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Response to European Commission Call for evidence regarding Directive 1997/9/EC on Investor-Compensation Schemes

Assogestioni¹ welcomes the opportunity given by the European Commission to comment on the Call for Evidence concerning the Directive 1 997/9/EC on Investor-Compensation Schemes (hereinafter "ICSD"); in particular, we deem important to consult market participants and other stakeholders about the application of the ICSD and the possible amendments that could be useful in order to enhance investor protection.

Preliminary to our comments, we would like to underline the need to limit the scope of the ICSD to the investment firm's inability, in the event of insolvency or default, to i) repay money owed to or belonging to investors and held on their behalf; ii) return to investors any financial instruments belonging to them and held, administered or managed on their behalf. In particular, insolvency or default events should be compulsory requirements for the investors' right to claim compensation, in order to guarantee that the other companies bear – through the compensation scheme – the relevant costs only when such events occur.

Furthermore, the ICSD scope should not cover cases when an investment service is not provided by an entity authorized under the relevant applicable law or by an entity that does not provide the investment service within the limits of the authorization obtained.

On light of the above, we deem appropriate that the European Commission defines clearly by means of compulsory the scope of application of ICSD; such approach avoids that, at European level, a fair competition is jeopardized by compensation schemes covering different risks in each Member State.

¹ Assogestioni is the Italian association of the investment fund and asset management industry and represents the interests of 162 members who currently manage assets whose value exceeds 800 billion euro.



I. SCOPE - INVESTMENT SERVICES COVERED BY THE ICSD AND LOSS EVENTS (ARTICLE 1, POINT. 2 AND ARTICLE 2 (2) OF THE ICSD)

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

There is not the need to include the operation of multilateral trading facilities (MTFs) within the scope of ICSD; as mentioned by the European Commission, an MTF is essentially a trading platform bringing together multiple third-party interests in accordance with certain rules. The provision of such investment activity does not imply the holding of clients' assets and there is not a direct contractual relationship between the entity managing the MTF and retail investors; therefore, the ICSD should not require the participation of such entity to a compensation scheme and, as a consequence, the Directive should not recognize to investors the right to raise claim against it. A different solution would imply a useless duty which would not be linked to a concrete enhancement of the protection level recognized to investors.

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

In our opinion, ICSD should require the participation to a compensation scheme only when an investment firm is authorized to hold client assets, irrespective of its decision not to adopt such operating solution. On the contrary, the ICSD should not cover the case where, even though an investment service is provided, there is not the need of a concrete protection, since the investment firm does not have the legal possibility to hold clients' assets; as a consequence, in this case, the ICSD should not recognize to investors the right to raise claim against the compensation scheme. In our opinion, a different approach would burden investment firms, not allowed to hold clients' assets, with costs that would result unnecessary, given that they are not linked to an increased protection of investors.

On light of the above, the aforementioned case shouldn't be covered by ICSD even if – as highlighted by the European Commission – investors feel confident to receive the service by an authorised entity and may not fully perceive the limitations to the scope of the authorisation of such entity; in fact, the perception of safety that investors may have should not imply that the authorised entity shall join compensation schemes when an effective need of protection does not really exist. Therefore, for example, it would not be appropriate to subject the provision of the investment advice service to the participation to a compensation scheme when the clients' assets are not held by the investment firm.



Question 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?

In order to avoid that an investment firm becomes subject to useless costs, the participation to a compensation scheme should be required only if there is a material increase of investor protection, i.e. compensation is guaranteed in case of loss of the assets held by the firm. Such principle should be applicable even when, pursuant to article 4, paragraph 2, of the ICSD, a Member State provides that professional and institutional investors – listed in Annex 1 of the Directive – shall be excluded from cover by the compensation scheme. Therefore, in this case, an investment firm should not be required to join a compensation scheme, as long as it is authorized under the applicable law to provide services only to non-retail clients; as underlined by the European Commission in the Call for Evidence, such firm does not give rise to a claim against the scheme.

On the contrary, a firm should participate to a compensation scheme when, according to the authorization obtained by the competent authority, it can provide investment services to retail clients, even though it decides to provide them only to professional or institutional investors.

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

Investors should be able to claim protection only when the losses are directly linked to the entity which provides the investment service and participates to the compensation scheme; therefore, the default of the third party where the clients' assets had been deposited should not fall within the scope of the ICSD. Furthermore, it is important to underline that the investment firm which transfers the assets to the third party is responsible towards the clients for the selection of such entity and, therefore, it is liable if the latter defaults; as a consequence, in this case, the clients can proceed against the investment firm.

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

We believe that should not fall within the scope of ICSD the case where the UCITS depositary or the institution which has been mandated to safe keep the assets fail to perform its duty; the applicable legislation already provides adequate protection to investors and, therefore, the Directive should not introduce the right of UCITS or UCITS unit holders to claim compensation for loss of assets.

Furthermore, a different solution would not be consistent with the aims pursued by the Directive, because it would extend excessively its scope, introducing an unjustified topic if compared with those already addressed; in fact, the Call for



Evidence proposal would imply that the ICSD should apply, not only to MiFID investment services, but also to the collective portfolio management activity, although its scope would be limited to the specific case described under question 4b).

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

Assogestioni deems appropriate to maintain the present scope of the directive and to exclude the losses resulting from the violation of conduct of business rules. The ICSD should address exclusively: i) the investment firm's inability to repay money owed to or belonging to investors and ii) the inability to return to investors any financial instruments belonging to them. A different solution would go beyond the aims pursued by the Directive and would burden the entities participating to a compensation scheme with an unjustified cost linked to violations for which such entities should not be deemed – even indirectly – responsible; in fact, investment firms acting in compliance with the applicable law would have to guarantee through the compensation scheme an adequate protection to those investors that suffer losses as a consequence of the unlawful conduct of the firm that provided them the service.

Therefore, the losses resulting from the violation of conduct of business rules could be regulated separately and with a specific funding system. In Italy, for example, the Legislative Decree n. 179/2007 has already introduced a relevant compensation scheme that covers losses resulting from the violation of conduct of business rules and such a scheme is financed by half of the amount of the pecuniary sanctions levied for such violations.

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

The amount covered by the ICSD should not be adapted following the updating of the DCSD, because from a legal standpoint there is a significant difference between the circumstances considered by the two directives. The risk that a credit institution fails to repay deposits is higher than the risk that an investment firm fails to return the money or the financial instruments belonging to an investor; in fact, the credit institution has the availability of the clients' amounts while, on the contrary, financial instruments and funds of individual clients held by an investment firm are separate assets for all intents and purposes from those of such firm and from those of other clients.

Question 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?

It would be advisable to maintain the present minimum harmonization approach with reference to the funding systems of the schemes; consequently, each Member



State should be free to assess the best solution available, taking into account even the peculiarities of its legal system.

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

Italian legislation does not rule measures aimed at preventing the carryover of unpaid reimbursement debts of the compensation schemes.

Question 8b) Should this kind of mechanisms be prohibited?

We deem appropriate to prohibit mechanisms aimed at preventing the carryover of unpaid reimbursement debts of the compensation schemes because, as underlined by the European Commission, such measures could jeopardize the objectives of the Directive and deceive investors expecting to receive protection from the scheme; furthermore, such solution guarantees a level playing field, avoiding misalignment between the levels of protection assured to investors by each Member State.

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

There is not the need to harmonize through the ICSD the process of recognizing the eligibility of the claim; in fact, each Member State should define such process autonomously, in order to assure the best solution for investors through an adequate coordination with the national insolvency law.

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

The ICSD should not introduce a mechanism which provides for provisional partial compensation, given that Member States can guarantee a well-balanced system even when they do not recognize such mechanism; furthermore, a different solution could be hard to implement because it could face difficulties in assuring a satisfactory coordination with national insolvency law.

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

The ICSD should not require that compensation schemes have minimum reserve funds in order to comply rapidly with any immediate needs, because Member States should be left free to consider the opportunity of adopting such measure taking also into account the national applicable law.



II. OTHER ISSUES TO BE DISCUSSES: MONEY MARKET FUNDS

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

The ICSD should maintain the present approach and should not protect investors from investment risks linked to the value of financial instruments; such approach should be a general principle applicable to all financial instruments in order to avoid to extend excessively the scope of the Directive and to introduce a topic not consistent with the aims pursued by it. Consequently, we deem appropriate that investment schemes should not provide protection from investment losses in money market funds when the fund investments lose value, even though such funds are perceived to be safe by investors.

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

We don't see other issues other than the ones mentioned in the Call for Evidence that should be analyzed.

We remain at your disposal for any clarification or request on the comments made in this response.

The Director General