

EC Call for evidence
Review of the Directive 1997/9/EC
on investor-compensation scheme
Comments by AMAFI

1. AMAFI - the *Association française des marchés financiers* - is the new name adopted on 19 June 2008 by the French Association of Investment Firms (AFEI). It represents financial market professionals in France (i.e. investment firms, credit institutions and market infrastructures) and has more than 120 members representing over 10,000 professionals who operate in the cash and derivative markets for equities, fixed-income products and commodities. Nearly one-third of the members are subsidiaries or branches of non-French institutions.

2. AMAFI welcomes the opportunity to comment on the European Commission's call for evidence in relation to the review of Directive 1997/9/EC on investor-compensation schemes ("ICSD"). After 10 years of the entry into force of the ICSD, after the entry into force of MiFID which covers new financial services and after the recent review of the Deposit Guarantee Schemes Directive¹ ("DGSD") which has led to the adoption of Directive 2009/14/CE of 11 March 2009, it is particularly appropriate to review the application of the ICSD with a view to assessing whether it needs to be modified in order to better protect investors.

3. Under the difficult current financial markets circumstances, it is also fair to question the need to modify the ICSD. However, it should be recalled that the purpose of the ICSD is to provide minimum protection to investors, and particularly to retail investors, in the event that an investment institution is unable to meet its obligations to return assets held on behalf of its clients and has no early prospect of being able to do so due to reasons directly related to its financial circumstances (e.g. bankruptcy or a moratorium of payment). It is not intended to provide for protection to investors during financial crises but rather to provide for some protection in a stable financial climate. Therefore, the current financial crisis should not modify the objective that is to be achieved. It only makes it more important to ensure harmonization of applicable rules throughout the EU so as to avoid any harm to the level playing field.

4. Having said that it should be kept in mind that any decision to amend the ICSD should be preceded and based on careful assessments of the appropriateness and impact of such modifications.

5. Naturally, AMAFI remains at the disposal of the Commission services, should they wish to discuss this response or have any further question in relation to this matter.

¹ Directive 94/19/EC

➤ I. **ISSUES AT STAKE**

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

✓ **3.1.1 MTFs**

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

As mentioned above, the primary objective of the ICSD is to provide minimum compensation to small retail investors against the risk of physical losses in case of the inability of an investment firm (including credit institutions which are authorized to provide investment services) to return assets held on behalf of the client, due to reasons directly related to its financial circumstances.

The management of an MTF is a particular type of investment service in the sense that an MTF is a trading platform bringing together multiple third-party interests in accordance with certain rules, a number of them being defined by MiFID to ensure investor protection. The investment firm which manages an MTF merely ensures that the clients' orders are executed but in doing so, it is never in a situation where it actually holds assets on behalf of the clients. Therefore, even in the event of its bankruptcy, it could never be in a situation where it would be unable to return client's assets.

Consequently, there is no reason to include the management of an MTF into the scope of the ICSD. This inclusion would not serve any useful purpose as it would not provide the investor with any useful protection in that respect. In addition, it must be recalled that already in the case of MTFs operated by market operators, the membership of an investor compensation scheme is not required. It would therefore be illogical to impose such membership in the case of an MTF operated by an investment firm

While the operation of an MTF should therefore be excluded from the scope of the ICSD, it must be recalled that the clients' assets which are traded on an MTF are covered by the ICSD, if for instance an investment firm holding such assets were to become unable to return them due to its own financial circumstances.

✓ **3.1.2 Loss covered**

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

The key question is not whether the investment firms are authorized to provide investment services in general but whether the type of service that they provide implies that they may hold clients' assets and, in turn, may find themselves unable to return such assets, due to financial difficulties.

A regulation cannot be based merely on the perception that clients could have of a given rule assuming that the perception mentioned by the EC in its call for evidence² is correct. Again, the only relevant question is whether the investor would be better protected against the loss of its assets if investment firms which are not allowed to hold clients' assets were to file for bankruptcy (it must be recalled that the ICSD is not intended to protect investors against the irregularities or illegal acts that may be committed by

² In relation to question 3.1.2, page 4.

investment firms but only against the consequences of their own financial difficulties). Clearly, the answer is negative.

(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?

First of all, there is a need to define what is covered by “non retail clients”.

It would seem that the category of “non retail clients” includes in fact two different types of clients: “professional and institutional investors”, on the one hand (those described in §1 of Annex 1 to the ICSD); other clients, such as, for instance, corporate entities, which, under MiFID, would be considered as “professional clients” without being “professional and institutional investors”, on the other hand.

While the latter (the “professional and institutional investors”) may be excluded from cover by the compensation schemes under article 2 of the ICSD, there is no reason to exclude also the other “professional clients”, such as the corporate entities which would qualify as “professional clients” under MiFID (an articulation with the MiFID categorization would be desirable, save that no possibility of “opt in” or “opt out” should be allowed for the purpose of the ICSD). These investors (for instance the corporate entities) also deserve protection under the compensation scheme. The fact that they may have the “*experience, knowledge and expertise to make (their) own investment decisions and properly assess the risks that (they) incur*” does not mean that they should not receive adequate protection if the investment firm they are dealing with fails to return their assets due to its own financial circumstances. Indeed while the “professional client” should bear the possible loss of value attached to the investments it chooses to make, there is no reason why it should bear the loss of its financial assets held by an investment firm that would be unable to return them due to its own financial circumstances.

Therefore investment firms providing their services only to non retail clients should be included in the scope of the ICSD.

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

No, they should not. Taking into consideration the objectives of the ICSD, it not intended for compensation in that case. Compensation should be available for failure of the principal, due to its own financial circumstances, not for the failure of a subcontracting third party, assuming the client has no contractual relationship with that subcontracting third party. In that case, the compensation scheme should not apply (otherwise the financial balance of the compensation scheme could be in jeopardy). This does not mean that the client will not be able to obtain compensation from its own contracting party. Such compensation should be possible on the basis of the principles of contractual liability applicable in each country.

(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 fail to perform its duty?

A UCITS unit holder is and should be protected under the ICSD against the loss of its shares (or units) provided of course that such loss is due to the type of financial circumstances which is covered under the ICSD.

UCITS themselves, on the other hand, should not be protected under the ICSD against the loss of their assets, i.e. of the assets owned by the entities: first of all because UCITS is an “institutional investor” (as mentioned in relation to question (3) above) and as such should not be protected under ICSD; secondly, because the ICSD is not intended to protect investors against the loss of value of the investment they have made. It is only a protection to ensure the restitution of the investor’s assets.

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

No, they should not. The ICSD does not aim at compensating investors for losses incurred as a result of the violation of conduct of business rules. It is not an insurance against mismanagement by the investment firms. If the consequences of this type of behaviour were to be covered collectively by such a national scheme, it could be counterproductive as investment firms would not be inclined to feel responsible... There are civil liability insurance schemes which are intended to cover that sort of situation, the cost of which is to be borne by each firm individually.

3.2 – The amount of compensation (art. 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?

Indeed, it makes sense to have harmonized amounts between the ICSD and the DGSD.

3.3 – The 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?

Any harmonization of the funding systems should only be proposed on the basis of a preliminary assessment of the costs and benefits involved. A study has been initiated by the EC concerning the harmonization of the funding systems under the DGSD. It would also be interesting to have a record of the cases where the compensation schemes, both under the DGSD and the ICSD, were activated. After completion of this study, the proposals which will be made could serve as a basis for possible modifications to be brought to the funding systems of the investor compensation schemes. At this point and pending such proposals and the receipt of relevant information concerning the use of the compensations schemes since they were put in place, it is too early to envisage any change to the funding scheme under the ICSD.

3.4 – The restrictions on the carry over of unpaid reimbursement debts

(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 say their compensation unpaid as a result of such mechanisms?

N/A

(8) (b) Should this kind of mechanism be prohibited?

Yes, it should. These questions should be harmonized.

3.5 – The reduction of payout delay (art. 9(2) of the ICSD)

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

The determination of the eligibility of the claim is clearly more complex under the ICSD than it is under the DGSD. Such determination, in most cases, depends on national insolvency law and harmonization is therefore very difficult to achieve. There could be however a control by the national supervision authorities. Generally speaking, the idea of reducing the pay out delay should be supported but at the same time, it is important to ensure that the process to recognize the eligibility of the claim is fair and secure in the interest of all parties concerned. Further investigation on this subject is needed.

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

A provisional partial compensation is not desirable. To ensure the continuity and the proper functioning of the investor compensation scheme, compensation should be granted when all the conditions set by the ICSD are met, but only then. In case of undue partial payment, there would no guaranty that the funds unduly paid would be returned. This could jeopardize the system as the whole. It is preferable to improve the functioning of the system, notably to ensure that payment of rightful claims can occur within a reasonable time period, but not allow compensation for claims which have not yet been fully validated.

In addition, the need for a provisional partial compensation seems less justified in relation to the loss of financial instruments that it would be for the loss of cash. Indeed, a rapid indemnification in that case may be vital, particularly for the retail investor, whereas the loss of financial instruments is less likely to affect immediately such retail investor in his every day life.

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

While it seems important to ensure that the compensation schemes have the ability to comply rapidly with any immediate needs, any decision in that respect appears to be a bit premature pending the result of the study currently conducted by the EC and referred to above in question (7). Please refer to our answer to that question.

➤ **II. 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?

Investors in financial instruments should not be protected against investment risks associated with their investments. In other words, there should be no compensation for the loss of value of the investment. It is not and should not be the objective of the ICSD to compensate investors for loss of value of their investments. This approach has applied so far and should continue to apply to money market funds as to any other financial instrument.

We do not believe that this objective should be affected by the current financial crisis.

(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?

The objective should be to achieve harmonization as much as possible throughout the EU with respect to investor compensation schemes. One way of doing this would be to reduce the number or scope of the national options which may be chosen under ICSD.

Another area in which harmonization should be sought is the question of the possible set-off between debts and claims. There appear to be significant differences within the EU as regards the conditions in which set off is permitted which lead to significant differences regarding the amount of the claims to be indemnified.



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