisions are made for investors to be compensated in the event of the failure of a third party custodian with whom an investment firm has deposited a client's assets.

The draft of the proposal to amend the ICSD is available at the following link http://ec.europa.eu/internal_market/securities/isd/investor_en.htm

36 It would seem inevitable, based on the proposals from the EU Commission, Parliament and Council, that an increase in the minimum compensation threshold to at least €30,000 will be implemented in due course.

Q6. Do you have any observations on the proposals to amend the ICSD as outlined above?

(viii) Further efficiencies to the general operation of Funding

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

- E-Invoicing
  - The ICCL is currently exploring the potential to deliver annual contribution invoices by electronic means. The ICCL has a robust IT solution in place and is investigating whether a suitably reliable database of contact email addresses, which could be used for billing purposes, is available.

- Alternative payment methods
  - In August 2011, the ICCL implemented an on-line payment solution to complement the other existing payment methods of Direct Debit, EFT, Cheque/Draft. The response from participant firms was strong in the first twelve months of operation with in excess of 20% of firms opting to pay online rather than by cheque or draft. Approximately 40% of firms continue to pay by Direct Debit annually which the ICCL considers the most efficient and preferred method of payment.

Q7. Do you support the implementation of E-invoicing?

Q8. Besides the current payment methods, are there other methods that you believe merit consideration?

38 The ICCL will continue to operate a self-assessment model for participant firms to determine their appropriate annual contribution to be declared and paid. The annual rate payable by Fund A firms is based upon their number of eligible clients while, for Fund B firms, the annual rate payable is based on their income derived from investment and insurance business. The ICCL advises the Bank of these figures which may then be subject to verification by the Bank as part of its ongoing supervisory process.

39 In August 2010, the ICCL introduced pro-rata invoicing for new and exiting firms which requires that participant firms pay their annual contribution based upon the number of months for which they are authorised within the funding year. The ICCL considers that, based on our experience to date, this method of calculating the annual contribution should remain in place for the forthcoming funding cycle.

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

(ix) Regulatory and Economic Environment

41 The Board welcomes the publication by the Bank of the Client Asset Task Force review which was commissioned to review the regulatory regime for the safeguarding of client assets and included reviewing the scope of the regime and the adequacy of the Bank's supervisory arrangements. The ICCL looks forward to working closely, on matters of mutual interest, with the recently established Client Asset and Markets Strategy division of the Bank.

42 PRISM – The Bank has devoted a significant level of resources to develop its supervisory risk assessment model, called PRISM (**P**robability **R**isk and **I**mpact **S**yste**M**). PRISM has been designed with a core objective of identifying the potential for a supervised firm, were it to experience problems, to adversely impact the Irish economy, the public finances, and, ultimately, the Irish taxpayer. PRISM uses a range of regularly updated risk metrics to produce an impact assessment which allows for the categorisation of individual supervised firms into 4 general impact categories. PRISM will underpin the allocation of supervisory resources within the Bank with those firms which are likely to have the greatest potential impact attracting the highest level of supervisory oversight. The Bank has confirmed, and the Board accepts, that it does not consider the use of PRISM to be an appropriate basis for the determination of contributions to funds maintained by the ICCL (see also paragraph 48).

43 The Board is conscious of the decreasing number of authorised investment firms within both Fund A and B of the Scheme. Since 2009, the number of Fund A participant firms has decreased from 229 firms to 190, an 18% decrease, while the number of Fund B participant firms has decreased from 4,781 to 3,836, a 20% decrease. The Board is aware of the challenges such decreased numbers will pose to the longer term funding of the Scheme and has considered the matter when setting proposed target Fund Reserves as part of this Funding Review.

(x) Pre-determined client assets distribution rules

44 The Department of Finance has confirmed that forthcoming legislation will include a provision that will enable the Minister for Finance to introduce requirements in relation to pre-determined distribution rules via statutory instrument. This matter was discussed more fully in the 2009 Funding Consultation process. The 2009 Funding Consultation document is available from our website at www.investorcompensation.ie.

3 Proposed Fund Reserve levels (effective 1 August 2013)

(i) Introduction

45 At present there are some 190 firms in Fund A, which is comprised of Section 10 firms (23), MIFID investment firms (126), Licensed Banks (39) and UCITS Managers (2). Some 138 of the total number of Fund A firms (whose authorisation requires them to be a member of the Scheme because it permits them to have eligible clients) currently have no eligible clients and, therefore, make a basic contribution. As a result, the main obligation for contributing to Fund A falls on the remaining 52 Fund A participants.

46 Fund B currently comprises some 3,836 contributors which are categorised based on the Bank's authorisation framework. These include Insurance Intermediaries (893), Tied Insurance Intermediaries (434), Authorised Advisors (401), Multi-Agency (non-RAIPIs and RAIPIs) Intermediaries (1,823) and members of accountancy bodies (285).

(ii) Contribution Categories

47 The Board of the ICCL believes that the current structure of the Scheme, divided into Fund A and Fund B, provides an appropriate level of segmentation between participants and that any further sub-division would not be in the best interests of the Scheme as a whole.

(iii) Fund A - Funding criteria and levels

(i) Basis for contributing

48 During the previous Funding Review (2010 – 2013), the ICCL explored at length, including through the engagement of external consultants, options to facilitate the development of a pragmatic and cost-effective risk-based funding model. The absence of robust, consistent and comparable risk-relevant data on participant firms continues to be a significant hurdle to the further pursuit of this objective. The level of resources which would be required to develop, maintain and validate such a model are unavailable to the ICCL at this time, and would, in any event, result in significant additional cost for contributors. Consequently, a risk-based funding model is not being actively pursued at this time.

49 The Board continues to believe that the best basis of allocating contributions for Fund A firms is the use of eligible client numbers. Furthermore, in respect of Fund A firms, which have self-assessed themselves as having zero eligible clients, a basic contribution and special top-up rules[8] will continue to apply. Therefore, no amendment to the contribution basis is envisaged. Table 7 below sets out the existing band structure and rates for Fund A contributors.

Table 7 - Fund A: Existing contribution band and rate structures for the funding year commencing 1 August 2012

Band	No. of Firms	No. of Eligible Clients	Rate (€)
0	138	Zero	4,050
A	6	1 - 9	12,775
B	24	10 - 499	20,425
C	7	500 - 2,499	41,680
D	1	2,500 - 4,999	87,505
E	9	5,000 - 24,999	139,435
F	2	25,000 - 49,999	146,090
G	3	Over 50,000	233,575

(ii) Band structure

50 The eligible client ranges established in 2004, which determine the contribution rates applicable to Fund A firms, appear to have the support of participants and have not given rise to any material issues in the interim. In the circumstances, the Board does not intend to make any amendment to the ranges.

(iii) Cap on contributions

51 In light of the relatively small number of Fund A participants who are required to contribute the majority of the funding, the Board recognises the potential benefit (both from a financial planning and a cash flow point of view) of a cap on the maximum level of additional 'top-up' funding to Fund A, that may be required in any one year. In this context, the ICCL policy would be to introduce a cap on the amount that may be raised in any one year, in the event of a top-up call on Fund A contributions, which would be equal to twice the annual contribution rate. However, 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.

[8] For details refer to section 16 of the Funding Arrangements (June 2010) available on www. investorcompensation.ie

(iv) Marginal relief

52 Marginal relief, which came into effect on 1 August 2004, and which provides relief for firms which move to a higher band due to a relatively small and temporary increase in eligible client numbers, will remain in force. However, this relief will typically only be available to a firm for one contribution year.

(v) Funding Reserve level

53 The Board acknowledges the support of Fund A contributors in rebuilding Fund A reserves following the failures of Money Markets International Stockbrokers Limited [“MMI”] and W&R Morrogh Stockbrokers [“Morrogh”]. However, in light of the failure of Custom House Capital Limited [“CHC”], a Band C firm, in October 2011, the significant progress made in the 10 years free from failure has resulted in Fund A reserves returning to a relatively low level of €10 million which is not sufficient to meet our existing insurance excess in the event of a significant new failure of one or more investment firm(s). MMI, Morrogh and CHC were relatively small firms and it is clear that another failure or sequence of failures would put serious strain on the Scheme’s capacity to meet its legal obligations to fund compensation claims effectively. On that basis alone, it would appear prudent for the ICCL to continue to re-build its reserves towards a minimum target fund of €30 million so as to be in a position to deal with a similar event should it arise (Tables 10 and 11 below refer). The ICCL considers, however, that the actual level of reserves required to ensure that Fund A is adequately funded could be significantly more than this amount (possibly in excess of €50 million). The Board considers that, in order to achieve the higher level of reserves within the current funding cycle, very significant increases to annual contributions would be required which could represent a very heavy funding burden for many firms. In those circumstances, and having regard to the Excess of Loss Insurance policy coverage of €50 million, the exceptional recovery of €1.5 million in subrogated income from Morrogh and the €50 million standby credit facility which is now in place, the Board considers that the funding target as set out in paragraph 24 is reasonable and achievable within the three-year period commencing 1 August 2013.

54 Notwithstanding the ICCL’s established policy of consulting on, and agreeing, contribution rates over a 3-year cycle, the Board will carry out an interim review should the need arise. Circumstances that could arise include:

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

55 The proposed contribution rates for the 3-year funding cycle commencing 1 August 2013, given the economic conditions, seek to strike a balance between the requirement to have funds available to pay claims and the increased financial pressures on firms funding the Scheme.

56 Tables 8 & 9 below set out the ICCL's proposals for consideration. Proposal A:1 and A:2 respectively target Fund Reserves of €25 million/€30 million by end July 2016.

The assumptions underlying the projections are:

- 5% decrease year on year in the number of contributor firms with no clients;
- A decrease of one medium sized firm with clients year on year;
- Interest income forecast at 1% per annum based on opening reserves;
- Excess of Loss Insurance policy renewable at a premium not exceeding €500,000 per annum;
- No bad debts incurred.

Q9. Do you believe the assumptions set out in paragraph 56 are reasonable? – Please state your reasons.

PROPOSAL A:1 - €25 million Target

Annual increase in contribution rates of **17%** in 2013/14, **13.5%** in 2014/15 and **10%** in 2015/16 for all bands except 'Band 0' firms.
Annual increase in contribution rates of **10**% year-on-year for firms in 'Band 0'

Table 8 - Fund A: Proposed contribution rates for the 3-year funding cycle commencing 1 August 2013/2014/2015 (Proposal A:1)

Band	Number of eligible clients	Existing Rate (€)	Proposed rate effective 1 August 2013 (€)	Proposed rate effective 1 August 2014 (€)	Proposed rate effective 1 August 2015 (€)
0	Zero	4,050	4,460	4,910	5,400
A	1 – 9	12,775	14,950	16,970	18,670
B	10 – 499	20,425	23,900	27,130	29,840
C	500 – 2,499	41,680	48,770	55,350	60,890
D	2,500 – 4,999	87,505	102,380	116,200	127,820
E	5,000 – 24,999	139,435	163,140	185,160	203,680
F	25,000 – 49,999	146,090	170,930	194,010	213,410
G	Over 50,000	233,575	273,280	310,170	341,190

PROPOSAL A:2 - €30 million Target

Annual increase in contribution rates of **30%** in 2013/14, 2014/15 and 2015/16 for all bands except 'Band 0' firms.

Annual increase in contribution rates of **25%** year-on-year for firms in 'Band 0'

Table 9 - Fund A: Proposed contribution rates for the 3-year funding cycle commencing 1 August 2013/2014/2015 (Proposal A:2)

Band	Number of eligible clients	Existing Rate (€)	Proposed rate effective 1 August 2013 (€)	Proposed rate effective 1 August 2014 (€)	Proposed rate effective 1 August 2015 (€)
0	Zero	4,050	5,060	6,330	7,910
A	1 – 9	12,775	16,610	21,590	28,070
B	10 – 499	20,425	26,550	34,520	44,880
C	500 – 2,499	41,680	54,180	70,430	91,560
D	2,500 – 4,999	87,505	113,760	147,890	192,260
E	5,000 – 24,999	139,435	181,270	235,650	306,350
F	25,000 – 49,999	146,090	189,920	246,900	320,970
G	Over 50,000	233,575	303,650	394,750	513,180

Q10. Do you support the implementation of Proposal A1 or A2?

57 Tables 10 & 11 below set out the projected Fund Reserve levels for Fund A under proposal A:1 and proposal A:2.

Table 10 - Fund A: Projected Fund Reserve levels under funding proposal A:1

Year	Contributions (€ million)	Interest Income (€ million)	Fund Reserve (€ million)
2012*	-	-	10.395
2013	3.753	0.104	13.280
2014	4.306	0.133	16.747
2015	4.806	0.168	20.750
2016	5.194	0.208	25.179

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

Table 11 - Fund A: Projected Fund Reserve levels under funding proposal A:2

Year	Contributions (€ million)	Interest Income (€ million)	Fund Reserve (€ million)
2012*	-	-	10.395
2013	3.753	0.104	13.280
2014	4.798	0.133	17.240
2015	6.127	0.172	22.567
2016	7.786	0.226	29.607

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

(iv) Fund B - Funding criteria and levels

(i) Basis for contributing

58 As previously described in paragraph 48, it has not been feasible or practical to pursue the development of a risk-based funding model and, in the absence of such a model, the Board of the ICCL believes that the use of income[9] continues to be the most appropriate basis upon which annual contributions are allocated to Fund B contributors.

59 Following the implementation of the European Communities (Insurance Mediation) Regulations 2005, insurance intermediaries who conduct insurance mediation on an ancillary basis (e.g. motor traders, travel agents etc.) must be registered with the Bank and, consequently, these entities currently fall within the scope of the Scheme.

(ii) Band structure

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

(iii) Fund Reserve level

61 Given the impact of three failures on Fund A, the ICCL continues to consider that the current level of fund reserves may not be at an optimum level should an equivalent case arise in Fund B. Therefore, the Board believes that it is necessary to continue to build up the fund reserves of Fund B to a target Fund Reserve level of some €24 million within the three-year funding cycle (Tables 14 and 15 below refer).

62 The proposed contribution rates for the 3-year funding cycle commencing 1 August 2013, given the economic conditions, seek to strike a balance between the requirement to have funds available to pay claims and the increased financial pressures on firms funding the Scheme while also trying to achieve greater proportionality within the rate structure.

(iv) Rate structure

63 The ICCL has reviewed the rate structure on the basis of continuing to (i) provide an appropriate basis upon which to levy firms, (ii) provide an appropriate level of proportionality between bands, and, (iii) ensure that, for the majority of firms, any changes from existing rates do not appear to create an unreasonable burden for firms. It will be noted that, under proposal B:1 no changes are proposed. (Refer to Table 12)

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9 Income, for these purposes, will be the total income of a firm from investment and insurance business.

Under proposal B:2 below, contributions from all bands commencing at income levels of €700,000 will increase by 3% on an annual uplift basis. The existing top band would be adjusted from "income in excess of €15 million" to "€15 million to €25 million" with a new top band of "income in excess of €25 million" introduced. Rates for firms with income levels below €150,000 would be reduced by approximately 20% on a one-off basis in the funding year commencing 1 August 2013. (Refer to Table 13)

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

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

65 Tables 12 & 13 below set out the ICCL's proposals for consideration. Proposal B:1 and B:2 target Fund Reserves of circa €24 million by end July 2016. B:1 does not propose any change to the existing annual rates or income bands. B:2 proposes to enhance proportionality within the Fund.

The assumptions underlying the projections are:

- 5% decrease year on year in the number of contributor firms at Levels 1 & 2;
- 1% decrease year on year in the number of contributor firms at all other levels;
- Interest income forecast prudently at 1% per annum based on opening reserves;
- Insurance premium unchanged at €50,000 per annum;
- Bad debts incurred at €50,000 per annum (equivalent of approx. 200 firms unpaid).

> Q11. Do you believe the assumptions set out in paragraph 65 are reasonable? – Please state your reasons.

PROPOSAL B:1

Proposal B:1 – Maintain contribution rates at 1 August 2012 levels

Table 12 - Fund B: Proposed contribution rates for the 3-year funding cycle commencing 1 August 2013/2014/2015 (Proposal B:1)

Band	Existing income band structure (€)	Existing Rate (€)	Proposed Rate effective 01/08/2013 (€)	Proposed Rate effective 01/08/2014 (€)	Proposed Rate effective 01/08/2015 (€)
1	< 60,000	250	250	250	250
2	60,001 - 150,000	300	300	300	300
3	150,001 - 700,000	550	550	550	550
4	700,001 - 1.5m	950	950	950	950
5	1,500,001 - 3m	1,650	1,650	1,650	1,650
6	3,000,001 - 6m	3,000	3,000	3,000	3,000
7	6,000,001 - 15m	11,550	11,550	11,550	11,550
8	> 15m	18,900	18,900	18,900	18,900

PROPOSAL B:2

Proposal B:2 Revise the existing lower income bands and rates, increase the rates for income bands from €700,000 upwards and introduce a new top band and rate to achieve greater proportionality.

Table 13 - Fund B: Proposed contribution rates for the 3-year funding cycle commencing 1 August 2013/2014/2015 (Proposal B:2)

Band	Existing income band structure (€)	Existing Rate (€)	Proposed income band structure effective 01/08/2013 (€)	Proposed Rate - effective 01/08/2013 (€)	Proposed Rate - effective 01/08/2014 (€)	Proposed Rate - effective 01/08/2015 (€)
1	< 60,000	250	***< 75,000***	200	200	200
2	60,001 - 150,000	300	***75,001 - 150,000***	250	250	250
3	150,001 - 700,000	550	150,001 - 700,000	550	550	550
4	700,001 - 1.5m	950	700,001 - 1.5m	980	1,010	1,040
5	1,500,001 - 3m	1,650	1,500,001 - 3m	1,700	1,750	1,800
6	3,000,001 - 6m	3,000	3,000,001 - 6m	3,090	3,180	3,280
7	6,000,001 - 15m	11,550	6,000,001 - 15m	11,900	12,260	12,630
8	> 15m	18,900	**15m – 25m**	19,470	20,050	20,650
9			**> 25m**	23,500	24,210	24,940

Q12. Do you support the implementation of Proposal B1 or B2?

66 Tables 14 & 15 below set out the projected Fund Reserve levels for Fund B under proposal B:1 and proposal B:2.

Table 14 - Fund B: Projected Fund Reserve levels under funding proposal B:1

Year	Contributions (€ million)	Interest Income (€ million)	Fund Reserve (€ million)
2012*	-	-	19.051
2013	1.657	0.191	20.354
2014	1.612	0.204	21.624
2015	1.578	0.216	22.872
2016	1.544	0.229	24.099

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

Table 15 - Fund B: Projected Fund Reserve levels under funding proposal B:2

Year	Contributions (€ million)	Interest Income (€ million)	Fund Reserve (€ million)
2012*	-	-	19.051
2013	1.657	0.191	20.354
2014	1.494	0.204	21.505
2015	1.476	0.215	22.650
2016	1.460	0.227	23.792

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

4 Request to contributors for comments

67 The Board invites participants to consider the contents of this paper and to respond, to the issues and proposals set out, by ***7 December 2012*** at the latest. In responding, participants are requested to bear in mind the statutory responsibilities which are imposed upon the ICCL by the Investor Compensation Directive and the Investor Compensation Act. Accordingly, the Board will only be in a position to give serious consideration to suggestions and proposals that will not compromise its ability to operate a viable pre-funded Scheme in accordance with its statutory obligations.

68 All responses should be clearly marked 'Funding Consultation' and made in writing, so as to be received by ***7 December 2012***.

Responses should be sent to:

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

Or

by e-mail to info@investorcompensation.ie

It would assist the ICCL greatly if, where appropriate, respondents utilised the template provided at appendix 1 and any comments or observations provided were cross-referenced with the relevant question or section number which precedes each paragraph of this Consultation Paper.

69 Respondents are requested to note that the ICCL intends to publish all submissions received on the Funding Section of our website www.investorcompensation.ie – However, the ICCL reserves the right not to publish any content that it deems inappropriate or defamatory. Any confidential or commercially sensitive information which respondents wish to supply in support of their views and which the respondents do not wish to be published should be provided separately and should be clearly marked "Not for publication". The ICCL shall not be liable nor have any liability whatsoever in respect of any information provided by a respondent which is subsequently released by the ICCL whether marked "Not for publication" or otherwise or in respect of any consequential damage suffered as a result.

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

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

72 The Board intends to complete the consultation element of the review of its funding arrangements by February 2013 and to commence the process of preparing a revised funding arrangements document. Subsequently, the revised funding arrangements will be drafted for approval by the Board before being submitted to the Bank for approval. In these circumstances, new funding arrangements should be published by May 2013. These arrangements will take effect from 1 August 2013.

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

31 October 2012

5 Template to assist with the generation of focussed responses

Name of Respondent Firm/ Body/Organisation:				
Question No.	**Question**	**Yes / No**	**Comment**	**Paragraphs numbers referenced in your response:**
1	Do you agree with the target Fund Reserves for Fund A?			
2	Do you agree with the target Fund Reserves for Fund B?			
3	Do you support the continued placement of Excess of Loss Insurance for Fund A?			
4	Do you support the continued placement of Excess of Loss Insurance for Fund B?			
5	Do you support the current borrowing arrangements?			

Name of Respondent Firm/ Body/Organisation:				
Question No.	**Question**	**Yes / No**	**Comment**	**Paragraphs numbers referenced in your response:**
6	Do you have any observations on the proposals to amend the ICSD as outlined in paragraph 35?			
7	Do you support the implementation of E-invoicing?			
8	Besides the current payment methods, are there other methods that you believe merit consideration?			
9	Do you believe the assumptions set out in paragraph 56 are reasonable? – Please state your reasons.			
10	Do you support the implementation of Proposal A1 or A2?			

Name of Respondent Firm/ Body/Organisation:				
Question No.	**Question**	**Yes / No**	**Comment**	**Paragraphs numbers referenced in your response:**
11	Do you believe the assumptions set out in paragraph 65 are reasonable? – Please state your reasons.			
12	Do you support the implementation of Proposal B1 or B2?			
N/A	(Please include headings here for any other specific areas upon which you are submitting comments or proposals)	**N/A**	(Please include the detail of your focussed comments/proposals)	**(Please reference the relevant paragraphs from the document)**

The Investor Compensation Company Limited
C/o The Central Bank of Ireland
P.O. Box 11517
North Wall Quay
Spencer Dock
Dublin 1

Telephone: (01) 224 4955
Fax: (01) 894 4614
Email: info@investorcompensation.ie
Website: www.investorcompensation.ie