



The Investor Compensation Company Limited

**Response of ICCL to Submissions on
Funding the Investor Compensation Scheme**

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1. Overview

In October 2012, the Investor Compensation Company Limited ('ICCL') issued its Consultation Paper – Funding the Investor Compensation Scheme. The deadline for receipt of submissions was 7th December 2012.

The main issues proposed in the consultation paper were:

- Target funds for the Scheme.
- Proposed contribution rates in two scenarios to take effect from 1 August 2013/2014/2015.

The view of stakeholders was sought on the following related matters:

- Excess of Loss Insurance Contract.
- Borrowing Arrangements.
- Proposals to amend the ICSD.
- E-invoicing and other payment methods.

This paper details the ICCL response to the key themes that emerged from our consultation on "Funding the Investor Compensation Scheme". Nineteen responses were received, three of which were received after the deadline. *(Refer to appendix 1 for a list of non-confidential respondents)*

The Funding Committee of the ICCL has, on review, approved three late responses for inclusion in the consultation process.

The ICCL would like to thank the contributor firms and representative bodies that responded to the consultation paper.

1.1. Section 2 – Target funds for the Scheme

This section confirms that the Target funds identified by the ICCL in the consultation paper will apply from 1 August 2013.

These are an identified minimum target for Fund A of €30 million and an identified short-term target fund of €24 million for Fund B with a long term target for Fund B of €30 million.

1.2. Section 3 – Proposed contribution rates 1 August 2013/2014/2015

This section confirms that we will be implementing proposal A1 for Fund A firms. It also confirms that in light of the feedback received, we will be implementing a modified version of proposal B2 for Fund B firms.



1.3. Section 4 – Excess of Loss Insurance Contract

This section confirms that we will seek to renew the Excess of Loss Insurance for the duration of the revised Funding Arrangements with the support of our stakeholders.

1.4. Section 5 – Borrowing Arrangements

This section confirms that the existing borrowing arrangements will continue to operate on the existing bases.

1.5. Section 6 – Proposals to amend the ICSD

This section summarises some of the views expressed by our stakeholders on current proposals to amend the ICSD. ICCL will convey the views of respondents to the Department of Finance and the Central Bank of Ireland as part of our on-going contact with these parties.

1.6. Section 7 – E-invoicing and other payment methods

This section summarises some of the views expressed by our stakeholders concerning E-invoicing and other payment methods.

1.7. Section 8 – Other matters

This section summarises some of the other issues that were raised by respondents during the consultation process and the relevant ICCL responses thereon.

2. Target funds for the Scheme

In this section we provide feedback on the responses which we have received concerning the identified target funds. Where it is appropriate to deal with the responses or the issues on a fund specific basis, we have taken that approach. Otherwise, our feedback is given at a general level and is applicable to the Investor Compensation Scheme [‘the Scheme’] as a whole.

Fund A

On the basis of the responses received, there is a general degree of agreement among contributors and representative bodies that the reserve level for Fund A does need to be rebuilt in light of the cost of the Custom House Capital Limited [‘CHC’] failure.

Respondents have expressed the views that:

- the proposed timeframe to rebuild the Fund to the identified minimum target of €30 million, should be extended to 5 or 6 years.
- a representative sample of contributor firms should be taken to provide information on their ability to pay the proposed contribution rates.

Fund B

The common consensus among respondents is that the short-term target fund represents an adequate maximum fund with some respondents recommending that the fund is already adequate when compared to the claims history experienced.

Fund A

We note the alternative proposals from respondents, in particular, concerning the timeframe to rebuild the Fund. We believe that we have already incorporated an extended timeframe of 5 years (2012 to 2017) within which it is proposed to rebuild Fund A to a minimum target of €30 million, as provided for under proposal A1. We consider that this is an appropriate timeframe and any extension could undermine the viability of the Scheme, particularly as these targets assume no further failures in the intervening period.

Fund B

We note that respondents believe Fund B is adequately funded when compared to the relatively low value of claims experienced for the Fund. However, the claims experience arises from the failure of one relatively small intermediary and there are approximately 4,000 intermediaries currently covered by Fund B. We believe that the identified target fund is appropriate given the significant population of firms subject to coverage at present.

General

In accordance with section 22(3)(b)(ii) of the Investor Compensation Act [‘the Act’], one of the factors that the ICCL specifically consider is the funding capacity of contributors. The ICCL also consult with the Central Bank of Ireland, the supervisory authority for investor compensation in Ireland, prior to issuing Funding Arrangements for the Scheme.

3. Proposed contribution rates 1 August 2013/2014/2015

We provide feedback here on the responses we have received concerning the proposed contribution rates. Our feedback is provided at a fund specific level.

Fund A

On the basis of the responses received, the majority of respondents are in favour of proposal A1. A number of related matters were raised in connection with the proposed contribution rates. They were:

- The continuing absence of an exemption category for firms with no eligible clients;
- An alternative proposal to rebuild over a longer timeframe at existing rates;
- A potentially reduced risk of claims arising from firms not offering certain business services is not reflected in proposed rates.

Fund B

The majority of respondents identified proposal B2 as the preferred funding option. Among the common matters raised by respondents regarding the funding options for Fund B were:

- Level 3 – €150,001 to €700,000 is too wide of a range and should be split;
- Level 1 – €0 to €75,000 does not adequately cater for low income firms / individuals;

Other respondents, consistent with their view that Fund B is currently adequately funded, were seeking an administration charge only until the next Funding Cycle.

Fund A

1) Continuing absence of an exemption category for firms with no eligible clients

A number of contributors that do not have eligible clients expressed concern that an exemption category is not available. We are conscious that certain firms do not at present, on the basis of self-assessment, have eligible clients for compensation purposes. We also note that the authorisation of these firms does not prevent them from having eligible clients. Furthermore, the Investor Compensation Act is clear in so far as all authorised firms are required to contribute to the Scheme, and, consistent with that requirement, a significantly reduced rate of contribution is applicable to those firms. The Special Top-up arrangements also recognise the position. (We also address a related issue under item (3) below).

2) An alternative proposal to rebuild over a longer timeframe at existing rates

We have already considered the possibility of rebuilding Fund A through the use of a Special Top-up arrangement or by maintaining the current rates over an extended period. In recognition of the legal requirement to have an adequately funded Scheme, we believe that the proposed timeframe is appropriate and should not be extended. We have sought to strike a balance between the requirements to have sufficient funds available to pay claims as they arise on one hand and the impact of continuing difficult economic conditions and increased financial pressures on firms' ability to fund the Scheme on the other hand. In particular, we have considered the potential cost of a further failure and the impact a revised Investor Compensation Services Directive ["ICSD"] would have.



3) Potentially reduced risk of claims arising from firms not offering certain business services is not reflected in proposed rates

Notwithstanding that a firm may certify that it has zero clients or that its authorisation does not contemplate the holding of client assets, a risk remains for the ICCL as experience (at home and abroad) has shown that:

- a) compensation schemes are normally activated where fraud has occurred and/or where client assets have been misappropriated;
- b) once an investment firm obtains a formal authorisation/licence/registration there is a risk that, by virtue of fraud or other improper conduct, the resources of the ICCL will be called upon to provide compensation to clients notwithstanding that the firm may have no formal approval to hold client assets or that it may have asserted that it does not have eligible clients, and,
- c) clients that had been considered as 'excluded' by the firm may be deemed by the Administrator as eligible on review.

Fund B

As outlined in the Funding Consultation paper, Fund B reserves have yet to reach the previously identified target. We firmly believe that Fund B should continue to steadily build its reserves further over time while achieving greater proportionality between income and the annual amount payable. On this basis, we do not believe that an "Administration Only" charge is appropriate at present.

We acknowledge that there may be some contributors that generate relatively low levels of income from mediation business. However, the Band 1 rate reflects a continuing move to ensure greater proportionality is achieved for all contributions. We do not believe that an exemption from contribution, or as indicated above, an "Administration Only" charge are appropriate at this time.

We recognise the wide income range covered by the existing Band 3 (€150,001 - €700,000) and the proposals of some respondents in that regard. The model now proposed by the ICCL, while it will represent a 3% increase per annum for a number of the larger firms, it will also represent an average decrease of circa 20% for other contributors which make up 95% of the contributor base by number. The following table outlines the details of the revised bands and rates for Proposal B2:

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 - 400,000	400	400	400
4	150,001 - 700,000	550	400,001 - 700,000	550	550	550
5	700,001 - 1.5m	950	700,001 - 1.5m	980	1,010	1,040
6	1,500,001 - 3m	1,650	1,500,001 - 3m	1,700	1,750	1,800
7	3,000,001 - 6m	3,000	3,000,001 - 6m	3,090	3,180	3,280
8	6,000,001 - 15m	11,550	6,000,001 - 15m	11,900	12,260	12,630
9	> 15m	18,900	15m – 25m	19,470	20,050	20,650
10			> 25m	23,500	24,210	24,940



4. Excess of Loss Insurance Contract

We welcome the strong level of support received for the continued placing of Excess of Loss Insurance for both Fund A and Fund B. As outlined in the consultation paper, the contract has proved beneficial to Fund A, and, while no claim has been experienced for Fund B under the contract, similar benefits would accrue. It is also clear that the Excess of Loss Insurance Contract is a key element of the “Cascade” funding model employed by the ICCL. On that basis, the ICCL intend to seek continued renewal of the contract subject to successful negotiations at acceptable terms.

5. Borrowing Arrangements

It is clear from the responses received that the current borrowing arrangements; Inter-fund and External, are broadly supported and accepted. The Inter-fund arrangements require that:

- 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.

Alternative proposal

It was suggested that the National Pensions Reserve Fund could be approached as an alternative provider of a Stand-by facility to the current external borrowing arrangement.

ICCL Response

The Stand-by facility is reviewed annually. While the current rates are viewed as representing good value to the Company, at the next review the ICCL will consider whether an equivalent facility can be negotiated at more favourable rates.

6. Proposals to amend the ICSD

The majority of respondents raised concerns about the implications for current arrangements if some or any of the proposals are implemented. Among the issues raised were:

- Some proposals that may be appropriate to large markets may be unsustainable in a small market.
- Clarity is sought on the required target fund if applying the 0.5% cover for monies and instruments held or administered.
- Significant concerns that the funding costs necessitated by a 0.5% fund or €50,000 compensation limit would have on the current Scheme participants ability to continue in business, particularly in the current environment.
- Potential implications of the €30,000 compensation limit on the ICCL's ability to renew the Excess of Loss insurance annually.
- It is preferable to increase the compensation limit to at least €30,000 but preferably €50,000 – pre-funded, where the contribution that applies to the firm is directly linked to the value of client instruments held by the firm and custodians.



- No strong objection to increasing the compensation limit up to €30,000. However, concerns were expressed about the existence of an additional cost associated with this, or indeed, the ability of a small scheme to fund any limit that goes beyond €30,000.
- Concerns at proposals to include mis-selling or similar provisions and compensation for bad advice.
- Isolated support for an increase in the compensation limit to €100,000 so that it is aligned with the DGS.

We welcome the views expressed by respondents regarding the current proposals to amend the ICSD. It is the intention of the ICCL to relay these views to the Department of Finance who are leading the negotiations of a revised ICSD from an Irish perspective. It would appear unlikely, at present, that formal agreement on the revised ICSD will be achieved in advance of final agreement on the Resolution Directive and the Deposit Guarantee Scheme Directive.

7. E-invoicing and other payment methods

Respondents broadly welcomed the proposal by the ICCL to investigate the potential to deliver invoices by electronic means. ICCL are currently considering the most effective approach to advancing this objective.

In general, respondents were satisfied with the current payment methods. One respondent recommended that consideration should be given to a staged payment option e.g. Quarterly Payments subject to an administration charge.

ICCL Response

We welcome the proposal to offer staged payments to contributors subject to an additional charge. On initial review, it would appear that the payment methods and arrangements operated at present are appropriate to the current population of contributor firms (authorised investment firms and insurance intermediaries) while also being an efficient use of available ICCL resources. Where a firm is experiencing difficulty in meeting its obligations under the Act, the ICCL and Bank liaise directly with the firm to ensure that its obligations are satisfied in a manner acceptable to all parties involved.

8. Other matters

Previous arrangements for funding following a failure

“We note that the Arrangement for funding the Investor Compensation Scheme operated by ICCL, May 2004, stated that in light of the fact that Morrogh was a stockbroking firm the ICCL required this subset of investment firms, i.e. stockbrokers, to contribute 50 per cent of the top up requirement with the other Fund A firms contributing the balance.



It is our strong view that, given that the above was considered to be a wholly valid basis of apportionment of costs in 2004, the same methodology should now be applied with regard to the funding requirements post the collapse of Custom House Capital, an Investment Firm, not a Stockbroking firm....”

ICCL Response

The failure of W&R Morrogh, the second stockbroking firm to fail in a short space of time, occurred at a time when Fund A was in its infancy. The reserve at that time was considered wholly inadequate to deal with that failure. A significant risk existed that the Fund would fall into a substantial deficit if an exceptional measure was not taken. Such a scenario would have represented a breach of the ICCL’s legal obligation under Section 22(2) of the Act which requires that “...the Company maintains a sufficient balance in all funds maintained by it which will enable it to meet such obligations.” The Board of the ICCL gave substantial consideration to the possibility of a W&R Morrogh type Top-up when considering the funding model proposed in the Consultation Document. It concluded that the context within which the CHC failure occurred was fundamentally different. In particular and learning from the W&R Morrogh experience, ICCL had put in place a Stand-by Borrowing Facility and an Excess of Loss Insurance Policy. In addition, Fund A had more substantial reserves and has remaining reserves in excess of €10 million after taking account of the Administrator’s estimate of compensatable loss and payout from the Excess of Loss Insurance Policy.

Wrong metric – basis of assessment (FUND A)

ICCL Response

While other metrics are possible, it is the strong view of the ICCL that the current basis of allocating contributions using eligible client numbers is the most appropriate basis in the absence of an efficient and cost effective risk based model. It would also appear to the ICCL that the basis is widely supported. We will continue to investigate alternative bases that are both operationally and administratively efficient while being suitably robust.

Disappointment that a Risk based model has not been developed

ICCL Response

The ICCL acknowledges that a Risk Based Funding model is desirable for numerous reasons. It should also be clear from the Consultation Paper that the ICCL has made a very considerable effort to facilitate the development of an appropriate model. Due to the reasons outlined in the Consultation paper, the development of a model is not being actively pursued at this time.



Need to implement the Pre-determined Asset Distribution Rules

ICCL Response

The ICCL initiated the process of drafting Pre-determined Asset Distribution Rules ["PADR"] for inclusion in primary legislation in the absence of the matter being actively progressed by the relevant stakeholder. The ICCL have passed a drafted PADR to the Department of Finance and have continued to engage with the Department on the matter as requested. The ICCL understand that the PADR will not be enacted as primary legislation, but instead, will be legislated for by way of granting the Minister for Finance a power to introduce the PADR by way of Statutory Instrument. This is ultimately a matter for the legislature.

Need to undertake market research surrounding general awareness and understanding of the operation of the Scheme

ICCL Response

The ICCL note the comments received in relation to the apparent absence of research or active education of investors, concerning the operations and/or benefits to investors, of the Investor Compensation Scheme. However, the objectives of the ICCL are clearly defined in the Act and these do not extend to the areas of research or education of investors. Nonetheless, the ICCL has worked with NALA to publish a "Plain English" information booklet for investors about the role of the ICCL and how investor compensation operates in Ireland. We also maintain a website which is regularly updated to provide accurate content for investors generally and also in respect of current ICCL compensation events. The ICCL intends to review its website in 2013 to make it more interactive and user friendly. While it would support research on matters concerning statutory Investor Compensation by an appropriate body, the ICCL must work to its core mandate, which is to establish and maintain compensation funds, in an efficient cost effective manner.

Research on average claim and average investment and adequacy of compensation limit (current or proposed)

ICCL Response

The ICCL, at appropriate intervals, considers the general adequacy of the current compensation limit. A review was conducted of certified claims in the W&R Morrogh case, in which it was highlighted, that for the majority of cases, the compensation limit provided an adequate level of cover.

It should be noted that the EU ICS Directive prescribes the minimum compensation limit, while it is the responsibility of the Oireachtas to agree any increase above the minimum compensation limit prescribed in the Directive. The ICCL is responsible for ensuring that arrangements are in place to pay compensation at the agreed level.

9 Appendix 1 – List of Non-Confidential Respondents

Submission Number	Classification	Name	Published
CP2012-01	Fund A	RSI Europe Limited	Yes
CP2012-03	Fund A	J & E Davy	Yes
CP2012-04	Fund A	Covestone Asset Management Limited	Yes
CP2012-05	Fund A	Campbell O'Connor & Company	Yes
CP2012-07	Fund A	BVP Investments Limited	Yes
CP2012-08	Fund B	Kinsella Financial Services Limited	Yes
CP2012-09	Fund B	Declan O'Neill	Yes
CP2012-10	Fund B	John Kelly	Yes
CP2012-12	Fund B	William Cullen & Sons Limited	Yes
CP2012-13	Rep Body	Irish Brokers Association	Yes
CP2012-14	Rep Body	Professional Insurance Brokers Association	Yes
CP2012-15	Rep Body	Society of Irish Motor Industry	Yes
CP2012-16	Rep Body	Irish Association of Investment Managers	Yes
CP2012-17	Rep Body	National Consumer Agency	Yes
CP2012-18	Rep Body	Irish League of Credit Unions	Yes
CP2012-19	Rep Body	Irish Banking Federation	Yes