

Ministry of Finance of the Czech Republic
Comments to the Call for evidence on Investor Compensation
Scheme Directive

The Czech Republic welcomes the initiative of the European Commission on the possible review of investor compensation scheme regime. We consider investors' protection in the area of financial services to be an important issue. Nevertheless, we think that any amendment to the current EU legislation must be based on an impact assessment made by the European Commission covering the issues mentioned in this call for evidence.

Please find below some specific comments regarding the questions in the paper. The comments are only an indication of the approach the Ministry of Finance of the Czech Republic takes. Therefore these comments should be seen as preliminary.

1. Should the operation of multilateral trading facilities be excluded from the scope of the ICSD?

No, it should not. All investment services should be covered by the ICSD. Also investment firms operating multilateral trading facilities benefit from the confidence framework provided to market participants by virtue of the ICS.

2. Would it be appropriate to include in the scope of the ICSD all investment firms seeking authorisation to the provision of investment services, although their authorisation would not allow holding clients' assets?

We think it would be appropriate. We believe that all investment firms should be included as well. Nevertheless, the compensation under the ICSD shall be provided only in cases the investment firm is not capable to meet its obligations to its clients (i.e. return of a financial instrument or a repayment of money to investors).

3. Would it be appropriate to include in the scope of the ICSD all investment firms seeking authorisation to the provision of investment services, although they provide their service only to non-retail clients?

Although the primary objective of the ICSD is the protection of retail investors, we believe it would be appropriate to include all investment firms in the scope of the ICSD (despite their relatively very limited drawing rights). Practically, the differentiation between retail and non-retail clients' assets does neither correspond to the current market conditions in many EU countries, including the Czech Republic, nor it is suitable for running the investor compensation scheme.

Czech law, for instance, already provides coverage for all investors, irrespective to their category or nature (retail or non-retail).

4a. Should investors be able to claim compensation in the case of default of the third party where their assets had been deposited?

4b. Should investors (such as UCITS or a UCITS unit holder) be able to claim compensation for loss of assets under the ICSD in those cases where the UCITS depository or the institution which has been mandated to safe keep the assets, fail to perform its duty?

No, we do not think it is necessary and/ or appropriate.

We are convinced that in case of default of the third party, it is not justifiable to transfer the investment firms' responsibility for choosing a depository on to guarantee schemes. If there is a default of the third party, investor should be reimbursed directly by the investment firm and concurrently there should be a settlement between the investment firm and the third party. National civil law provisions concerning the recourse should apply here. Only in the case where the investment firm is not capable to meet its obligations to its client, the client should have right for direct compensation by the ICS (i.e. return of a financial instrument or a repayment of money to investors).

Additionally, it is worth highlighting the European Commission's Communication for the Spring European Council where it is stated that "the rules on holding and transferring intermediated securities should be harmonised at global level" (Volume I, page 17). Therefore, we would like to point out that these issues have been discussed at international level on a long-term basis and are covered by the international convention UNIDROIT, which is to be finalised this autumn.

5. Should loss events include also any losses suffered by (retail) investors as a consequence of the violation of conduct of business rules?

No, it should not.

The ICS should be designated only for cases where an investment firm is unable to meet its obligations arising from investors' claims (return of a financial instrument or a repayment of money to investors). An unsuitable advice and a violation of conduct of business rules should be left up national civil liability regimes.

6. Do you agree with the idea that the amount covered by the ICSD should be adapted following the updating of the DGSD?

No, we do not agree.

We do not think it is necessary to increase the amount covered by the ICSD at the moment. The ICSs do not represent similar systemic relevance in comparison to the DGSSs. Before any changes are introduced, an analysis assessing risks and profits of such a measure should be taken.

7. The ICSD does not harmonize the funding systems of the schemes. Should the ICSD provide for some general principles concerning the funding of the schemes?

We generally support the harmonisation of the funding systems of the schemes. We think that ex ante financing by investment firms is a suitable solution and should be

adopted by all Member States. The current differences in financing mechanisms that have led to an uneven level playing field should be avoided.

However, we do not support a harmonisation of mechanisms determining the calculation and amount of participants' contributions.

8a. Does the legislation of the Member State you know the best provide mechanisms aimed at limiting compensation schemes' obligations over time? If yes, how many clients saw their compensation unpaid as a result of such mechanisms?

According to the Czech law there is a five-year limitation period. The period starts running as from the moment the individual claim for compensation from the Czech ICS - The Securities Brokers Guarantee Fund (hereinafter "GF") is due and payable.

Investors, who are entitled to be compensated, must take an action to the court in order to prevent the limitation period from expiring. If the period expires, the claim of investors to receive their compensation from the GF does not cease to exist but cannot be enforced in judicial proceedings. The number of clients, who saw their compensation unpaid as a result of such mechanisms, is difficult to measure, but we do not think to be significant.

8b. Should this kind of mechanisms be prohibited?

We believe the complete carelessness of claimants should not be protected. It is fair to protect those who take care of their rights actively. We would welcome a comparative analysis analyzing various systems existing within the EU Member States and describing Member States' experience in this field.

With regard to the application of respective provisions of the Czech law we believe this prescription period is long enough for the settlement of the compensation claims laid by investors and therefore there is no reason for its amendment, for example it should not be prolonged. The principle of legal certainty should be taken into account and therefore it would not be appropriate to determine that this limitation period would be unlimited. So, every person should take care of its rights (the principle of *vigilantibus iura*).

9a. Should the process of recognizing the eligibility of the claim be regulated for the purposes of the ICSD?

We do not see a need for such harmonisation therefore we do not support harmonisation of this issue.

9b. Should, at least, a mechanism be introduced providing for provisional partial compensation based on a summary assessment of clients' positions?

No, it should not be introduced.

Only a duly verified claim should be reimbursed by the ICS. Recognizing any preliminary claim could lead to significant legal and administrative problems (such as dealing with the GF's requests for consecutive compensation reimbursement to be

provided by clients who have already obtained such a compensation but who are afterwards detected by the GF not to be entitled to receive it as a whole or a partially).

9c) Irrespective of the harmonisation of their funding systems, should compensation schemes ensure that they have minimum reserve funds in order to comply rapidly with any immediate needs?

We are not convinced that this kind of measure should be adopted. Investor guarantee schemes are different from deposit guarantee schemes as depositors could be very shortly out of any money deposited at their account (shortly after the announcement of the incapability of their credit institution to meet its obligations to its clients). Investments protected under the ICSD compared to clients' money deposited at bank accounts have a less urgent nature from the client's point of view.

10. Do you think special attention should be given to money market funds?

Yes, we think so. We would welcome if the European Commission provides Member States with an analysis on this topic.

On the other hand, we believe that money market funds should remain outside the scope of the ICSD. In general, any collective investment vehicles shall be excluded from the scope of ICSD.

11. Based on the concrete application of the ICSD do you see further issues other than the ones mentioned in the present document that might be of relevance to this analysis?

No, we do not see any further issues at present.

Prague, 6th April 2009