

**DIRECTIVE 97/9/EC ON INVESTOR-COMPENSATION SCHEMES
CALL FOR EVIDENCE**

3. ISSUES AT STAKE

3.1. Scope - Investment services covered by the ICSD and loss events (Article 1, point. 2 and Article 2 (2) of the ICSD)

3.1.1. MTFs

<i>1) Should the operation of multilateral trading facilities be excluded from the scope of the ICSD?</i>
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Answer: No practice. According to current legal regime MTFs are excluded from the application of Investor compensation scheme.

Current definition of investment services

Article 2, Paragraph 10, of the Republic of Lithuania Law on Insurance of Deposits and Liabilities to Investors (No. IX-975, 20 June 2002, as last amended by Law No. X-1429, 18 January 2008, amended version effective as of 5 February 2008) states:

10. Investment services shall mean the investment and ancillary services referred to in paragraphs 13 and 22 of Article 3 of the Republic of Lithuania Law on Markets in Financial Instruments.

Article 3, Paragraphs 13 and 22, of the Republic of Lithuania Law on Markets in Financial Instruments (No. X-1024, 18 January 2007, effective 8 February 2007) foresee:

13. Investment services and investment activities (hereinafter referred to as “**investment services**”) – the following services and activities related to one or several financial instruments:

- 1) reception and transmission of orders;
- 2) execution of orders on behalf of clients;
- 3) dealing on own account;
- 4) management of a financial instrument portfolio;
- 5) provision of investment advice;
- 6) underwriting and/or placing of financial instruments on a firm commitment basis;
- 7) placing of financial instruments without a firm commitment basis;
- 8) operation of a multilateral trading facility.

22. Ancillary services:

- 1) safekeeping, accounting and administration of financial instruments for the account of clients, including custodianship and related services such as cash or collateral management;
- 2) granting a credit or a loan to an investor to allow him to carry out a transaction in one or more financial instruments, where the undertaking granting the credit or loan is involved in the transaction;
- 3) advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to reorganisation and the purchase of undertakings;
- 4) foreign exchange services where these are connected to the provision of investment services;
- 5) investment research, financial analysis or other forms of general recommendation relating to transactions in financial instruments;
- 6) services related to underwriting;
- 7) investment services, investment activities as well as ancillary services related to financial instruments, assets or other objects to which the derivatives indicated in subparagraphs 5, 6, 7 and 10 of paragraph 4 of this Article are related where the investment services or ancillary services provided or the investment activities performed are connected to these derivatives.

Definition of MTF

Article 3, Paragraph 2, of the Republic of Lithuania Law on Markets in Financial Instruments (No. X-1024, 18 January 2007, effective 8 February 2007) foresees the definition of Multilateral Trading Facility (cf. Article 4(1)(15) of MiFID directive 2004/39/EC)

2. Multilateral trading facility – a multilateral system, operated by a financial brokerage firm or a market operator, which brings together third-party buying and selling interests in financial instruments – in the system and in accordance with non-discretionary rules – in a way that results in a contract in financial instruments.

In compliance with Article 5(2) of MiFID directive Article 4, Paragraph 3, of the Republic of Lithuania Law on Markets in Financial Instruments (No. X-1024, 18 January 2007, effective 8 February 2007) excludes MTF from obligation to take part in authorised Investor Compensation Scheme.

Cf. Article 4, Paragraphs 1 and 3, in conjunction:

Article 4. Provision of Investment Services – Licensed Activities

1. Only the financial brokerage firms holding the licence of a financial brokerage firm as issued by the Securities Commission or the supervisory institution of another Member State, also the credit institutions licensed in the Republic of Lithuania or another Member State, where the licence of a credit institution grants the right to provide investment services, and the financial adviser undertakings holding the licence of a financial adviser undertaking as issued by the Securities Commission may provide investment services in the Republic of Lithuania as a regular occupation or business on a professional basis.

3. Paragraph 1 of this Article shall not apply to a market operator operating a multilateral trading facility and not proposing to provide other investment services. In such a case, the licence shall not be issued to the market operator, however it shall have the right to operate a multilateral trading facility only after the Securities Commission ascertains that the market operator meets the requirements specified in this section (with the exception of Article 11 of this Law) and inform the market operator thereof.

No obligation for MTFs to join Investor compensation scheme

Article 11, Paragraphs 1 and 2, of the Republic of Lithuania Law on Markets in Financial Instruments (No. X-1024, 18 January 2007, effective 8 February 2007) foresees obligation for undertaking seeking to obtain the licence of financial brokerage firm (licensing authority – Lithuanian Securities Commission) to join investor compensation scheme.

This requirements is applicable to licensed credit institutions (licensing authority – Bank of Lithuania) seeking to engage into the provision of investment services.

Article 11. Membership of an Authorised Investor Compensation System

1. An undertaking seeking to obtain the licence of a financial brokerage firm must insure the undertaking's liabilities to investors in accordance with the procedure laid down by the Law on Insurance of Deposits and Liabilities to Investors.

2. Provisions of paragraph 1 of this Article shall apply *mutatis mutandis* to licensed credit institutions.

3.1.2. Loss covered

(a) Firms not holding client's assets.

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?

Answer: Yes

Obligation to obtain the licence

Article 2, paragraph 25, of the Republic of Lithuania Law on Financial Institutions (No. IX-1068, 10 September 2002, effective 1 July 2003) foresees the definition of licensed financial services:

25. **“Licensed financial services”** shall mean the financial services subject to a licence issued in accordance with the procedure set forth by laws.

According to this definition, any financial undertaking or credit institution (financial institution) is obliged by law to obtain the license prior to entering into provision of licensed financial services.

Article 4, Paragraphs 1 and 3, in conjunction of the Republic of Lithuania Law on Financial Institutions treats financial undertakings and credit institutions as financial institution subject to this law.

Article 4. Financial Institution

1. A **financial institution** shall be a **financial undertaking** or a **credit institution**, which meets both requirements, set in paragraph 42 of Article 2 of this Law and engages in the provision of at least one of the financial services referred to in Article 3 of this Law.

3. The activities of a financial institution, which is engaged in the provision of licensed financial services, shall be supervised by the supervisory institutions specified in the laws of the Republic of Lithuania regulating pursuit of the activities of such institutions.

Article 4, Paragraph 1, of the Republic of Lithuania Law on Markets in Financial Instruments (No. X-1024, 18 January 2007, effective 8 February 2007) expressly requires any undertaking providing investment services on a regular occupation or business on a professional basis to obtain a license from relevant supervisory authority.

Licences issued by Lithuanian Securities Commission

Lithuanian Securities Commission issues licences for financial brokerage firms and financial adviser undertakings.

Licences issued by the Bank of Lithuania

The Bank of Lithuania issues licences for credit institutions. Credit institution seeking to provide investment services has to comply with requirements established by Lithuanian Securities Commission. Therefore, the Bank of Lithuania in any case shall request Lithuanian Securities Commission to state that the institution in question (applicant for the licence of credit institution) will comply with requirements for the provision of investment services.

The banking licence for a bank will include (or not) the provision of investment services only subject to requirements of Article 2, Paragraph 6, Subparagraph 4, of the Republic of Lithuania Law on Banks (No. IX-2085, 30 March 2004, effective 1 May 2004).

By analogy, the licence of Central Credit Union will include (or not) the provision of investment services subject to requirements of Article 2, Paragraph 5, Subparagraph 4, of the Republic of Lithuania Law on Central Credit Union (No. IX-2101, 8 April 2004, effective 1 May 2004).

Therefore the proposition in the Commission working documents has certain legal ratio.

Consistently with the rationale of the ICSD, the existence of an authorisation to the provision of at least one investment service may justify the coverage under the directive, even in the cases clients' assets are only de facto held by the investment firm.

(b) Investment services to non-retail clients.

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 services only to non-retail clients?

Answer: No

Exclusion from the scope of insurance cover

Article 3, Paragraph 4, of the Republic of Lithuania Law on Insurance of Deposits and Liabilities to Investors (No. IX-975, 20 June 2002, as last amended by Law No. X-1429, 18 January 2008, amended version effective as of 5 February 2008) foresees cases where the insurance cover may not be provided.

Article 3. Insurance Cover

4. Insurance coverage may not be provided to debt securities/deposit certificates issued by the same insurer or liabilities arising out of own acceptances and promissory notes and to the deposits of or liabilities to the following persons:

- 1) the Bank of Lithuania;
- 2) insurance undertakings;
- 3) credit institutions;
- 4) brokers undertakings;
- 5) insurance undertakings operating under the Law on Insurance;
- 6) pension funds and management undertakings of pension funds;
- 7) investment companies of variable capital and management undertakings;
- 8) undertakings engaged in leasing/financial lease.

Exclusion from the payment of compensation

Article 12, Paragraph 1, of the Republic of Lithuania Law on Insurance of Deposits and Liabilities to Investors (No. IX-975, 20 June 2002, as last amended by Law No. X-1429, 18 January 2008, amended version effective as of 5 February 2008) foresees the cases where the compensation may not be paid up:

Article 12. Limitations on Compensations

1. Compensations shall not be paid in the following cases:

- 1) to depositors or investors whose deposits or liabilities to the investors have been declared by a court ruling as acquired illegally;
- 2) to depositors or investors whose deposits or liabilities to the investors have been transferred, subject to contracts or any other way, after the day of the insured event;
- 3) to heads of the administration of a bank, a credit union or undertaking, heads of the subsidiaries/branches of a bank, a credit union or undertaking, members of the council/supervisory board and the board; to persons having at least 5 per cent of the bank's authorised capital, or persons holding at least 50 per cent of the capital of undertakings having at least 5 per cent of the bank's share capital; to persons who are carrying out independent audit of a bank, a credit union or undertaking; to children, adopted children, spouses, cohabitants living in registered partnership, parents and adoptive parents of the persons indicated above;
- 4) to borrowers of a bank, a credit union or undertaking where the deposits or liabilities to the investors are not in excess of their liabilities (the outstanding loans and interest). If the deposit of a borrower of a bank, a credit union or undertaking is in excess of his liabilities (the outstanding loans and interest), the insured sum shall be calculated by deducting the liabilities of the borrower from the deposit or liabilities to the investor, however, it may not be higher than the amount specified in Article 9(3) of this Law;
- 5) for deposits kept in anonymous and coded accounts;
- 6) for deposits for which the insured has fixed the interest rate twice as high as the interest rate set for comparable deposits held with the same credit institution.

The above provision comply Recital 17, Article 4 (2) and Annex I of the ICSD.

As a consequence, firms only providing services to non-retail clients, in principle, do not give rise to a claim against the scheme.

(c) Failure of third parties.

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

Answer: Yes

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

Answer: Yes

Transposition of Articles 12 and 13 of ICSD

According to Articles 12 and 13 of the ICSD, the Republic of Lithuania Law on Insurance of Deposits and Liabilities to Investors (No. IX-975, 20 June 2002, as last amended by Law No. X-1429, 18 January 2008, amended version effective as of 5 February 2008) foresees cover for investors in cases provided in Article 2(2) of the ICSD.

Article 2, Paragraph 1, of this Law foresees that an **insurance undertaking** shall mean the **state company Deposit and Investment Insurance**.

Article 20, Paragraph 1, Subparagraph 9, Republic of Lithuania Law on Insurance of Deposits and Liabilities to Investors (No. IX-975, 20 June 2002, as last amended by Law No. X-1429, 18 January 2008, amended version effective as of 5 February 2008) (transposing Article 12 of the ICSD) foresees:

Article 20. Rights of the Insurance Undertaking

1. The insurance undertaking shall have the right:

9) to receive a share of the assets of the bank, undertaking or credit union in liquidation which provided insurance coverage for deposits of depositors or liabilities to investors under this Law;

Article 87, Paragraph 2, Republic of Lithuania Law on Banks (No. IX-2085, 30 March 2004, effective 1 May 2004) (transposing Article 12 of the ICSD):

Article 87. Ranking of Creditors' Claims

2. The claims of the State undertaking "Deposit and Investment Insurance" on the expenses related to the payment of insurance benefits to the depositors or investors of a bank referred in the Law on Insurance of Deposits and Liabilities to Investors shall be satisfied second.

Article 71, Paragraph 2, Republic of Lithuania Law on the Central Credit Union (No. VIII-1682, 18 May 2000, version of the Law No. IX-2101, 8 April 2004, effective 1 May 2004) (transposing Article 12 of the ICSD):

Article 71. Ranking of Creditors' Claims

2. The claims of the State undertaking "Deposit and Investment Insurance" on the expenses related to the payment of insurance benefits to the depositors or investors of the Central Credit Union referred in the Law on Insurance of Deposits and Liabilities to Investors shall be satisfied second.

Article 10, Paragraph 5, Republic of Lithuania Law on Insurance of Deposits and Liabilities to Investors (No. IX-975, 20 June 2002, as last amended by Law No. X-1429, 18 January 2008, amended version effective as of 5 February 2008) (transposing Article 13 of the ICSD):

Article 10. Procedure for Paying an Insurance Compensation

5. Disputes over the right of a depositor or an investor to an insurance compensation shall be settled by court.

Management of accounts of financial instruments (X-1024, Article 65, transposing MiFID)

Article 65 of the Republic of Lithuania Law on Markets in Financial Instruments (No. X-1024, 18 January 2004, effective 8 February 2007) describes general principle of management of accounts of financial instruments. Paragraph 1 of this Article states:

Article 65. Management of Accounts of Financial Instruments

1. Financial brokerage firms, licensed credit institutions and the Central Depository shall have the right to open personal accounts of financial instruments.

Accounting of financial instruments (X-1024 (Article 64), transposing MiFID – ex Article 45 IX-655, transposing ISD

Article 64 of the Republic of Lithuania Law on Markets in Financial Instruments (No. X-1024, 18 January 2004, effective 8 February 2007) foresees basic principles of accounting of financial instruments. In general financial instruments are recorded by making entries in the personal accounts of financial instruments.

Article 64. Basic Principles of Accounting of Financial Instruments

1. Financial instruments shall be recorded by entries in the personal accounts of financial instruments managed in accordance with the procedure laid down by the Rules on Accounting of Financial Instruments and Their Circulation. These rules shall be prepared by the Central Depository and approved by the Securities Commission. Personal accounts shall be opened in the name of owners of the financial instruments, with the exception of the exceptions specified in paragraphs 2, 3, 4 and 5 of this Article.

2. The accounts of pledged financial instruments may be opened in the name of the holder of the pledge also indicating the owner of the financial instruments. The entry of pledged financial instruments in an account opened in the name of the holder of the pledge shall be considered as transfer thereof to the holder of the pledge.

3. Accounts of customers of the managers of accounts registered in foreign states may be opened in the name of the managers of the accounts indicating that they act as managers of accounts and an account is opened for the benefit of the customers. Managers of foreign accounts in the name whereof such accounts are opened must, on demand of the Securities Commission or the Central Securities Depository of Lithuania, indicate the clients for the benefit whereof financial instruments have been acquired.

4. The financial instruments pledged to the European Central Bank or the central bank of another Member State may be recorded by entries in the accounts opened in the name of the Bank of Lithuania in the Central Depository indicating the holder of the pledge and the owner of the financial instruments. Entries in these accounts shall be made according to instructions of the Bank of Lithuania.

5. The financial instruments transferred into the ownership of the European Central Bank or the central bank of another Member State according to repurchase or other transactions may be recorded by entries in the accounts opened in the name of the Bank of Lithuania in the Central Depository indicating the European Central Bank or the central bank of the Member State as the holder of the financial instruments. Entries in these accounts shall be made according to instructions of the Bank of Lithuania.

Claims against third parties

Entering record of financial instrument in the account of the pledge holder is considered a transfer of financial instrument in trust with him. The right to possess and use passes to the pledge holder (cf. Article 4.213 of the Civil Code in conjunction with Article 64, Paragraph 2, of the Republic of Lithuania Law on Markets in Financial Instruments (No. X-1024, 18 January 2008))

The Law on Markets in Financial Instruments (Article 64, Paragraphs 4 and 5) foresee the cases of pledge and title transfer of financial instruments (to the ECB and the NCBs of the ESCB including the Bank of Lithuania) kept in the account of CSDL. The right to possess, use and dispose of the object of title transfer (cash, book entry financial instruments and, and in future - credit claims, subject only to entitlement (right to possess and use), shall pass to the titleholder. However, the general law does not foresee the title transfer as a separate kind of security of obligations (Article 6.70 of the Civil Code).

It might be rationale to supplement Civil Code with specific Chapter (Title Transfer):
Chapter XII-1 “Title transfer and Re-use of Collateral”

Enforcement of financial collateral (Article 4(1) of FCD)

Republic of Lithuania Law on Financial Collateral Arrangements (No. IX-2127, 15 April 2004)

Article 9. Enforcement of Financial Collateral Arrangements

Paragraphs 1, 2 and 3

1. The collateral provider shall notify the collateral taker in writing of the performance of relevant financial obligations not later than on the same day.
2. According to the financial collateral arrangement, the collateral taker (creditor) shall have the right, in case the debtor defaults on his relevant financial obligations secured by financial collateral, to satisfy his claim from the financial collateral or its value prior to other creditors.
3. On the occurrence of an enforcement event, the collateral taker shall have the right to realise financial collateral provided under the security financial collateral arrangement unilaterally in the following manners, subject to the terms agreed in a security financial collateral arrangement:
 - 1) to sell or appropriate financial instruments or apply their value in discharge of the relevant financial obligations;
 - 2) in case of cash, to set off the amount against or otherwise apply it in discharge of the relevant financial obligations.

Appropriation of financial collateral (Article 4(2) of FCD)

Republic of Lithuania Law on Financial Collateral Arrangements (No. IX-2127, 15 April 2004)

Article 9. Enforcement of Financial Collateral Arrangements

Paragraph 4

4. Appropriation of financial instruments is possible only if the parties have agreed on the appropriation of financial instruments and their valuation in the security financial collateral arrangement.

The manners of realising the financial collateral (Article 4(4) of FCD)

Republic of Lithuania Law on Financial Collateral Arrangements (No. IX-2127, 15 April 2004)

Article 9

Paragraph 5

5. The manners of realising the financial collateral referred to in paragraph 3 shall, subject to the terms agreed in the security financial collateral arrangement, be without any requirement to the effect that:
 - 1) prior notice of the intention to realise must have been given;
 - 2) the terms of the realisation be approved by a court, other institution or other person;
 - 3) the realisation be conducted by public auction or in any other manner established in the legislation;
 - 4) any additional time period must have elapsed.

Effectiveness of financial collateral arrangement in accordance with its terms notwithstanding the commencement or continuation of winding-up proceedings or reorganisation measures in respect of the collateral provider or collateral taker

Republic of Lithuania Law on Financial Collateral Arrangements (No. IX-2127, 15 April 2004)

Article 9. Enforcement of Financial Collateral Arrangements

Paragraph 8

8. A financial collateral arrangement shall come into effect in accordance with its terms notwithstanding the commencement or continuation of winding-up proceedings or reorganisation measures in respect of the collateral provider or collateral taker.

Republic of Lithuania Law on Settlement Finality in Payment and Securities Settlement Systems

(No. IX-1597, 5 June 2003)

(Version of the Law No. IX-2128, 15 April 2004, with effect as of 1 May 2004)

Article 9. Right to Collateral

Paragraph 1

1. If a system participant or a transaction counterparty of the Bank of Lithuania, the central banks of the Member States and the European Central Bank does not fulfil the obligation secured by a collateral in a

timely manner, other system participant or the said banks shall have a right to take over the collateral and to realise it in accordance with the procedure set forth by legal acts. This right shall be applied notwithstanding the suspension of operations and (or) bankruptcy proceedings initiated against a system participant or a transaction counterparty of the Bank of Lithuania, the central banks of the Member States and the European Central Bank. Upon satisfying the claims secured by a collateral, the remaining amount shall be paid to the provider of the collateral or allocated for satisfying the claims of other creditors.

Republic of Lithuania Enterprise Bankruptcy Law (No. IX-216, 20 March 2001)

(Version of the Law No. IX-2129, 15 April 2004, with effect as of 1 May 2004)

Article 10. Instituting Bankruptcy Proceedings in Court

Paragraph 7, Subparagraph 3

7. After the court decision to institute bankruptcy proceedings becomes effective:

3) discharge of liabilities not met prior to the institution of bankruptcy proceedings, including payment of interest, penalties, taxes and other mandatory payments, also recovery of debts from the enterprise through court or without suit shall be prohibited. Computation of penalties and interest on all obligations of the enterprise, including on default in payments related to employment relationship, shall be suspended. A judgement mortgage may not be imposed. The effect of the collective bargaining agreement concluded in the enterprise shall be restricted as prescribed by the meeting of creditors. Prohibitions to discharge financial liabilities and to recover debts are not applied in the cases set out by the Law on Settlement Finality in Payment and Securities Settlement Systems and the Law on Financial Collateral Arrangements;

Article 14. Disposal of the Assets of the Enterprise in Bankruptcy

Paragraph 1, Subparagraph 1

1. From the day the decision to institute of bankruptcy proceedings becomes effective:

1) the right to manage, use and dispose of the assets/funds of the enterprise in bankruptcy shall be granted only to the administrator. No creditor of the enterprise shall have the right to take over the property and funds owned by the enterprise otherwise than prescribed by this Law, except the cases set out by the Law on Settlement Finality in Payment and Securities Settlement Systems and the Law on Financial Collateral Arrangements;

Republic of Lithuania Law on Restructuring of Enterprises (No. No. IX-218, 20 March 2001)

(Version of the Law No. IX-2130, 15 April 2004, with effect as of 1 May 2004)

Article 9. Liabilities of the Enterprise under Restructuring and Meeting the Liabilities to the Enterprise under Restructuring

Paragraph 1, Subparagraphs 1 and 3

1. From the day when a decision to initiate restructuring proceedings becomes effective the following shall apply:

1) it shall be prohibited to discharge liabilities which were not discharged before the day when the court order to initiate the enterprise restructuring proceedings became effective, including payment of interest, default interest and compulsory payments, to recover debts from the enterprise in a judicial or extrajudicial manner, to apply judgement mortgage, servitudes, usufruct, to offset claims, to pledge, with the exception of cases under subparagraph 5 of this paragraph, sell or transfer in any other way the assets of the enterprise necessary for the continuation of its activities. Prohibitions to discharge financial liabilities and to recover debts are not applied in the cases set out by the Law on Settlement Finality in Payment and Securities Settlement Systems and the Law on Financial Collateral Arrangements;

3) recovery under writs of execution and a set-off of the claims shall be suspended if they are not provided for in the restructuring plan, except the cases set out by the Law on Financial Collateral Arrangements;

Republic of Lithuania Law on the Bank of Lithuania (No. I-678, 1 December 1994)

(Version of the Law No. IX-2131, 15 April 2004, with effect as of 1 May 2004)

Article 53. Recovery of Funds and Securities from Borrowers Failing to Fulfil their Obligations

Paragraph 3

3. In the event the borrower fails to fulfil its obligations on the date specified in an agreement, and the performance of the said obligations has been secured by a pledge of securities or any financial assets other than the funds on the borrower's bank account, the Bank of Lithuania shall have the right to take over and realise the pledged assets in the manner prescribed by legal acts. The Bank of Lithuania may exercise such a right even if bankruptcy proceedings are initiated against the borrower or the prohibition on disposal of pledged assets is imposed on him.

Law on the amendment of Articles 1, 6, 7, 8, 11, 12, 14, 18, 19, 20, 25, 31, 33, 35, 36, 38, 47, 49, 50, 53, 54, 54¹, 55, amendment of titles of Chapters Four and Five of the Republic of Lithuania Law on the Bank of Lithuania, repeal of Article 26, 27, 28, 29, 30, 32, 37 and supplement of Annex to the Law (No. X-569, 25 April 2006)

(Takes effect upon abrogation of derogation pursuant to Article 122(2) of the EC Treaty)

Article 28. Amendment of Paragraph 3 of Article 53

Paragraph 3 of Article 53 shall be amended and shall be worded as follows:

“3. In the event that a borrower fails to fulfil its obligations on the date specified in the agreement, and the performance of said obligations has been secured by a financial collateral (collateral), the Bank of Lithuania shall have the right to take over the provided financial collateral (collateral) and realise it in the manner prescribed by legal acts. The Bank of Lithuania may exercise such a right even if bankruptcy proceedings have been initiated against the borrower or a prohibition on the disposal of the financial collateral (collateral) has been imposed.”

Proposal for the draft amendment of the Republic of Lithuania Code on Civil Procedure:

Law No. X- on the supplement of Article 587 of the Republic of Lithuania Code on Civil Procedure with the new Subparagraph 4 and supplement of Article 626, Subparagraph 3, with a new sentence (2007)

(Takes effect upon abrogation of derogation pursuant to Article 122(2) of the EC Treaty)

Article 2. Supplement of Article 587 with the new Subparagraph 4

1. To supplement Article 587 with the new Subparagraph 4 and to word it:

“4) decisions of managing bodies of the Bank of Lithuania, the European Central Bank, national central banks of the Member States of the European Union and any other participant of the payment and securities settlement system legally operating (registered) in the Republic of Lithuania on the exaction of financial collateral pledged or transferred by a title transfer to the Bank of Lithuania, the European Central Bank, national central banks of the Member States of the European Union and any other participant of the payment and securities settlement system legally operating (registered) in the Republic of Lithuania from the debtor or any other person, with the exception of a honest acquirer (honest pledgee or honest buyer).”

2. The former Subparagraph 4 of Article 587 shall become Subparagraph 5.

Article 3. Supplement of Article 626, Subparagraph 3

To supplement Article 626, Subparagraph 3, with the new sentence and to word it:

“3) upon institution of bankruptcy case to the debtor, with the exception of non proprietary cases. In this case the writ of execution is transmitted to the court instituting the bankruptcy case. **The executive case is not stayed where the Bank of Lithuania, the European Central Bank, a national central bank of the Member State of the European Union or any other participant of the payment and securities settlement system legally operating (registered) in the Republic of Lithuania, in the order prescribed by laws, is exacting financial collateral pledged or transferred to them by a title transfer for a security of an obligation.**”

Unity of primary and secondary obligations

The answer to the question whether an investor (such as an individual, a UCITS or a UCITS unit holder) should be able to claim compensation for losses provoked by the third party, even if he may not have a direct contractual relationship with that party, shall depend on the nature of main obligation and subsidiary obligation.

General rule is that main obligation and subsidiary obligation may not be severed.

This rule has to be enforceable throughout the legal system of the nation and cross-frontier subject to the fallback rule (exclusion of *ren voi*) whereas any choice of law may not refer back to the law of forum.

In case of Lithuania state company Deposit and Investment Insurance is an entity which will receive a share of the assets of the bank, undertaking or credit union in liquidation which provided

insurance coverage for deposits of depositors or liabilities to investors under the Republic of Lithuania Law on Insurance of Deposits and Liabilities to Investors.

Republic of Lithuania Law on Banks provides a possibility to take bank shares for public needs and thus to perform the obligations to investors.

(d) Violation of conduct of business rules

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

Answer: To be discussed. It is necessary to conjunct the matter of compensation with the safeguard clause requiring intermediaries to abstain from misconduct and/or misuse of financial instruments in trust with them set by Article 19(5) of MiFID.

As a rule, national law should imply an obligation for intermediaries (cf. register, account, central depository) to protect customers financial instruments.

Cf. CESR – Code of Conduct – CCPS, CSDs, Clearing Houses

Cf. CESR – Standard 12 (Protection of Customers' securities) Standards for Securities Clearing and Settlement Systems in the European Union

Scope of insurance of liabilities to investors

Recital 8 and Article 2(2) of the ICSD.

Article 2(2) of ICSD

Article 2, Paragraph 2, Article 9, Paragraph 1, Second Sentence, and Article 10, Paragraph 1, of the Republic of Lithuania Law on Insurance of Deposits and Liabilities to Investors (No. IX-975, 20 June 2002, as last amended by Law No. X-1429, 18 January 2008, amended version effective as of 5 February 2008) transpose Article 2(2) of the ICSD).

Article 2, Paragraph 2, IX-975, foresees:

Article 2. Definitions

2. Insured event shall mean institution of bankruptcy proceedings against a credit union, bank or undertaking or taking of a decision by a supervisory authority on discontinuation of banking activities, acceptance of deposits or provision of investment services where the credit union or bank (branch of the bank) is not able to settle with creditors or when the undertaking (branch of the undertaking) is not capable of meeting its liabilities to investors.

Article 9, Paragraph 1, Second Sentence, IX-975, foresees:

Article 9. Amount of an Insurance Compensation

1. When calculating an insurance compensation for liabilities to investors, only those securities and funds of the investor shall be included into the liabilities to the investor which the insured is not able to repay to the investor.

Article 10, Paragraph 1, IX-975, foresees:

Article 10. Procedure for Paying an Insurance Compensation

1. Insurance compensations shall be paid in Litas within three months from the day of an insured event. The council of the insurance undertaking may extend this time limit for up to three months (in case of deposit insurance – not more than twice for up three months each time).

Important client losses could result from the violation of conduct of business rules, in the case the firm is unable to compensate the investor itself. This kind of event is clearly outside the current scope of the ICSD (which covers the inability of the firm to refund the money or securities belonging to investors).

Lithuania has chosen to cover only those securities and funds of the investor shall be included into the liabilities to the investor which the insured is not able to repay to the investor.

Losses suffered by the investor as a consequence of unsuitable advice

Article 19 (5) of the MiFID.

Article 22, Paragraphs 7, 8, 9, of the Republic of Lithuania Law on Markets in Financial Instruments (No. X-1024, 18 January 2007, effective 8 February 2007) foresee:

Article 22, Paragraphs 7, 8, 9, X-1024, foresees:

Article 22. Duties of a Financial Brokerage Firm in Providing Investment Services to a Client

7. Prior to commencing the provision of the investment services other than those referred to in paragraphs 5 and 10 of this Article, a financial brokerage firm must offer to a client or potential client to provide information regarding his knowledge and experience in the investment field relevant to specific investment services or financial instruments offered by the financial brokerage firm or demanded by the client or potential client himself. On the basis of the information received, the financial brokerage firm must assess whether specific investment services and financial instruments are appropriate for the client.

8. In the case a financial brokerage firm considers, upon assessing the information indicated in paragraph 7 of this Article, that an investment service or financial instrument is not appropriate to a specific client or potential client, it must warn the client or potential client. The warning may also be provided in a standardised format.

9. In cases where a client or potential client refuses to provide the information referred to in paragraph 7 of this Article or provides insufficient information regarding his knowledge and experience in the investment field, a financial brokerage firm must warn the client or potential client that the client's refusal to provide the required information or provision of insufficient required information does not allow the financial brokerage firm to determine whether specific investment services and financial instruments are appropriate for the client. This warning may also be provided in a standardised format.

The fact is given that the issue may relate to events such as losses suffered by the investor as a consequence of unsuitable advice, inappropriate investments (without the warning required by MiFID) and, more in general, losses in circumstances where the violation of conduct of business rules has been a decisive factor in the investor choice.

In this context, Lithuanian national legal regime in principle eliminates the possibility of misconduct by intermediaries and/or misuse by intermediaries of financial instrument in trust with them.

Since the matter correlates with the national Execution Measures of the member States transposing the provisions of Article 19(5) of MiFID, it is first of all necessary to find out whether all of the Member States have transposed the requirement set by MiFID.

The question is given whether the ICSD should cover such losses, in the case the investment firm is unable to compensate the investor because of default or insolvency events.

Article 68, of the Republic of Lithuania Law on Markets in Financial Instruments (No. X-1024, 18 January 2007, effective 8 February 2007) foresees:

Article 68. Rights and Duties of the Central Depository

1. The Central Depository must:

3) open accounts of managers of accounts and personal accounts of financial instruments and manage them;

- 4) ensure a timely transfer of financial instruments from an account of financial instruments of one manager of accounts to an account of financial instruments of another manager of accounts when executing transactions in the financial instruments;
- 5) control the correspondence of the number of the financial instruments of each issue put into circulation to the number of these financial instruments actually in circulation;
- 7) control compliance, by managers of accounts, with provisions of the rules on accounting of financial instruments and other documents regulating the accounting of the financial instruments and their circulation.

The Central Securities Depository of Lithuania is obliged by law to control the operations by intermediaries. Thus it should ensure the safe and sound turn-over (circulation) of financial instruments.

Lithuanian Securities Commission has established a List of Regulated Markets (Resolution No. 1K-28, 6 September 2007)

- 1) Vilnius Stock Exchange Official Trading List (CSDL)
- 2) Vilnius Stock Exchange Supplementary Trading List (CSDL)
- 3) Vilnius Stock Exchange Debt Securities Trading List (CSDL)

3.2. The amount of compensation (Article 4 of the ICSD)

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

Answer: Yes. The increase of the coverage of the DGSD done by directive 2009/14/EC may justify a parallel adaptation of the ICSD.

Lithuania had transitional periods for implementation of directives 94/19/EC (DGSD) and 97/9/EC (ICSD). Transitional period in case of Lithuania was transitional period regarding minimum level of deposit guarantee schemes and minimum level of investor compensation schemes. The Act of Accession has postponed the final date for implementation of certain provisions of directives 94/19/EC and 97/9/EC on the minimum level of deposit guarantee schemes and minimum level of investor compensation schemes.¹

In 2006 the Commission has adopted a Communication from the Commission to the European Parliament and the Council concerning the review of Directive 94/19/EC on Deposit Guarantee Schemes, Brussels, 27.11.2006, COM(2006) 729 final. In case of Lithuania it was necessary to adapt national law at the end of transitional period.

Republic of Lithuania Seimas (Parliament) adopted the Law on Amendment and Supplement of Articles 1, 2, 3, 4, 5, 7, 8, 9, 10, 12, 14, 15, 21, 24, 25 and Annex of the Law on Insurance of Deposits and Liabilities to Investors (No. X-1429, 18 January 2008)². The law is effective as of 5 February 2008. It foresees the minimum level of deposit guarantee schemes and investor compensation from the 1 January of 2008. The insured amount of deposit and liabilities to investor is EUR 22 thousand. Thus the minimum level of compensation to each depositor and/or investor shall not be less than EUR 20 thousand.

¹ Annex IX: List referred to in Article 24 of the Act of Accession: Lithuania – 3 Freedom to provide services, Items: 1. 31994L0019 and 2. 31997L0009, Act concerning the conditions of accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic and the adjustments to the Treaties on which the European Union is founded, *Official Journal of the European Union*, L 236, 23 September 2003, p. 838.

The cross references of transitional periods for Lithuania in CELEX and EUR-LEX databases are:

- 31994L0019 – 12003TN09/03 (minimum level of deposit guarantee schemes);
- 31997L0009 – 12003TN09/03 (minimum level of investor compensation schemes).

² Republic of Lithuania Law on Amendment and Supplement of Articles 1, 2, 3, 4, 5, 7, 8, 9, 10, 12, 14, 15, 21, 24, 25 and Annex of the Law on Insurance of Deposits and Liabilities to Investors/Seimas of the Republic of Lithuania, <http://www.lrs.lt>.

In fall of 2008 Lithuania has raised an insurance amount of deposits. It has adopted an amendment of a law. The amendment came into effect on 1 November 2008. Article 5, Paragraph 1, Subparagraph 5, of the Republic of Lithuania Law on Insurance of Deposits and Liabilities to Investors (the Law on Insurance of Deposits and Liabilities to Investors) states:

“1. The insured sum shall be equal to the depositor’s deposit kept with a bank, a branch of a bank or a credit union on the day of the insured event, however it may not exceed:

5) the amount in Litas equivalent to EUR 100 000 – from 1 November 2008 until 31 October 2009.”

Amount of an Insurance Compensation shall be equal to the insurance amount of deposit. Article 9, Paragraph 3, Subparagraph 6, of the Law on Insurance of Deposits and Liabilities to Investors foresees:

“3. Amounts of insurance compensations for depositors or investors shall be as follows:

6) from 1 November 2008 until 31 October 2009 – 100 per cent of the deposit up to the amount of Litas equivalent to EUR 100 000.”

This national measure is without prejudice to the Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay.³ The above national measure is without prejudice to future National Execution Measures to be adopted in transposing the Community measure.

Lithuania will have to adopt National Execution Measures in transposing directive 2009/14/EC. Accordingly, it will have to adopt relevant National Execution Measures in transposing future Community measure dealing with investor compensation schemes.

3.3. Funding of the investor compensation schemes (Recital 23 of the ICSD)

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?

Answer: To be discussed. Current legal regulation in Lithuania is fully consistent with the minimum harmonization approach taken by the ICSD.

Insurance premiums by undertakings

The Republic of Lithuania Law on Insurance of Deposits and Liabilities to Investors (No. IX-975, 20 June 2002, as last amended by Law No. X-1429, 18 January 2008, amended version effective as of 5 February 2008 foresees the amounts of insurance premiums to be paid up by undertakings (providers of investments services).

Article 7. Insurance Premium of Undertakings

1. The annual premium for the undertakings which are not entitled to provide a supplementary service of safekeeping of the securities and funds belonging to clients shall amount to LTL 3000. The annual premium for the undertakings which are entitled to provide a supplementary service of safekeeping of the securities and/or funds belonging to clients shall amount to LTL 10000.

2. The undertakings which execute orders on account of clients shall additionally pay a portion of the annual premium – 0.01 per cent of the total value of the orders executed over the previous calendar year, however, this portion may not be lower than LTL 1000 and not higher than LTL 10000.

Insurance premiums by credit institutions

The above law also provides the amounts of insurance premiums to be paid by credit institutions. These premiums prelate to acceptance of deposits and other repayable funds, as well as to provision of the investment services. The insurance premium of banks and branches of banks shall not depend on the investment services provided by them.

³Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay Text with EEA relevance, *Official Journal of the European Union*, No. L 68, 13.3.2009, p. 3–7

Article 6. Insurance Premium of Banks, Branches of Banks and Credit Unions

1. The insurance premium for banks, branches of banks and credit unions shall be calculated from the amount of the Litas-denominated and/or foreign currency-denominated balance of money on the depositors' accounts opened under bank deposit and/or bank account agreements at credit unions, banks and branches of banks where the deposits held with them are not compensated or protected in any other way under the legislation of a foreign state having jurisdiction over the foreign bank which has established the branch. When providing, in the case provided for by this Law, supplementary cover for deposits, the insurance premium shall be calculated from the amount which consists the difference between the balance of money on the accounts of deposits under supplementary coverage opened under bank deposit and/or bank account agreements and the compensations payable to depositors under the legislation of a foreign state.

2. The annual rate of an insurance premium shall, with the exception of the case provided for in paragraph 3 of this Article, be as follows:

1) 0.45 per cent for banks and branches of banks;

2) 0.2 per cent for credit unions.

3. The council of the insurance undertaking shall have the right to change the rate of the insurance premium in the following cases:

1) when the ratio between the Deposit Insurance Fund and all the deposits covered by insurance becomes higher than 3 per cent, but does not exceed 4 per cent. In this case, the annual rate of the insurance premium for the insured indicated in subparagraph 1 of paragraph 2 of this Article may not be lower than 0.045 per cent, and for the insured indicated in subparagraph 2 of paragraph 2 of this Article – not lower than 0.0025 per cent;

2) when the ratio between the Insurance Fund and all the deposits covered by insurance becomes higher than 4 per cent. In this case, the annual rate of the insurance premium for the insured specified in subparagraph 1 of paragraph 2 of this Article may not be lower than 0.001 per cent, and for the insured specified in subparagraph 2 of paragraph 2 of this Article – not lower than 0.0005 per cent.

4. The banks which have acquired the right to accept deposits, in the cases provided for in paragraph 1 of Article 4 the foreign banks which have established the branches entitled to accept deposits shall, in accordance with the procedure laid down by the council of the insurance undertaking, pay to the account of the insurance undertaking the first (advance) insurance premium in the amount of LTL 5000. The credit unions which have the right to accept deposits and the newly established credit units which have acquired the right to accept deposits shall, in accordance with the procedure laid down by the council of the insurance undertaking, pay to the account of the insurance undertaking the first (advance) insurance premium in the amount of LTL 500. Other insurance premiums shall be calculated by the insured and shall be paid by it to the account of the insurance undertaking each month.

5. The insurance premium of banks and branches of banks shall not depend on the investment services provided by them.

Calculations of Insurance Contributions and Procedure of Payment by State Undertaking “Deposit and Investment Insurance”

Calculations of Insurance Contributions and Procedure of Payment has been approved by State Undertaking “Deposit Insurance Fund” council’s decision of 26th of March 2001, No 2. Currently the updated version of State Undertaking “Deposit and Investment Insurance” council’s decision No 02-5-1 of the 20th of May 2008 is effective as of 28 May 2008.

Calculation of Insurance Contributions for Banks, Bank Branches and Credit Unions

11. Banks which were granted the right to take deposits and foreign banks, after opening branches, which have a right to accept deposits according to Part 3 of Article 3 of the Law pay the first (advance) insurance contribution of 5000 Litas into the insurance undertaking’s account. Credit unions which were granted the right to take deposits and newly formed credit unions which were granted the right to take deposits pay the first (advance) insurance contribution of 5000 Litas into the insurance undertaking’s account. The first (advance) insurance contribution is included in other payable insurance contribution amounts.

12. Annual insurance contribution is:

12.1. 0.45 per cent for banks and bank branches

12.2. 0.2 per cent for credit unions

13. The insurance contribution is calculated in Litas. The contribution is calculated by policyholder based on the insured deposits. Policyholders convert foreign currency deposits into Litas according to the official exchange rate between Litas and other foreign currencies set by the bank of Lithuania on that particular day.

Paragraph 14 provides a formula for calculation of insurance contribution for banks, bank branches and credit unions.

15. Banks, bank branches and credit unions must provide reports to the insurance undertaking where the balance of insured deposit for each calendar month and calculated insurance contributions are indicated. Reports must be printed, signed by the chairperson of the bank, bank branch or credit union (or his/her authorized representative) and by the chief accountant and delivered to the insurance undertaking until the 15th of the following month. Data of the report must also be presented to the insurance undertaking by electronic means. The form of the report is determined by the insurance undertaking administration and banks, branches and credit unions shall be informed accordingly.

Calculation of Insurance Contributions for Companies and Company Branches

16. Insurance contribution:

16.1. For companies and company branches which do not have a right to provide additional services, i.e. safeguard the equities and cash sums of the customers, annual contribution is 3000 Litas;

16.2. For companies and company branches which have a right to provide additional services, i.e. safeguard the equities and cash sums of the customers, annual contribution is 10000 Litas;

16.3. Companies or company branches, executing transfers for customer accounts, additionally pay annual contribution of 0.01 per cent from the gross value of executed transfers during the previous calendar year, but this contribution cannot be lower than 1000 Litas and cannot exceed 10 000 Litas.

Paragraph 17 provides a formula for calculation of first annual insurance contribution for newly established companies or newly established company branches or for companies or company branches, which insurance has been terminated temporarily or permanently.

18. Insurance contribution is calculated in Litas. Companies and company branches convert all transfers made for customer accounts in foreign currency for the last calendar year into Litas according to the official exchange rate of Litas and the foreign currency set by the bank of Lithuania on the date of the transfer.

19. Companies and company branches must submit reports to the insurance undertaking, where they indicate whether they have or have not the right to provide an additional service, i.e. to safeguard the equities and cash sums of the customers, whether they make or not transfers for customer accounts, the gross value of all transfers made for customer accounts during the previous calendar year and insurance contributions. Reports must be printed, signed by the company or company's branch chairperson (or his legal representative) and by the chief accountant and presented to the insurance undertaking until the 15th of January, newly established companies or company branches submit the report within 5 business days from the receipt of the notification, indicated in point 9 of this procedure and companies or company branches, which insurance has been temporarily terminated, after insurance renewal must submit the report within 5 business days of the insurance renewal day. Data of the report must also be presented to the insurance undertaking by electronic means. The form of the report is determined by the insurance undertaking administration and it informs companies and company branches.

3.4. The restrictions on the carryover of unpaid reimbursement debts

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?

Answer: Yes. State Undertaking "Deposit and Investment Insurance" may provide data on unpaid compensations if there were such cases in practice.

8b) Should this kind of mechanisms be prohibited?

Answer: To be discussed. The procedure for payment of insurance compensations is established by law and the regulatory enactment of State Undertaking “Deposit and Investment Insurance”. The law provides the limitations on insurance compensations. Disputes over the right of a depositor or an investor to an insurance compensation shall be settled by court.

Procedure for Paying of Insurance Compensation

The Republic of Lithuania Law on Insurance of Deposits and Liabilities to Investors (No. IX-975, 20 June 2002, as last amended by Law No. X-1429, 18 January 2008, amended version effective as of 5 February 2008) foresees the procedure for paying of insurance compensation.

Article 10. Procedure for Paying an Insurance Compensation

1. Insurance compensations shall be paid in Litas within three months from the day of an insured event. The council of the insurance undertaking may extend this time limit for up to three months (in case of deposit insurance – not more than twice for up three months each time).
2. A depositor or an investor shall be entitled to an insurance compensation for a period of five years from the day of an insured event.
3. An insurance compensation shall be calculated and paid by the insurance undertaking on the basis of the data as of the day of an insured event about depositors or investors, their deposits or liabilities to the investors as well as about the amounts of deposits or liabilities to the investors covered by supplementary insurance. The procedure for calculating and paying insurance compensations shall be determined by the council of the insurance undertaking and published in the official gazette Valstybės žinios.
4. The amount of a supplementary insurance compensation shall be calculated by deducting from the insurance compensation calculated pursuant to provisions of Article 9 of this Law the insurance compensation (guarantee) calculated pursuant to the legislation of a foreign state.
5. Disputes over the right of a depositor or an investor to an insurance compensation shall be settled by court.

Article 3 of ICSD

Article 12, Paragraph 2, of IX-975

Article 12. Limitations on Insurance Compensations

2. Payment of insurance compensations to the depositors and investors against whom an application has been filed with law enforcement or courts in respect to the legality of acquisition of their deposit funds or liabilities to the investors shall be suspended until the coming into effect of a ruling.

Article 4(2) and Annex I of ICSD

Article 3, Paragraph 4, of IX-975

Article 3. Object of Insurance

4. Insurance coverage may not be provided to the debt securities (deposit certificates) issued by the same insured or the liabilities arising out of own acceptances and promissory notes, the mortgage bonds issued under the Republic of Lithuania Law on Mortgage Bonds and Mortgage Loans, also the deposits or liabilities to the following entities:
 - 1) the Bank of Lithuania;
 - 2) insurance undertakings;
 - 3) credit institutions;
 - 4) financial brokerage firms;
 - 5) the insurance undertakings operating under the Law on Insurance;
 - 6) pension funds;
 - 7) management companies;
 - 8) the undertakings engaged in leasing (financial lease);
 - 9) collective investment undertakings.

Article 12, Paragraph 1, of IX-975

Article 12. Limitations on Insurance Compensations

1. Insurance compensations shall not be paid in the following cases:

- 1) to the depositors or investors whose deposits or liabilities to the investors have been declared as illegally acquired by a court ruling;
- 2) to the depositors or investors whose deposits or liabilities to the investors have been transferred, under contracts or in any other way (with the exception of inheritance), after the day of an insured event;
- 3) to heads of the administration of a bank, a credit union or an undertaking, heads of branches of a credit union or an undertaking, members of the council (supervisory board) and the board; to the persons holding at least 5 per cent of a bank's share capital, or the persons holding more than 50 per cent of the capital of the undertakings holding at least 5 per cent of the bank's share capital; to the persons who are carrying out an independent audit of a bank, a credit union or an undertaking; to the children, adopted children, spouses, cohabitants living in registered partnership, parents and adoptive parents of the persons indicated in this subparagraph;
- 4) to borrowers of a bank, a credit union or an undertaking, where the deposits or liabilities to investors are not in excess of their liabilities (the outstanding loans and interest). If the deposit of a borrower of a bank, a credit union or an undertaking is in excess of the borrower's liabilities (the outstanding loans and interest), the insured amount shall be calculated by deducting the borrower's liabilities from the deposit or liabilities to the investor, however, it may not exceed the amount indicated in paragraph 3 of Article 9 of this Law;
- 5) for the deposits kept in anonymous and coded accounts;
- 6) for the deposits for which the insured has fixed an interest rate twice as high as the interest rate set for comparable deposits held with the same credit institution.

Article 9(3) of ICSD

Article 12, Paragraph 2, of IX-975

Article 12. Limitations on Insurance Compensations

2. Payment of insurance compensations to the depositors and investors against whom an application has been filed with law enforcement or courts in respect to the legality of acquisition of their deposit funds or liabilities to the investors shall be suspended until the coming into effect of a ruling.

Procedure of Calculation and Payment of Insurance Compensations by State Undertaking "Deposit and Investment Insurance"

The Procedure of Calculation and Payment of Insurance Compensations has been approved by State Undertaking "Deposit Insurance Fund" council's decision of 26th of March 2001, No. 4. Currently the updated version of State Undertaking "Deposit and Investment Insurance" council's decision No. 02-6-2 of the 27th of June 2008 is effective as of 4 July 2008.

Payment of Insurance Compensations

22. Insurance compensations shall be paid in Litas within 3 months from the day of the insured event. The board of the insurance undertaking may extend this time limit for up to 3 months (in case of deposit insurance - at most twice for up to three months each time). Depositor's or investor's right to receive insurance compensation shall be valid for 5 years from the day of the insured event.

23. Insurance undertaking shall publicly announce the information for depositors and investors about the time and place of payment of insurance compensation at least in two Lithuanian daily newspapers.

Limitation of Insurance Compensations

20. Insurance undertaking shall not pay insurance compensation in the cases set forth in the Article 12 Part 1 of the Law

21. Insurance undertaking shall terminate the payment of insurance compensation in the cases set forth in the Article 12 Part 2 of the Law.

4. OTHER ISSUES TO BE DISCUSSED: MONEY MARKET FUNDS

4.1 Custodian risk or claims arising from operational failure/default of institutions holding investor assets

4.2 Investment risk

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

Answer: Yes.

Reference to 'instruments' in Article 1(3) of ICSD should be replaced and construed as reference to „instruments listed in Section C of Annex I to Directive 2004/39/EC“, because Section C of Annex I to Directive 2004/39/EC (MiFID) has replaced Section B of the Annex to Directive 93/22/EEC.

Directive 2004/39/EC has entered into force on 30 April 2004 on the day of its publication in the Official Journal of the European Union. Member States of the EU had to transpose the directive by 31 January 2007 and apply national measures with effect as of 1 November 2007.

Investment into money market instruments are already subject to insurance of obligation to the investors whereas the provisions of the Law on Insurance of Deposits and Liabilities to Investors and Law on Markets in Financial Instruments are read in conjunction.

Alongside with the current situation, the new directive amending ICSD may provide the definition of the object of insurance of liabilities to investors.

Article 1(3) of ICSD and corresponding provisions in national law

X-1024-2007

Republic of Lithuania Law on Markets in Financial Instruments (No. X-1024, 18 January 2007, effective 8 February 2007)

Article 3, Paragraphs 4 and 5

Article 3. Definitions

4. Financial instrument – any of the instruments listed below:

- 1) transferable securities;
- 2) money-market instruments;
- 3) securities of collective investment undertakings;
- 4) options, futures, swaps, forward rate agreements and other derivative contracts relating to securities, currencies, interest rates or yields, also other derivatives instruments, financial indices and the measures which may be settled in cash or physically;
- 5) options, futures, swaps, forward rate agreements and other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of insolvency and termination events);
- 6) options, futures, swaps, and other derivative contracts relating to commodities and admitted to trading on a regulated market and/or a multilateral trading facility, which can be physically settled;
- 7) options, futures, swaps, forwards and other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in subparagraph 6 of this paragraph and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, *inter alia*, they are cleared and settled through a recognised clearing house or are subject to regular margin calls. Definition of the financial instruments as provided for in this subparagraph is specified in Commission Regulation (EC) No 1287/2006 of 10 August 2006;
- 8) derivative instruments for the transfer of credit risk;
- 9) financial contracts for differences;
- 10) options, futures, swaps, forward rate agreements and other derivative contracts relating to climatic variables, freight rates, emission allowances, inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of insolvency and termination events), as well as other derivative contracts relating to assets, rights, obligations, indices and other measures not otherwise mentioned in this Section, which have the characteristics of other derivative financial instruments, having regard to whether, *inter alia*, they are admitted to trading on a regulated market or a multilateral trading facility, are cleared and settled through recognised clearing houses or are subject to regular margin calls. Definition of the financial instruments as

provided for in this subparagraph is specified in Commission Regulation (EC) No 1287/2006 of 10 August 2006.

5. Money-market instruments – the instruments which are normally dealt in on the money market, such as treasury bills, certificates of deposit, commercial papers and others, excluding instruments of payment.

Article 2(1) of ICSD and corresponding provisions in national law

IX-975-2002 (as amended)

The Republic of Lithuania Law on Insurance of Deposits and Liabilities to Investors (No. IX-975, 20 June 2002, as last amended by Law No. X-1429, 18 January 2008, amended version effective as of 5 February 2008)

Article 3, Paragraphs 2 and 3

Article 3. Object of Insurance

2. Insurance coverage for liabilities to investors shall be obligations provided for liabilities to investors to repay the securities irrespective of their denomination or money in Litas or the foreign currency.

3. The deposits and liabilities to investors indicated in paragraphs 1 and 2 of this Article must be insured at an insurance undertaking by banks, credit unions, undertakings as well as foreign banks or the undertakings having established branches in the Republic of Lithuania with which deposits are held or whose liabilities to investors have no insurance coverage (are not subject to compensation) or which are not covered by any other protection schemes under the legislation of a foreign state exercising jurisdiction over the bank having a branch or the undertaking.

Continuation of answer:

Article 18 of Commission directive 2006/73/EC implements Article 18(3) of MiFID (2004/39/EC) requiring an investment firm to safeguard clients rights when holding funds belonging to clients.

Article 18 of Commission directive 2006/73/EC establishes an obligation of investment firm to place clients funds with the qualifying money market fund.

Article 18 of directive 2006/73/EC implementing Article 18(3) of directive 2004/39/EC (MiFID)

Lithuania has transposed provisions of Article 18 of Commission directive 2006/73/EC implementing Article 18(3) of directive 2004/39/EC (MiFID). Article 18(3) of MiFID (2004/39/EC) requires an investment firm to safeguard clients rights when holding funds belonging to clients. Article 18 of Commission directive 2006/73/EC establishes obligation of investment firm to place clients funds with any of the following:

- (a) a central bank;
- (b) a credit institution authorised in accordance with Directive 2000/12/EC (Directive 2006/48/EC with effect as of 31 December 2006);
- (c) a bank authorised in a third country;
- (d) a qualifying money market fund.

A qualifying money market fund is indicated as one of possible recipients for placement of clients funds (Article 18(1)(d) of Commission directive 2006/73/EC).

Acceptance and Execution of Clients Orders

X-1303-2007

Republic of Lithuania Law on Collective Investment Undertakings (Version of the Law No. X-1303, 25 October 2007, effective as of 1 March 2008)

Article 4, Paragraph 6

Article 4. Activities of Management Companies and Investment Companies

6. A management company that has the right to engage in the activities indicated in subparagraphs 1-4 of paragraph 1 of this Article shall be subject *mutandis mutandis* to the requirements set forth in Articles 13 and 22 of the Law on Markets in Financial Instruments and the implementing regulations of the Securities Commission. When applying the abovementioned requirements of the Law on Markets in Financial

Instruments, account shall be taken of the provisions of paragraph 5 of Article 2 of the Law on Markets in Financial Instruments.

X-1024-2007

Republic of Lithuania Law on Markets in Financial Instruments (No. X-1024, 18 January 2007, effective 8 February 2007)

Article 22

Article 22. Duties of a Financial Brokerage Firm in Providing Investment Services to a Client

1. When providing investment services and/or ancillary services to a client, a financial brokerage firm must act honestly, fairly and professionally under the conditions best to the client and in interests thereof and comply with the requirements set forth in this Article.

2. All information which a financial brokerage firm supplies to clients and/or potential clients, including marketing communications about the activities of the firm and the services provided, must be fair, clear and not misleading. Marketing communications must be clearly identifiable as such.

3. A financial brokerage firm must clearly and comprehensibly supply to clients and potential clients all the required information on the basis whereof they would be able to understand the essence of the investment services and financial instruments that are being offered as well as the risk typical thereof and to take investment decisions on an informed basis. Information may be provided in a standardised format.

4. When implementing the requirements set forth in paragraph 3 of this Article, a financial brokerage firm must supply information about:

- 1) the firm and the services provided by it;
- 2) financial instruments and proposed investment strategy, including guidance on and warning of the risk which is typical of certain investment strategies or investments in certain financial instruments;
- 3) venues of execution of client orders;
- 4) costs of execution of an order and other payments.

5. Prior to commencing the provision to a client of the investment services covering the provision of investment advice and/or management of a financial instrument portfolio, a financial brokerage firm must collect information regarding the client's or potential client's:

- 1) knowledge and experience in the investment field relevant to specific investment services or financial instruments;
- 2) financial situation;
- 3) investment objectives.

6. Upon collecting and assessing the information indicated in paragraph 5 of this Article, a financial brokerage firm must recommend to the client or potential client specific the investment services and financial instruments that would best meet the interests of the client.

7. Prior to commencing the provision of the investment services other than those referred to in paragraphs 5 and 10 of this Article, a financial brokerage firm must offer to a client or potential client to provide information regarding his knowledge and experience in the investment field relevant to specific investment services or financial instruments offered by the financial brokerage firm or demanded by the client or potential client himself. On the basis of the information received, the financial brokerage firm must assess whether specific investment services and financial instruments are appropriate for the client.

8. In the case a financial brokerage firm considers, upon assessing the information indicated in paragraph 7 of this Article, that an investment service or financial instrument is not appropriate to a specific client or potential client, it must warn the client or potential client. The warning may also be provided in a standardised format.

9. In cases where a client or potential client refuses to provide the information referred to in paragraph 7 of this Article or provides insufficient information regarding his knowledge and experience in the investment field, a financial brokerage firm must warn the client or potential client that the client's refusal to provide the required information or provision of insufficient required information does not allow the financial brokerage firm to determine whether specific investment services and financial instruments are appropriate for the client. This warning may also be provided in a standardised format.

10. A financial brokerage firm providing investment services that only consist of execution of orders on account of clients and/or the reception and transmission of orders, irrespective of whether it provides ancillary services, may provide these services without collecting information regarding the client's knowledge and experience in the investment field and without assessing whether specific investment services or financial instruments are appropriate for the client, provided that all the following conditions are met:

- 1) investment services relate to shares admitted to trading on a regulated market or in an equivalent third country market, also money market instruments, bonds or other forms of securitised debt, excluding these bonds and other forms of securitised debt that embed a derivative, the securities issued by collective investment undertakings and other non-complex financial instruments;
- 2) an investment service is provided at the initiative of the client or potential client;
- 3) the client or potential client has been warned that the financial brokerage firm providing investment services is under no duty to assess the suitability for the client of financial instruments and the investment services provided or offered, therefore the client is not under the protection of the interests of a client as specified in this Law and provided for in the provision of other investment services. Such a warning may be provided in a standardised format;
- 4) the financial brokerage firm complies with the requirements set forth in Article 21 of this Law to avoid conflicts of interest.

11. A financial brokerage firm must keep the documents establishing the contractual relations of the firm and a client and their mutual rights and duties as well as other terms and conditions of the provision of investment services. The mutual rights and duties of the parties may be specified by reference to other documents or legal acts.

12. A financial brokerage firm must provide to a client adequate reports on the services provided to him. These reports must supply information about the costs associated with the entering into transactions and provision of services to the client.

13. In cases where an investment service is provided as part of a financial product which is subject to the legal acts of the European Community governing risk assessment of clients or supply of information or common European standards related to credit institutions or consumer credits, the requirements as set forth by this Article shall not apply.

14. The requirements set forth in this Article shall apply *mutatis mutandis* to licensed credit institutions.

1K-22-2007

Lithuanian Securities Commission Resolution No. 1K-22 of 31 May 2007 „On the approval of the Rules on the provision of Investment Services and the Acceptance and Execution of Client Orders“ (effective as of 1 November 2007)

Items from 92 till 99

XXI. The General Requirements for the Execution of Client Order

92. A financial brokerage firm shall commence the execution of the Client order immediately unless the Client order or the Agreement specifies differently.

93. A financial brokerage firm shall have a right to refuse to execute an order submitted by the Client where the Client has not submitted the required financial instruments or monetary funds. A financial brokerage firm shall ensure that the financial instruments are provided before the arising of the ownership rights according to the concluded deals, and the monetary funds – before the settlement moment. It shall be prohibited, without a written permission of the Client, to use the financial instruments or the funds by title owned by the Client to discharge the obligations according to the deals concluded at the account of other Clients of the financial brokerage firms.

94. In the cases where in the view of certain reasons a financial brokerage firm is not able to start executing the order of the Client, or the order could not be, within reasonable terms, executed due to unfavourable circumstances emerging in the regulated market or beyond it (price decline, absence of supply, etc.), the financial brokerage firms shall immediately notify the Client thereof in the manner specified in Items 75-78 of the present Rules by submitting a notification of the obstacles and the circumstances preventing the execution of the specific order of the Client.

95. A financial brokerage firm shall execute the Client order exactly in accordance with the terms specified in the order. A financial brokerage firm shall have a right to deviate from the terms specified in the order in case, in the view of the specific circumstances this is necessary for the purpose of the protection of the Client's interests, and the financial brokerage firm did not have a possibility to inquire the Client in advance, or did not, on a timely basis, receive a reply to its inquiry. In this case the financial brokerage firm shall collect and keep in custody the evidence certifying the necessity to amend the terms of the Client's order (the evidence shall be provided upon a request of the Client), and immediately notify the Client that his order has been executed under the terms different from those specified in the order.

96. A financial brokerage firm shall execute each of the Client's order individually except the cases specified in Section XXII of the present Rules.

97. When executing the Client orders the financial brokerage firm shall:

97.1. ensure that all orders executed to the benefit of the Client are immediately and accurately accounted and allocated;

97.2. execute the Client orders that are similar in nature in sequence and without delay, except in cases where this is impossible due to the characteristics of the order or the prevailing market conditions or is contradictory to the interests of the Client;

97.3. without delay, as soon as the firm becomes aware thereof, notify a retail Client of all material difficulties potentially preventing an appropriate execution of the orders.

98. Where a financial brokerage firm is responsible for overseeing or arranging the settlement of an executed order, it shall take all reasonable steps to ensure that any client financial instruments or client funds received in settlement of that executed order are promptly and correctly delivered to the account of the appropriate client.

99. A financial brokerage firm shall not misuse information relating to pending client orders, and shall take all reasonable steps to prevent the misuse of such information by any of its relevant persons.

Items 100 and 101

XXII. Peculiarities of Execution of Client Orders

100. A financial brokerage firm may execute client orders also in the cases where financial instruments meant to be submitted to a counterparty are accounted in another financial brokerage firm or a depository, and the funds allocated to be used for the payment for the financial instruments are held in the other than the financial brokerage firm, provided appropriate legal basis is provided for the fulfilment of the obligations arising on the basis of such actions.

101. A financial brokerage firm may transfer the execution of the client order on sub-commission basis. The order of the client of the sub-commissioner is registered in the procedure established in Items 67-72 of the present Rules. A sub-commissioner shall specify that the sub-commissioner is acting on the sub-commission basis, indicate the terms specified in its client order in a most exact manner and identify its client.

Items 102 and 103

XXIII. Peculiarities of Execution of Client Orders for the Purpose of the Management of Assets of Collective Investment Undertakings and Pension Funds

102. Having received an order from a collective investment undertaking, pension funds or a management company the financial brokerage firm shall execute such order in the manner stipulated in Item 100 of the present Rules, and the functions of an account manager shall be delegated to the depositories of collective investment undertakings and pension funds.

103. A financial brokerage firm executing order to perform the operations with the assets of a collective investment undertaking, pension fund or a pension scheme, and is not a depository of the collective investment undertaking or pension scheme, shall not be required to examine whether the order complies with the management agreement.

Items from 131 till 136

XXX. Best Execution Obligation

131. When executing client orders, financial brokerage firms take into account the following criteria for determining the relative importance of the factors referred to in Article 24(1) of the Law:

131.1. the characteristics of the client including the categorisation of the client as retail or professional;

131.2. the characteristics of the client order;

131.3. the characteristics of financial instruments that are the subject of that order;

131.4. the characteristics of the execution venues to which that order can be directed.

132. For the purpose of Items 131–136 and 145–147 of the present Rules “execution venue” means a regulated market, an MTF, a systematic internaliser, or a market maker or other liquidity provider or an entity that performs a similar function in a third country to the functions performed by any of the foregoing.

133. A financial brokerage firm satisfies its obligation under Article 24(1) of the Law to take all reasonable steps to obtain the best possible result for a client to the extent that it executes an order or a specific aspect of an order following specific instructions from the client relating to the order or the specific aspect of the order.

134. Where an investment firm executes an order on behalf of a retail client, the best possible result shall be determined in terms of the total consideration, representing the price of the financial instrument and the

costs related to execution, which shall include all expenses incurred by the client which are directly related to the execution of the order, including execution venue fees, clearing and settlement fees and any other fees paid to third parties involved in the execution of the order.

135. For the purposes of delivering best execution where there is more than one competing venue to execute an order for a financial instrument, in order to assess and compare the results for the client that would be achieved by executing the order on each of the execution venues listed in the firm's order execution policy that is capable of executing that order, the firm's own commissions and costs for executing the order on each of the eligible execution venues shall be taken into account in that assessment

136. Financial brokerage firms shall not structure or charge their commissions in such a way as to discriminate unfairly between execution venues.

Cf. Investment advice

Article 4, Paragraph 6, of the Republic of Lithuania Law on Collective Investment Undertakings (Version of the Law No. X-1303, 25 October 2007, effective as of 1 March 2008) in conjunction with **Article 22, Paragraph 3, of the Republic of Lithuania Law on Markets in Financial Instruments** (No. X-1024, 18 January 2007, effective 8 February 2007) requires **Management Companies and Investment Companies to** clearly and comprehensible supply to clients and potential clients all the required information on the basis whereof they would be able to understand the essence of the investment services and financial instruments that are being offered as well as the risk typical thereof and to take investment decisions on an informed basis. Information may be provided in a standardised format.

Following Article 22, Paragraph 14, of the Republic of Lithuania Law on Markets in Financial Instruments (No. X-1024, 18 January 2007, effective 8 February 2007) **The requirements to provide an investment advice set forth in this Article shall apply *mutatis mutandis* to licensed credit institutions.**

<p><i>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?</i></p>

Answer: No.