Investor-Compensation Schemes Directive (ICSD)

BHB 3

Call for evidence European Commission   
Febelfin contribution – Register ID : 1938561921-91

In spite of the fact that the **European Banking Federation (EBF)** has made a reply**, on behalf of the European banking sector as a whole,** **Febelfin – the Belgian Financial Sector Federation, including the Belgian Bankers’ and Stockbroking Firms’ Association as well as the Belgian Asset Managers Association – wants to make its own contribution**. Nevertheless, Febelfin would like to point out that **it can share the points of view of the EBF to a large extent** and that it also has made an active contribution to them.

**In general**, Febelfin fully endorses the following **two fundamental considerations** brought forward by the EBF :

1. The **fundamental aim** of the investor protection system is to offer a **minimum of protection** **to** **the** **‘ordinary’ or ‘small’ investor**, especially when the **investment company or bank** (if it offers investment services) **fails to meet** its obligations towards the customer-investor (especially, the **reimbursement of financial instruments given as a deposit or registered on an account**).
2. There are **substantial differences between investor protection on the one hand and the protection of depositors** at credit institutions and investment firms **on the other hand**. In the first case and if an investment company goes bankrupt, the financial instruments that make up the deposit, are no part of the devolution of the estate. The **customer still is the owner of the securities involved and consequently, can make a direct claim on them**. When there is a default in this claim, the investor protection actually has to offer protection. Furthermore, within the MiFID-framework, the customer-investor has the benefit of **additional protection**, in case of securities deposit or securities registering on an account. In Belgium, these protection measures are strengthened within the framework of the **legal process of securities dematerialisation**, which will be completed in 2013.

Apart from these general remarks, one can find **below a number of considerations about the various questions** from the European Commission in its consultation document.

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

* The principle according to which protection must be aimed at the ordinary investor always should be predominant.
* As for MTF, the question of broadening the scope of the ICSD becomes less important or even almost irrelevant, since one is dealing with professional counterparties. So, it seems that the answer to this question should be negative for the larger part of it, although it may be wise to make additional analyses in order to see more clearly.

1. ***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 authorization would not allow holding clients’ assets ?***

* It should be noted right from the beginning that normally speaking, a customer of a private portfolio asset manager for example with a status which indeed does not allow customer deposits nor securities deposit, will be protected, for this situation is the result of legal provisions. The asset manager must refer his customer to a credit institution or stockbroking firm. This will also be noted in the contract that is signed with the customer and the bank or stockbroking firm also will provide the customer with informative statements about the customer deposits or the securities deposit. As a rule, these customers will have the benefit of the protection provided by the ICS (and/or the deposit-guarantee system). The asset manager’s status also complies with a European registering regulation and with the rules laid down in the MiFID.
* In addition, according to the Belgian protection scheme, customers-investors may claim the benefit of the guarantee, if, in spite of the prohibition imposed by law, the assets (deposits or financial instruments) have been entrusted directly to an investment company other than a stockbroking firm or credit institution (offering investment services) and if these customers have acted in good faith. The latter implies among other things that the customers were unaware of the fact that the firm concerned was not authorized to collect, keep or safeguard deposits or financial instruments belonging to them.
* The Belgian protection scheme, into which the deposit-guarantee system and investor protection system were integrated (in 1999), already has the broader scope the Commission aims at in this question.
* Of course, it would be a good thing if the investment companies concerned which have no authorization for collecting funds or securities from customers, can communicate about this in an appropriate way and provide information within the framework of their customer relationship.

1. ***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 ?***

* As for this question, one should refer to the principle according to which protection must be aimed at the ordinary customer-investor.
* Hence, we do not see the need for including non-retail customers into the scope of the protection scheme. Neither is there a reason for broadening the scope of the ICSD in order to cover investment firms which exclusively deal with this kind of customers. This principle should be applied consistently. If not, there is a danger of an unwanted spreading which also could affect the financial solidity of the protection schemes (certainly in a system such as the Belgian system, in which the ex ante funding is based on the volume of assets that, as a matter of principle, are covered).

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

* Situations such as these can be very complex and it may be necessary to look deeper into this matter before it will be possible to take a balanced decision. One thing that can happen is a cumulation or overlap of protection, for example if the benefit of the protection scheme (possibly in combination with the deposit-guarantee system) can be called upon by the third party as well as by the company. The situation may become even more complicated in case of combined failures (e.g. the default of the third party at which the investment company has deposited the assets of its customers, subsequently causes the default of the investment company itself). One should also avoid creating distortions of competition between providers of financial services as a consequence of a cumulation or overlap of protection.
* A relevant point of discussion is that customers who act in full good faith (and for instance who do not know at all which is the third party receiving some assets from the investment company they are customers of), could be disadvantaged or could be victim, without having the possibility of actually sheltering themselves against this kind of misfortune.

***4.b) 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, fails to perform its duty ?***

* See 4.a).

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

* The actual purpose of the protection scheme has little or nothing to do with the application of professional rules of conduct, among other things as for counseling by investment companies and making investment choices. So, there is no reason to mix up both these things. Moreover, this would also affect the efficient and transparent functioning of the protection scheme. Since customers may start having wrong expectations, the moral hazard problem could be enhanced (if those expectations cannot be met) and the purpose of maintaining the confidence of savers and investors, also in difficult circumstances, also could be jeopardised.
* For these reasons, it would be very unwise to include losses caused by a violation of conduct of business rules into the scope of the cover provided by the protection scheme.

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

* There is a clear difference between the nature of risks as for deposit-guarantee on the one hand, and that of risks as for investor protection on the other. This conclusion clearly is endorsed by the evidence gained from the current financial crisis. Deposit-guarantee has been in the line of fire. There have been no major problems as for investor protection and ordinary investors in financial instruments hardly asked any questions in this respect.
* The conclusion from this is that there is no need nor reason for absolutely trying to maintaining the minimum amounts guaranteed under the system of deposit guarantee and that of investor protection at the same level. There is no need for increasing the minimum amount guaranteed under the system of investor protection (20,000 EUR), since the current level has had no negative influence on the confidence of savers and investors during this very bad crisis. Indeed, one must be well aware of the consequences of a possible increase of this kind (which may cause further distortions of competition among other things), especially as for protection schemes with ex ante funding.

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

* In Belgium, deposit-guarantee and investor protection have been put together into one single scheme in which both credit institutions and stockbroking firms take part. Funding is based on an integrated system covering the deposit-guarantee as well as the protection of those who hold financial instruments. Bringing both schemes together certainly offers advantages (especially in a small country) as for the financial capacity and cost-efficient functioning.
* It certainly would be wrong if Europe makes it difficult or even impossible to operate such a combined system.
* Consequently, it seems highly recommendable, within the EU regulation, to leave a large degree of freedom for the Member States as for system organization and functioning. So, there is no need for additional European rules.
* However, should there be any plans for tightening the EU regulation in this respect, one certainly has to take into account the need for compatibility with the rules governing the deposit guaranteed.

1. ***8.a) 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 ? 8.b) Should this kind of mechanisms be prohibited ?***

* Restrictive rules of this kind have not been included into the Belgian protection scheme for financial instruments.
* One may wonder if rules such as these would be compatible with the underlying principles of the ICSD.

1. ***9.a) Should the process of recognizing the eligibility of the claim be regulated for the purposes of the ICSD ? 9.b) Should, at least, a mechanism be introduced providing for provisional partial compensation based on a summary assessment of clients’ positions ? 9.c) Irrespective of the harmonization of their funding systems, should compensation schemes ensure that they have minimum reserve funds in order to comply rapidly with any immediate needs ?***

* It cannot be denied that the procedures for determining the eligibility and the exact amount of the claim as for financial instruments are complicated (and inevitably more complex than those for the deposit-guarantee). Part of this has to do with the customer’s possibility for direct recovery and with the problems in the field of the correct valuation which is necessary.
* Consequently, there is no need for a European regulation on the eligibility of the claims.
* Neither is there a need for shortening the period of reimbursement (3 months) nor for imposing a mechanism on the basis of which the protection schemes must make provisional and partial reimbursements based on a summary assessment of the clients’ positions. Indeed, in the case of investor protection, there rarely is a vital need for customers to have their assets immediately at their disposal. These assets quite naturally are to be considered as ‘investments’ (and not as cash balances, as is the case for demand deposits held by banks).

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

* Apparently, this is yet another concern which lies outside the actual scope of the investor protection scheme. The aim of this system is not to cover the investment risk. It would be unwise to call upon the financial solidarity of the sector for this kind of risk covering. One should use other channels and devices for providing optimal guarantees in the field of security and liquidity.
* If system stability is at stake, the responsibility first and foremost lies with the authorities which are competent for monitoring and safeguarding stability (among other things by means of adequate regulation and supervision of the activities and services providers concerned).
* A Money market fund, agreed by the regulator as a qualified fund, is, with deposits in Central Banks or in commercial banks, the third way at disposal of investment firms to invest segregated funds waiting for (re)investment. In a practical way, no qualified money market fund has received the agreement of the Belgian regulator. Investment firms would prefer investment in short term Treasury bills or assimilated.