

Directorate General Internal Market and Services  
Unit G3 – Securities Markets  
European Commission  
SPA 2 03/079  
B-1049 Brussels  
Belgium



The voice of banking  
& financial services

8 April 2009

Dear Madams and Sirs,

Sent by e-mail to Markt-g3@ec.europa.eu

**BBA Response to  
The European Commission Call for Evidence on the  
Investor Compensation Schemes Directive (1997/9/EC)**

The BBA is the leading association for the UK banking and financial services sector, speaking for 220 banking members from 60 countries on the full range of UK or international banking issues and engaging with 37 associated professional firms. Collectively providing the full range of services, our member banks make up the world's largest international banking centre, operating some 150 million accounts and contributing £50 billion annually to the UK economy.

**Executive Summary**

The BBA welcomes the opportunity to comment on the European Commission's call for evidence on the Investor Compensation Schemes Directive (Directive 1997/9/EC). It seems appropriate to review the functioning of this Directive given the length of time since the Directive was first introduced and the wider scope of the Markets in Financial Instruments Directive to cover new financial services. However, any decision to amend the ICSD must be preceded and based on careful assessments of the appropriateness and impact of such modifications and consider the ultimate objectives of financial stability and the protection of small retail investors, whilst also considering the important difference between the protection of depositors on the one hand and the protection of investors.

The BBA would like to provide the EU Commission with the following key messages:

1. The Investor Compensation Scheme Directive (ICSD) should not compensate investors against market risk.
2. The ICSD should not be aligned with MiFID to provide cover for all forms of investment services and activity: e.g. Multilateral trading facilities (MTFs) should be out of scope.
3. The maximum level of compensation under the ICSD should not increase to €100,000 as this would lead to excessive costs for firms.
4. The ICSD should not introduce a pre-funded or pooled fund as this would be prohibitively expensive, requiring a multi-billion euro /pound fund; moreover, alternative sources of liquidity could be considered.

Please see detailed comments to the question below in the Annex.

With kind regards,

A handwritten signature in black ink, appearing to read 'P. A. Tyler'.

Peter Tyler  
Policy Director, Retail

## **Annex – Answers to Commission Questions**

### ***Question 1 - Should the operation of multilateral trading facilities (MTFs) be excluded from the scope of the ICSD?***

Yes, the operation of MTFs should be excluded. The BBA does not believe that that the ICSD should cover MTFs because these are conduits to allow trades to occur. They are designed for market players and are therefore subject to the principle of 'buyer beware' and it is necessary to take a step back from compensating market players.

### ***Question 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.***

The BBA does not believe that the ICSD scheme should be extended to cover all forms of investment advice. The objective of the ICSD is to protect retail investors against losses of the investment firm holding the assets of the client. The ICSD - financed by the investment firms sector - should not be kept liable for irregularities or illegal acts committed by entities which are not authorised to hold clients' assets. An extension of the scope of application would also imply an unjustified and costly damage for conducting business.

The European Commission states (p.4) that an argument in favour of such inclusion would be that clients do not perceive any limitations in authorisations and should consequently be compensated by the firm which does not hold clients assets. The BBA believes that it is unlikely that clients do not perceive limitations in authorisations since they must either open a securities account with a bank themselves or shall give their consent to an investment firm to open the bank account on their behalf. Appropriate information on whether the investment firm in question is covered or not by the ICS would also be useful to ensure a high degree of investors' awareness.

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

We do not think that it is appropriate to extend the scope of the scheme to firms providing investment services to non-retail clients as these clients should be subject to the 'buyer beware' principle.

Professional investors are expected to conduct a survey on the manner in which investment firms make sure that they are able to return clients' assets and are expected to monitor the day to day business of their investment firm. Furthermore, professional clients are less in need of protection than are retail clients, which is why the protection of small investors is expressly mentioned in the ICSD recitals.

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

### ***Question 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 depositary or the institution which has been mandated to safe keep the assets, fail to perform its duty?***

No, they should not. Taking into consideration the objectives of the ICSD, it is not suited for compensation in these cases. Compensation for failures at the level of third parties should, nevertheless, be based on separate national laws on non-contractual liability and laws on investment firms' use of third parties.

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

No, they should not. The ICSD does not aim at compensating investors for losses in case of violation of business rules. At present if a purely advisory firm fails there is no pay-out from the scheme. It only operates if a firm holding client money or client assets fails. If the scope of scheme is extended to cover investment advice, mis-selling and violations of conduct of business rules, without a firm's failure, pay outs would be more frequent. Consequently, more funding would be required and the costs of compensation schemes would be much larger as a wider group of investments firms would be involved.

The industry as a whole should not have to pay for the failures of a single firm if it violates conduct of business rules, and is still solvent and able to compensate. Otherwise this could lead to perverse incentives for firms.

In the UK, the Financial Services Compensation scheme would cover investments if the firm becomes insolvent before a mis-selling claim is made against it. If the company is still trading, the investor would use established complaint resolution channels, such as the UK Financial Ombudsman Services (FOS).

Also, the justification of a clients' claim on compensation in these cases depends on a complex submission of evidence before a court or board of appeal; if the bank in question were found liable to pay compensation, this amount should be paid by the bankruptcy estate as a preferential claim or concurrent claim depending on the jurisdiction. Joint and multiple liability for other banks' bad investment advices should not be introduced.

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

No, it should not. There are important legal differences between deposit protection and investor protection. In addition, experience in Member States has so far shown no real problems at national level regarding investor protection schemes. Therefore, any potential increase of the level of coverage should be based on a thorough analysis of the need to raise the minimum level and, if so, to what maximum level, considering the importance of customer confidence in the financial system. Such analysis may very well prove that a smaller coverage level than that proposed in the revised Directive on Deposit Guarantee Schemes would suffice.

In the UK many aspects of Investor Protection are covered by the Financial Services Compensation Scheme and consumers already receive a high level of protection. The following levels of compensation apply: 100% of the first £30000 and 90% of the next 20000 to a maximum compensation £48,000.

Under the new proposals for the DGSD the maximum level of compensation will be increased to €100, 000 by 2010. We do not think that the maximum level of compensation for investments should also be increased to €100, 000 as this would lead to excessive costs.

**Question 7 - The ICSD does not harmonize the funding systems of schemes. Should the ICSD should provide some general principles concerning the funding of the schemes.**

No, the funding of the schemes should remain within the competence of the Member States. Funding mechanisms currently vary across Member States, some being ex post, others ex ante and yet others a mix between both. Moreover, in some Member States the Investor Compensation Scheme and the Deposit Guarantee Scheme are combined in one single fund, which implies that members pay one total contribution for both protection schemes together. In this situation, the funding mechanism of one scheme can hardly be discussed separately from the funding mechanism of the other and in any event, a revision of the ICSD should never result in the impossibility to combine DGS and ICS.

Any amendment to harmonise the funding mechanism should only be proposed where a preliminary assessment has proven that benefits would exceed costs incurred. In the case of the UK we are of the view that the Financial Service Compensation scheme should not be pre-funded nor should pool its funds with other EU compensations schemes.

***Question 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?***

The UK's Financial Services Compensation Scheme does not provide a mechanism to limit compensation scheme obligations over time.

***Question 9a - Should the process of recognizing the eligibility of the claim be regulated for the purposes of the ICSD?***

No, it should not because the determination of the eligibility of the claim under the ISC is much more complex than it is under DGS. However, the FSA's Compensation rules have a process to define an eligible claimant.

***Question 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. Most important is a careful and prudent investigation process regarding the eligibility of the claim. Given the rationale of the ICSD, a provisional compensation is not necessary. This does not mean that in case the prudent investigation shows that the client has a right for compensation such claim should not be paid out within a reasonable timeframe.

In the UK the FSA's compensation handbook provides for either reduced or interim payments in certain circumstances.

***Question 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 do not believe that schemes should be pre-funded or pooled in the EU, as this would be prohibitively expensive requiring a multi-billion Euro / British Pound fund. It is therefore, worth considering other methods of funding compensation schemes. For instance in the UK the Financial Services Compensation Scheme is able to borrow money to ensure that depositors are compensated.

It is also implicit in this question that a protection scheme needs to hold enough funds for immediate payout. However, while early repayment is needed for deposits this is less crucial for investor protection. People tend to meet their day to day liquidity from the deposits they hold in bank accounts. This does not arise for investments, like mutual funds, where funds tend not to be used for immediate liquidity needs.

***Question 10 - Do you think special attention should be given to money market funds?***

If the investor was sold a suitable product, the ICSD should not compensate investors against market risk if the fund they invested in loses value due to a fall in share price.

The BBA agrees with the Commission that investors in financial investments should not be protected from risks associated to their investments. There should therefore not be any compensation from ICS for any investment losses in money market funds due to fund investments losing value.

Since the purpose of the ICSD should not be to provide for guarantees in systemic crisis situations, the scope of the ICSD should not be extended to cover money market funds which would be deemed to be systemically relevant institutions. When a money market fund is systemically relevant, it (or the group of money market funds) has become too big to save by a guarantee scheme funded by other market participants.

The ICSD provides for a backstop when other protection measures have failed. The BBA views that investors in UCITS money markets funds should therefore only be compensated under the ICSD in the event that UCITS safeguards on asset segregation and depositary oversight have failed.

***Question 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 comment

End