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Proposal for a

**DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**amending Directive 97/9/EC of the European Parliament and of the Council on investor-  
compensation schemes**

{SEC(2010) 845}

{SEC(2010) 846}

## EXPLANATORY MEMORANDUM

### 1. CONTEXT OF THE PROPOSAL

Directive 97/9/EC on Investor-Compensation Schemes (ICSD<sup>1</sup>) was adopted in 1997 to complement the Investment Services Directive<sup>2</sup> (ISD), the directive regulating, at that time, the provision of investment services in the EU. The ISD has since been replaced by the Markets in Financial Instruments Directive<sup>3</sup> (MiFID). The ICSD provides for clients receiving investment services from investment firms (including credit institutions) to be compensated in specific circumstances where the firm is unable to return money or financial instruments that it holds on the client's behalf.

Ten years after the ICSD entered into force, and immediately after the financial crisis, it is the right time to review the functioning of the ICSD. There is no concrete evidence to suggest that the financial crisis contributed to more compensation claims from schemes under the ICSD. However, in recent years, the Commission has received numerous investor complaints about the application of the ICSD in a number of important cases involving large investor losses. The complaints are principally related to the coverage and funding of schemes and delays in obtaining compensation. The review of the ICSD is also an important element, together with the review of the Deposit Guarantee Schemes Directive<sup>4</sup> and the examination of protection for insurance policy holders, of the Commission's policy to strengthen the EU regulatory framework for financial services as set out in the Communication on "Driving European recovery"<sup>5</sup>. It also considers the objective set at G-20 level of addressing any loopholes in the regulatory and supervisory system and the objective of restoring investor confidence in the financial system.

This initiative is part of a broader package on compensation and guarantee schemes that will comprise two proposals for amendment of the Directives on Investor Compensation Schemes and on Deposit Guarantee Schemes and a White Paper on the insurance schemes.

### 2. CONSULTATION OF INTERESTED PARTIES

The initiative is the result of an extensive and continuous dialogue and consultation with all major stakeholders, including securities regulators, market participants, national investor compensation-schemes and consumers. A call for evidence was

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<sup>1</sup> Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor-compensation schemes (OJ L 84, 26.3.1997, p. 22).

<sup>2</sup> Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field (OJ L 141, 11.6.1993, p. 27–46).

<sup>3</sup> Directive 2004/39/EC (OJ L 145, 30.4.2004, p. 1–44).

<sup>4</sup> Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit guarantee schemes (OJ L 135, 31.5.1994, p. 5).

<sup>5</sup> Commission Communication for the Spring European Council "Driving European recovery" - COM(2009) 114, 4.3.2009.

submitted to public consultation from 9 February to 8 April 2009<sup>6</sup>. Questionnaires were sent to national investor compensation schemes and a meeting was held with them on 9 February 2010<sup>7</sup>. A targeted meeting was held on 3 September 2009 to gather views from industry and investor associations. This work is also built upon the observations and contributions from the European Markets Expert Group (ESME)<sup>8</sup> and the European Securities Committee (ESC)<sup>9</sup>. In addition it makes use of the findings of a study by OXERA, titled "Description and assessment of the national investor compensation schemes established in accordance with Directive 1997/9/EC" (February 2005)<sup>10</sup>.

### 3. IMPACT ASSESSMENT

In line with its "Better Regulation" policy, the Commission conducted an impact assessment of policy alternatives. Policy options were mainly related to the funding of the schemes, the payout delays, the coverage of the compensation and the level of compensation.

Each policy option was assessed against the following criteria: investor protection and confidence, level playing field in the protection provided for different types of investments or services in the EU and cost-effectiveness, that is the extent to which the option achieves the sought objectives and facilitates the operation of securities markets in a cost effective and efficient way<sup>11</sup>.

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<sup>6</sup> The Commission services received 70 contributions. The non-confidential contributions can be consulted in the Commission website:

[http://ec.europa.eu/internal\\_market/consultations/2009/investor\\_compensation\\_en.htm](http://ec.europa.eu/internal_market/consultations/2009/investor_compensation_en.htm)

<sup>7</sup> Two questionnaires relating to the operations of the national investor compensation schemes were sent in June 2009 and November 2009.

<sup>8</sup> ESME was an advisory body to the Commission, composed of securities markets practitioners and experts. It was established by the Commission in April 2006 and operated until end 2009 on the basis of the Commission Decision 2006/288/EC of 30 March 2006 setting up a European Securities Markets Expert Group to provide legal and economic advice on the application of the EU Securities Directives (OJ L 106, 19.4.2006, p. 14-17).

<sup>9</sup> The European Securities Committee (ESC) set up by Commission Decision 2001/528/EC (OJ L 191, 13.7.2001, p. 45) fulfils both comitology (Comitology Council Decision 1999/468/EC of 28 June 1999 (OJ L 184, 17.7.1999, p. 23) laying down the procedures for the exercise of implementing powers conferred on the Commission as amended by Decision 2006/51/EC (OJ L 200, 22.7.2006, p. 11) and policy advisor functions in the securities field. It is composed of high level representatives from the Member States and is chaired by a representative of the Commission. Discussions were held at meetings of the ESC on 14 November 2008, 11 February 2009 and 15 July 2009.

<sup>10</sup> The study is available at [http://ec.europa.eu/dgs/internal\\_market/docs/evaluation/national-investor-rep2005.pdf](http://ec.europa.eu/dgs/internal_market/docs/evaluation/national-investor-rep2005.pdf).

The opinions expressed in the Study by OXERA do not necessarily reflect the position of the European Commission. OXERA is a private firm that was contracted by the European Commission to undertake the study. The statements and opinions expressed in the study are the responsibility of the firm. The European Commission does not endorse the OXERA report, but uses it as a source of information for the review of the Investor-compensation schemes Directive.

<sup>11</sup> Commission Staff Working Document accompanying the Proposal for a Directive of the European Parliament and of the Council amending Directive 1997/9/EC on investor-compensation schemes - SEC (2010) 845.

## **4. LEGAL ELEMENTS OF THE PROPOSAL**

### **4.1. Legal basis**

The proposal is based on Article 53(1) of the TFEU.

### **4.2. Subsidiarity and proportionality**

The objectives of the proposal cannot be sufficiently fulfilled by the Member States. The current EU framework only provides for some minimum harmonisation principles leaving it up to Member States to develop it further. However, problems encountered in some Member States demonstrate that additional and notably more extensive harmonisation at EU level is necessary in order to ensure that the objectives of the Directive are fulfilled within the EU.

Indeed, the main problems with the application of the Directive are the large margin for discretion it grants to Member States. The proposal aims at improving the proper functioning of a single market for investment services, increasing investor protection and investor confidence in the EU. In particular, it aims at improving the practical functioning of the ICSD, at clarifying the scope of the ICSD taking into account the financial crisis and recent changes in the EU regulatory landscape, at reducing gaps in the regulatory system and disparities between the protection of clients of investment firms and of banking depositors. In the light of the existing differences in the functioning of the schemes at national level, the proposal introduces common rules to ensure a degree of harmonisation in the funding of the schemes and in the day-to-day practice; this is also the basis for the provision of a borrowing mechanism among national schemes as a last resort tool to compensate any temporary needs from schemes, subject to a rigorous assessment carried out by the European Securities and Markets Authority and to the obligation to repay any loan within the maximum period of five years.

Moreover, there are issues such as the current non-compensation of investors which due to the default of a depositary or third party cannot recover their assets or suffer a loss in the value of their units or shares in a UCITS, that need to be addressed at EU level, since other solutions could fragment the protection of investors in the EU markets. Taking into account that the provision of investment services is a cross border activity, investment firms should be treated in the same way in different Member States when they fail to return clients assets; investors across Member States should benefit from the same level of protection. This consistent approach is necessary in order to avoid level playing field problems between investment firms of different Member States and competition distortion between banks and investment firms.

An additional element relates to the fact that through the amendment of the Directive on Deposit Guarantee Schemes (Directive 94/19/EC<sup>12</sup> - DGSD), the level of protection for bank depositors was increased. Moreover, the functioning of the Deposit Guarantee Schemes is being modified in order to harmonise the scope of coverage, the modalities and timing of payout, the financing mechanisms and the provision of mutual solidarity between schemes. Investment firms should not be undermined due to the increase of protection in the bank deposits sector. Therefore it is necessary to assess the level of protection of investors at EU level, to take into account the situation of the markets in the EU and any regulatory change at EU level that might have consequences in the field of investments.

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<sup>12</sup> OJ L 135, 31.5.1994, p. 5-14.

In the meantime, the proposal takes into account the different underlying objectives between the two directives. The DGSD has a prevailing banking stability objective because banks are susceptible to the risk of a run if depositors believe that their deposits are not safe and try to withdraw them at the same time. The ICSD protects investors against the risk of frauds or administrative malpractices or operational errors making the investment firm unable to return assets to clients. The proposal preserves the specificities of the sectoral legislation.

The proposal respects the principle of proportionality as all solutions have been assessed against its cost-efficiency and they respect the particularities of markets in Member States. The proposal does not go beyond what it is necessary to achieve the objectives pursued, in particular, it keeps minimum harmonisation principles where pertinent, for instance concerning the modalities according to which the members of the compensation schemes have to contribute to the scheme. The introduction of a borrowing system between the national schemes is consistent with the proportionality principle in that it does not impinge any fiscal responsibility of Member States, it is a last resort measure subject to the previous use of other funding mechanisms (ordinary and additional contributions from members), it only introduces a lending possibility subject to the payment of interests and to a repayment obligation from the borrowing scheme and it is limited in time and size.

### **4.3. Detailed explanation of the proposal**

#### *4.3.1. Alignment with MiFID – Services covered and classification of clients – Article 1 (2) and Annex I*

The scope of the ICSD is currently defined by cross-reference to investment services as defined under the Investment Services Directive<sup>13</sup>. The ICSD protects investors when a firm is unable to return financial instruments or money held on a client's behalf in connection with investment services.

MiFID has repealed the ISD and broadened the scope of services covered under the sectoral legislation (for example the operation of Multilateral Trading Facilities or MTF is currently included in the scope of MiFID). A number of technical issues have also arisen, such as the coverage of firms depending on the scope of their authorisation (i.e. whether the firm is authorised to hold client assets or not).

The proposed amendment clarifies that all investment services and activities covered under MiFID should be subject to the ICSD and that if firms *de facto* hold client assets (irrespective of restrictions on their authorisation or the nature of their investment service) then clients should be entitled to compensation under the ICSD. This would be irrespective of whether the firm is doing so in contravention of any limitation on its authorisation (e.g. preventing it from holding client assets or from dealing with retail clients) and irrespective of the nature of the investment service it provides (e.g. if it is operating an MTF). This measure will enable retail investors to assume that they are covered by the ICSD without checking detailed conditions on a firm's authorisation. It will also result in more consistency across Member States in the application of the ICSD which will assist the proper functioning of the ICSD.

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<sup>13</sup> Article 1, n. 2 refers to investment services as defined in Article 1(1) of Directive 93/22/EEC (ISD) and the service referred to in point 1 of Section C of the Annex to that Directive.

Another amendment deriving from MiFID provisions concerns the classification of clients. Indeed, the ICSD is potentially applicable to all categories of investors. However, more sophisticated clients are normally able to select and monitor the activity of intermediaries to which they entrust their assets. In addition, the limitation of compensation to a certain amount (currently €20 000) makes the directive as typically targeted to "small investors"<sup>14</sup>. For this reason, national legislation in the Member States may currently provide that professional and institutional investors<sup>15</sup> can be excluded from coverage<sup>16</sup> under Annex I of the ICSD.

However, since the ICSD pre-dates the MiFID, the list of professional and institutional investors under the ICSD does not coincide with the corresponding list under MiFID<sup>17</sup>. This may create complexities in the phase of compensation, where the clients classified as professionals for the provision of services may not correspond to the clients which may be excluded from coverage according to the ICSD.

The proposal aligns the classification of clients in the ICSD with the MiFID definition of clients to be considered as professional. This will provide greater consistency and clarity and simplify the position for compensation schemes and investors, as there will be consistency between the two Directives. The alignment with the clients to be considered as professional will ensure certainty and will also result in a better protection for medium-sized enterprises which may currently be excluded from the protection granted by the ICSD and are instead normally classified as retail clients under the MiFID<sup>18</sup>. A cross-reference to the MiFID definition of client to be considered as professionals will allow the automatic adaptation of the ICSD to any future MiFID change.

#### 4.3.2. *Failure of a third party custodian - Article 2(2), Article 12*

The ICSD protects investors when a firm is unable to return financial instruments or money held on a client's behalf in connection with investment services. Under MiFID, financial instruments can be held in two different ways: (i) by the investment firm itself holding financial instruments for a client, or (ii) by a custodian (a "third party custodian") usually selected by the firm<sup>19</sup>. Investors may therefore not only be exposed to the failure of the firm, but also to the potential failure of a custodian. In a case where a third party custodian is not able to return the financial instruments to its client, the client will not be able to benefit from any compensation payment by the compensation scheme established under the ICSD. This is because under the current

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<sup>14</sup> See for example the reference to small investors in recital 4 of the ICSD.

<sup>15</sup> A list of such investors is set out in Annex 1 of the ICSD.

<sup>16</sup> Article 4(2) and Annex 1 of the ICSD.

<sup>17</sup> MiFID - Annex II.

<sup>18</sup> Currently firms which meet at least two of the following criteria are always able to claim compensation under the ICSD: Balance sheet total ≤ €4 400 000, net turnover ≤ €8 800 000, average number of employees ≤ 50. Under MiFID, only the bigger firms meeting at least two of the following criteria may be classified as professional clients *per se*: Balance sheet total ≥ €20 000 000, net turnover ≥ €40 000 000, own funds ≥ €2 000 000. As a result, the adoption of the MiFID definitions would narrow the scope of firms that may be excluded under the ICSD.

<sup>19</sup> Article 16 and 17 of Directive 2006/73/EC Implementing Directive 2004/39/EC as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

scope of the ICSD, compensation schemes are only available to investors whose financial instruments have been lost by the investment firm "for reasons directly related to an investment firm's financial circumstances". As a result, there is under the ICSD a difference in the level of protection provided for investors who have purchased a financial instrument, depending on whether the firm itself or a third party custodian holds their assets.

The proposal amends Article 2(2) to extend compensation to investors for claims relating to the failure of a firm to return financial instruments due to the failure of a third party custodian. This measure will deal with the potential gap that would arise if a custodian were to default. Investment firms remain responsible to take all reasonable steps to recover assets from a custodian.

The proposal does not amend the Article to include failure of an institution with whom monies are deposited by an investment firm. The reason for this difference is that the Directive 2006/73/EC Implementing MIFID provides for a very strict list of institutions where client funds may be deposited (a central bank, a credit institution, a bank authorised in a third country or a qualifying money market fund)<sup>20</sup>. This differentiates the treatment of funds compared with financial instruments, for which, subject to due diligence criteria from the investment firm concerned, entities which are not regulated might be appointed for the deposit of client financial instrument. This different regime justifies a different treatment under the ICSD.

#### 4.3.3. *Failure of a UCITS depositary - Article 1(4), Article 2(1), Article 2 (2b), Article 4a, Article 5, Article 10(1), Article 12*

The management of Undertakings for Collective Investment in Transferable Securities (UCITS)<sup>21</sup> is not a MiFID investment service. As a result the ICSD does not cover UCITS and their units' holders in cases where losses are suffered due to the failure of a UCITS depositary or sub-custodian. This situation however is comparable, in substance, to the one describe under paragraph 4.3.2 where losses are suffered due to the failure of an investment firm custodian or sub-custodian.

As a consequence, the proposed measure will give UCITS holders the right to be compensated by the investor-compensation scheme if the assets cannot be returned to the UCITS, because of the failure of a UCITS depositary or sub-custodian. The definition of "investor" under Article 1(4) would encompass a unit holder in a UCITS and a series of articles are being modified in order to capture the failure of a UCITS depositary or sub-custodian (Articles 2, 4, 5, 10, 12). Since the proposal will protect UCITS or UCITS depositaries or sub-custodians, the cost of this extension in coverage should be borne by these entities rather than investment firms. In addition, in light of the choice made to extend coverage of the ICSD in case of failure of a third party custodian used in connection with investment business, it makes sense that the risk is addressed in similar terms in the case of problems with depositaries or sub-custodians of the UCITS.

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<sup>20</sup> Article 18 of Directive 2006/73/EC.

<sup>21</sup> Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (OJ L 302, 17.11.2009, p. 32–96).

This measure will introduce some protection for UCITS investors. At the same time it should be complemented by changes to the legislation applicable to the UCITS depositaries function under the UCITS Directive<sup>22</sup> in order to further harmonise the depositaries' duties and their responsibility regime. The Commission is working on possible changes to that legislation<sup>23</sup>.

#### 4.3.4. *Exclusion of claims involving market abuse - Article 3 and Article 9(3)*

Article 3 of the ICSD excludes claims where a criminal conviction has been obtained for money laundering<sup>24</sup> but not claims by investors who have engaged in market abuse. By modifying Article 3, the ICSD will explicitly exclude any claim for compensation where the investor has engaged in actions that are prohibited under Directive 2003/6/EC on insider dealing and market manipulation<sup>25</sup>. The investors who have committed these acts should be excluded from compensation, as they should not benefit from the general protection offered by the Directive.

#### 4.3.5. *Level of compensation - Article 4(1) and Article 2(3)*

Article 4(1) of the ICSD harmonizes the minimum level of compensation (€20 000) for each investor. When the ICSD was introduced, it was considered sufficient to align this level with the one set under the Deposit Guarantee Scheme Directive (€20 000 at the time)<sup>26</sup>. But the compensation limit of €20 000 was never adjusted to reflect inflation or the increased exposure of European investors to financial instruments since the ICSD entered into force. Furthermore, the Deposit Guarantee Schemes Directive (DGSD) was recently amended to provide for at least €50 000 per depositor per credit institution, to be increased to a fixed level of €100 000.<sup>27</sup>

The Commission proposes the modification of Article 4(1) in order to increase the level of compensation to a fixed amount of €50 000. The level has been fixed to take account of the effects of inflation in the EU and to better align the level of compensation to the average value of investments held by retail clients in the EU. The level of compensation should be set at a fixed amount in order to avoid arbitrage and investors' choice to be influenced by any different coverage granted in different Member States. As some Member States have currently a higher level of compensation, a grandfathering clause of three years is foreseen to allow them to adapt to the €50 000 coverage level.

In the case of credit institutions doubts may arise as to the coverage under the ICSD rather than the DGSD of monies deposited in a bank in the context of the provision of investment services. To deal with situations of possible uncertainty due to the

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<sup>22</sup> Articles 22 to 26 and 32 to 36 of Directive 2009/65/EC.

<sup>23</sup> The relevant legislative proposal, preceded by consultation, should be adopted by Spring 2011.

<sup>24</sup> Money laundering was defined in Article 1 of Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering. The Directive has been repealed by Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (OJ L 309, 25.11.2005, p. 15–36).

<sup>25</sup> Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) (OJ L 96, 12.4.2003, p. 16–25).

<sup>26</sup> Article 7 of Directive 94/19/EC on deposit-guarantee schemes.

<sup>27</sup> See Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC as regards the coverage level and the payout delay (OJ L 68, 13.3.2009, p. 3–7).

specific nature of banks which may provide both banking activity and investment services, the Article 2(3) of the ICSD is being amended to specify that in cases of doubt the investor is to be compensated under the DGSD (which provided a higher level of coverage). This would protect investors in an efficient manner and reduce level playing field concerns.

#### 4.3.6. *Funding principles - Article 4a*

The broad discretion under the ICSD about how to fund schemes (e.g. *ex ante* or *ex post*, in respect of the occurrence of any loss events) and huge differences in the way funding is organised by individual Member States create a number of problems. It undermines investor protection and investor confidence in the use of investment firms (if investors are not confident that there will be adequate funding in place to pay their claims if there is a default). It also affects the proper functioning of the internal market if the likelihood of investor protection, and the contributions required from firms, vary significantly across Member States depending on the adequacy of individual funding arrangements.

A new Article is introduced specifying the basic principles about the funding of the investor-compensation schemes. In particular, according to the provision:

- in principle, the cost of financing schemes should continue to be borne by market participants;
- the schemes should be adequately financed in proportion to their potential liabilities;
- in order to provide a sufficient level of funding, a minimum target fund level will be established for all the schemes. This target fund level will be fully *ex ante* funded. Taking into account the current differences at national level, the target fund level should initially be reached within a 10-year period;
- when, in concrete cases, the *ex ante* funds are not sufficient to cover the liabilities of a scheme, additional calls for contributions from entities covered under the scheme should be ensured. However, they should not jeopardise the stability of the financial system of the Member State;
- once these funding sources have been exhausted, the scheme may have recourse to borrowing from other compensation schemes as further detailed in the following point 4.3.7;
- access to further multiple funding sources has to be ensured, including borrowing facilities;
- schemes should publish details about their level of funding.

The detailed implementation of some points will be specified via delegated acts to be adopted by the Commission in accordance with Article 290 of the Treaty. The details

to be made public by the schemes will be specified via technical standards by the future European Securities and Markets Authority (ESMA)<sup>28</sup>.

This measure is proportionate as it will result in more harmonisation of funding of schemes without being overly prescriptive and excessively detailed and it will still leave some flexibility to Member States as to the practical implementation of the principles. More harmonisation will improve the proper functioning of the single market for investment services by reducing discrepancies affecting the treatment of investment firms and investors in different Member States. It will also reduce the risk of a scheme having insufficient funding to meet its obligations and therefore result in greater consumer protection and investor confidence in the use of investment services.

#### 4.3.7. *Borrowing last resort mechanism between national schemes - Article 4b*

Together with the establishment of consistent funding rules between Member States, the introduction of cooperation arrangements among national schemes will provide greater protection to investors and promote investor confidence in investment services.

The system is based on the principle of solidarity between the national schemes. According to the proposed Article, a borrowing mechanism among schemes is introduced as a last resort tool.

These measures should provide schemes with an alternative back up source of funding, under specific conditions and on a temporary basis. They will also facilitate a closer relationship and better on-going coordination between national schemes and will act as an incentive to develop more harmonized practices and working procedures. Detailed funding principles and a repayment (mid-term) obligation upon the borrowing scheme will limit the risk of moral hazard between undersized and better funded schemes. More in detail:

- schemes should have the right to borrow from the other schemes if their funds are insufficient to cover their immediate needs;
- a portion of ex-ante funding in each compensation scheme will have to be available for lending to other schemes;
- ESMA should receive any borrowing request, assess whether the relevant requirements are met and, if this is the case, transmit it to the other schemes;

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In October, 2009 the European Commission has adopted a package of draft legislation to strengthen the supervision of the financial sector in Europe. The legislation will create a new European Systemic Risk Board (ESRB) to detect risks to the financial system as a whole. It will also set up a European System of Financial Supervisors (ESFS), composed of national supervisors and three new European Supervisory Authorities for the banking, securities and insurance and occupational pensions sectors. The ESMA is one of the three European Supervisory Authorities included in the legislative package. The relevant legislative proposal is available at the following link:  
[http://ec.europa.eu/internal\\_market/finances/docs/committees/supervision/20090923/com2009\\_503\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/committees/supervision/20090923/com2009_503_en.pdf)

- loans should be repaid to the lending schemes at the latest after 5 years since the request. Interests should accrue on the loans; the interest rate shall be equivalent to the marginal lending facility rate of the ECB;
- the borrowing mechanism should be limited to the claims covered under the Directive. For instance, schemes will not be able to borrow for any needs arising from the default of entities not included in the scope of the directive;
- in order to avoid that the funds available for lending at EU level are rapidly exhausted, a limit of 20% of the portion set aside for lending may be used for each case.

#### 4.3.8. *Compensation limit ("co-insurance principle") - Article 4(4), Article 8(1)*

Article 4(4) of the ICSD allows Member states to limit the coverage of the compensation to a specified percentage (equal to or exceeding 90%) of an investor's claim. This means that a client can be required to bear a proportion of the loss (within the compensation limit). The reason for this option in the ICSD was to encourage investors to take some care in choosing investment firms<sup>29</sup>. But arguably it is unrealistic to expect retail investors to be able to identify which firms are more or less likely to be affected by fraud or systems failures.

Eliminating this option under Article 4(4) will provide increased investor protection under the ICSD as clients will no longer have to bear part of the loss if there is fraud at a firm or other problems with the firm's systems or controls.

Moreover, in order to better protect investors, the provision giving the possibility to Member States to exclude from coverage of the compensation scheme funds in currencies other than of the Member States is eliminated. This provides better protection to investors as it ensures that clients' funds are covered irrespective of the currency involved.

#### 4.3.9. *Payout delays – Article 2, Article 9(2)*

Article 9(2) of the ICSD establishes a strict deadline for reimbursement (as soon as possible and at the latest within three months). But, this deadline only runs once the "eligibility and the amount of the claim" have been established. That is, it is not linked to the date on which the firm is declared to be in default. Processing claims takes considerably longer than the limits set, possibly up to several years as evidenced by recent cases. So in practice there is a considerable delay before an investor receives any compensation. This undermines investor protection and investor confidence.

The proposed modification to Article 9(2) introduces the obligation for schemes to provisionally pay partial compensation based on an initial assessment of the claim if payout delay exceeds a specified time period. The level of the partial payment will amount to one third of the initial assessment of the claim. The balance will be paid out later once the claim had been fully verified. Schemes will also need the ability to

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<sup>29</sup> See recital 13 of the Directive.

recover amounts provisionally paid out if it was subsequently determined that the claim was not in fact valid.

Article 2 is also being amended to clarify that a competent authority must make a determination of whether a firm is unable to meet its obligations to investors within three months. This is to mitigate concerns about individual cases where competent authorities could be very slow to make a determination.

The delays introduced by the proposal take into account the difference between situations covered under the ICSD and the DGSD, where depositors must be repaid within 20 working days of the date on which the authorities make their determination as to the inability of credit institutions to repay the deposits. In the case of compensation-schemes, the underlying situations of fraud, malpractices or operational problems covered by the directive make it necessary a longer delay in order to reconstruct the position of single investors.

#### *4.3.10. Investor information- Article 10(1)*

Article 10(1) of the ICSD requires Member States to ensure that investment firms make available to actual and potential investors information about the relevant investor compensation scheme including the amount and scope of cover. Information must be made available in a readily comprehensible manner. However, concerns have been raised about how this provision has been applied in practice in the Member States.

Article 10(1) is amended to require also to UCITS managers, as a consequence of the broadening of coverage of the Directive, to disclose to investors in clear and simple terms what is effectively covered by schemes (e.g. investment risk is usually not covered). Under this proposal the existing obligation for investment firms to provide information about compensation schemes to new clients will be supplemented by requiring further detail to be provided about what is compensated under the ICSD and how it applies in cross border situations, also for UCITS. Specifically it will require them to clearly explain that certain losses (e.g. due to investment risks) are not subject to the payment of compensation under the ICSD.

## **5. BUDGETARY IMPLICATION**

The proposal has no implication for the Union budget

Proposal for a

**DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**amending Directive 97/9/EC of the European Parliament and of the Council on investor-compensation schemes**

**(Text with EEA relevance)**

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 53(1) thereof,

Having regard to the proposal from the European Commission<sup>30</sup>,

After transmission of the draft legislative act to the national Parliaments,

Having regard to the opinion of the European Economic and Social Committee<sup>31</sup>,

Acting in accordance with the ordinary legislative procedure,

Whereas:

- (1) At the request of the Commission, a report published on 25 February 2009 by a high-level group of experts chaired by J. de Larosière concluded that the supervisory framework needed to be strengthened to reduce the risk and severity of future financial crisis and recommended far-reaching reforms to the structure of supervision of the financial sector in Europe, including the creation of a European System of Financial Supervisors, comprising three European Supervisory Authorities, one for the securities sector, one for the insurance and occupational pensions sector and one for the banking sector, and the creation of a European Systemic Risk Board. The Commission Communication of 4 March 2009, "Driving European Recovery", proposed to strengthen the Union's regulatory framework for financial services, in particular to enhance investor protection. The Commission proposed in September 2009 the legislative package for the creation of the new authorities, including the European Securities and Markets Authorities (ESMA) to, in particular, contribute to a consistent application of Union legislation and to contribute to the establishment of high quality common regulatory and supervisory standards and practices.
- (2) It is necessary to amend Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor-compensation schemes<sup>32</sup> in order to maintain

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<sup>30</sup> OJ C , , p. .

<sup>31</sup> OJ C , , p. .

<sup>32</sup> OJ L 84, 26.3.1997, p. 22–31.

confidence in the financial system and to better protect investors in view of the developments in the legal framework of the Union, the evolution in the financial markets and the problems experienced in the application of that Directive in Member States in cases of inability of investment firms to return assets held on behalf of clients.

- (3) At the time of its adoption, Directive 97/9/EC complemented Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field<sup>33</sup> to ensure that each Member State would set up an investor-compensation system to guarantee a harmonized minimum level of protection, at least for small investors, in the event of an investment firm being unable to meet its obligations to its clients. When Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC<sup>34</sup> repealed Directive 93/22/EEC, it introduced a new list of investment services and activities in order to encompass the full range of investor-oriented activities and to provide for the degree of harmonisation needed to offer investors a high level of protection and to allow investment firms to provide services throughout the Union. Therefore, it is necessary to align Directive 97/9/EC with Directive 2004/39/EC in order to ensure that the provision of all investment services and activities continue to be adequately covered under schemes.
- (4) At the time of its adoption, Directive 97/9/EC took into account the coverage and the functioning of deposit-guarantee schemes as regulated under Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes<sup>35</sup>. Consequently, it is appropriate to continue taking into account any modifications of Directive 94/19/EC.
- (5) Investors may not be aware of any limits of investment firms' authorisations, thus it is necessary to protect them in situations in which investment firms act in breach of their authorisation notably by holding client assets or providing services to a particular type of client contrary to the conditions of their authorisation. Therefore, schemes should cover clients' assets which are de facto held by investment firms in connection with any investment business.
- (6) Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive<sup>36</sup> allows investment firms to deposit financial instruments held on behalf of clients into accounts opened with a third party. The third party is not necessarily subject to specific regulation and supervision. Notwithstanding compliance with the conditions under Directive 2006/73/EC, failure of the third party may affect investors' rights if that party is not able to return the financial instruments to the investment firm. In order to strengthen investor confidence, it is appropriate to extend compensation under Directive 97/9/EC, without prejudice to applicable national liability regimes, to the inability of an investment firm to return client financial

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<sup>33</sup> OJ L 141, 11.6.1993, p. 27–46.

<sup>34</sup> OJ L 145, 30.4.2004, p. 1–44.

<sup>35</sup> OJ L 135, 31.5.1994, p. 5–14.

<sup>36</sup> OJ L 241, 2.9.2006, p. 26–58.

instruments due to the failure of a third party where the financial instruments have been deposited by the investment firm or by its custodians.

- (7) Directive 2006/73/EC requires investment firms to place any client funds they receive into one or more accounts opened with a third party. The third party entities are limited to a central bank, a credit institution or a bank authorised in a third country or a qualifying money market fund. The strict regime ensured by Directive 2006/73/EC make it unnecessary to extend the schemes coverage to the failure of the third party where funds have been deposited.
- (8) As the compensation coverage under Directive 94/19/EC is now higher than the one under this Directive, it is necessary to provide the highest protection to investors in cases where both Directives 94/19/EC and 97/9/EC could cover assets held by banks . Therefore, in those cases, the investor should be compensated under Directive 94/19/EC.
- (9) In order to be able to recover the funds paid for compensation, schemes making payments to compensate investors for failure of a depositary or a third party should have the right of subrogation to the rights of the investor, investment firm or undertakings for collective investment in transferable securities (hereinafter referred to as "UCITS") in liquidation proceedings for amounts equal to their payments. This Directive should not be intended to diminish the responsibility of investment firms or UCITS to recover assets from a depositary or custodian.
- (10) Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)<sup>37</sup> requires the UCITS' assets to be safe kept by a depositary. If the depositary or one of its sub-custodians defaults and is unable to return the financial instruments held in custody , this affects the value of the UCITS units or shares. In order to increase protection in this situation, unit and share holders in UCITS should benefit from the same level of protection as if they were investing directly into the financial instruments concerned, should the entity holding the financial instruments become unable to return them. Unit holders and share holders in UCITS should receive compensation for the loss of value of the UCITS. At the same time, they should be able to keep the UCITS units or shares in order to preserve their right to redeem them when they consider this is adequate.
- (11) Directive 97/9/EC already excludes from any compensation under investor-compensation schemes claims arising out of transactions where a criminal conviction has been obtained for money laundering within the meaning of Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing<sup>38</sup>. It is also appropriate to exclude any claim for compensation where the assets concerned result from conduct prohibited under Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse)<sup>39</sup> in which the claimant has been involved.

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<sup>37</sup> OJ L 302, 17.11.2009, p. 32–96.

<sup>38</sup> OJ L 309, 25.11.2005, p. 15.

<sup>39</sup> OJ L 96, 12.4.2003, p. 16.

- (12) The minimum level of compensation was established in 1997 and has not been modified since then. This level should be increased to EUR 50 000 in order to take into account developments in the financial markets and in the Union legislative framework. This amount takes into account the effects of inflation in the Union and the need to better align the level of compensation with the average value of investments held by retail clients in the Member States. In order to increase the protection provided to investors, it is necessary to remove the existing option for Member States to limit or exclude from cover funds in currencies other than those of the Member States.
- (13) In order to ensure investors receive the compensation provided for under this Directive and a comparable level of investor protection across Member States, it is necessary to introduce common rules governing the funding of the schemes. The schemes should be financed in proportion to their liabilities. An appropriate level of pre-funding should be ensured and the schemes should have in place adequate arrangements to assess and reach their target funding level prior to the occurrence of any loss event relevant under Directive 97/9/EC. A common minimum target fund level should be reached within a ten-year period.
- (14) Where necessary, exceptional call for contributions to the members of the scheme or access to borrowing sources, such as from commercial banks or public institutions on commercial grounds, should ensure a timely coverage of any needs which is not covered by the funds collected from members prior to the occurrence of loss events.
- (15) The functioning of the schemes is currently highly differentiated in Member States and this Directive aims at introducing further harmonisation while leaving some flexibility to Member States as to the detailed organisation of the schemes. The Commission should be empowered to adopt delegated acts on certain essential features of the functioning of schemes in accordance with Article 290 of the Treaty. In particular the delegated acts should be adopted in respect of the method to determine the potential liabilities of the schemes, the alternative funding arrangements that schemes must have in place to be able, where necessary, to obtain short term funding, the criteria to determine the contributions by entities covered by the schemes and the factors to be considered in assessing the ability of additional contributions to not jeopardise the stability of the financial system of a Member State. In order to determine the conditions of application of the provisions concerning the financing of the schemes, the European Securities and Markets Authority established by Regulation .../... of the European Parliament and of the Council [ESMA]<sup>40</sup> should develop technical standards relative to the details to be made public by the schemes.
- (16) In order to ensure that investors receive compensation in due time a last resort borrowing mechanism among national schemes in the Union should be established. The system should include the possibility for schemes to borrow funds from other schemes in the exceptional case they face a temporary lack of funding. For this purpose, a portion of ex-ante funding in each scheme should be available for lending to other schemes.

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<sup>40</sup> OJ L ...

- (17) The borrowing mechanism should not impinge any fiscal responsibility of the Member States. The borrowing schemes should be able to make recourse to the borrowing possibility provided for in this directive after exhausting the funds collected to reach the target fund level and the additional calls for contribution to their members. While respecting the supervision of investor-compensation schemes by Member States, ESMA should contribute to the achievement of the objective of making it easier for investment firms and UCITS to pursue their activities while at the same time ensuring effective protection for investors. To that end, ESMA should confirm that the conditions of borrowing between investor-compensation schemes laid down in this Directive are fulfilled and state, within the strict limits set by this Directive, the amounts to be lent by each scheme, the initial interest rate as well as the duration of the loan. In this respect, ESMA should also collect information on investor-compensation schemes, in particular on the amount of covered monies and financial instruments in each scheme, confirmed by competent authorities. It should inform the other investor-compensation schemes about their obligation to lend.
- (18) In order to simplify the lending process, if more than one scheme is established in a Member State, the Member State shall designate one scheme acting as the lending scheme of that Member State and inform the European Securities and Markets Authority accordingly. Borrowing should be limited to the coverage of compensation deriving from Directive 97/9/EC.
- (19) It is necessary to ensure that the overall funds available for lending may be used to satisfy a plurality of requests from borrowing schemes. For this purpose, no loan should exceed a pre-determined threshold of funds available for lending.
- (20) In order to accelerate the compensation process, the determination by a competent authority of the fact that an investment firm is not able to meet its obligations arising out of investors' claims should be made as soon as possible.
- (21) The procedures necessary to establish the eligibility and the amount of compensation claim, often depending on national administrative and insolvency laws, may cause long delays in the payments to investors. In order to make payment delays shorter, it is necessary to ensure that, in systems or situations where the eligibility and the amount of the claim depends on insolvency or judicial procedures regarding the entities failing to meet their obligations, the schemes should be able to participate in those procedures. In addition, the obligation to grant a provisional payout of partial compensation should be provided for in the case of delays longer than twelve months in order to allow investors to receive a portion of the compensation claimed. Mechanisms to return the money to the schemes in case it is established that the claim was not eligible should be envisaged.
- (22) Directive 97/9/EC allows Member States to exclude professional and institutional investors from cover but the relevant list is not aligned with the classification of clients of investment firms under Directive 2004/39/EC. In order to ensure consistency between Directives 97/9/EC and 2004/39/EC, to simplify the assessment for compensation schemes and to limit the possible exclusion, in the case of enterprises, only to large undertakings, Directive 97/9/EC should refer to investors who are considered as professional clients according to Directive 2004/39/EC.

- (23) The Commission should be empowered to adopt delegated acts in accordance with Article 290 of the Treaty. In particular, the delegated acts should be adopted in respect of the determination of the method to calculate the target fund level to be established by the schemes and to modify this target fund level, the percentage of the determined ceiling of the funds available for lending between national compensation schemes, the procedure to deal with investors' claims and the technical criteria to calculate the loss of value of a UCITS in the circumstances covered by this Directive. The Commission should also be empowered to amend, by means of delegated acts, the percentage of funds available for lending taking into account the developments in the financial markets.
- (24) Directive 97/9/EC should therefore be amended accordingly,

HAVE ADOPTED THIS DIRECTIVE:

*Article 1*  
*Amendments to Directive 97/9/EC*

Directive 97/9/EC is amended as follows:

(1) Article 1 is amended as follows:

(a) Point 2 is replaced by the following:

"2. 'investment business' shall mean investment services and activities as defined in Article 4(1)(2) of Directive 2004/39/EC and the ancillary service referred to in point 1 of Section B of the Annex I to Directive 2004/39/EC of the European Parliament and of the Council (\*);

\* OJ L 45, 16.2.2005, p. 18."

(b) Point 4 is replaced by the following:

"4. 'investor' means, in relation to investment business, any person who has entrusted money or instruments to an investment firm, and in relation to the activities of UCITS, a unit holder or share holder in a UCITS (hereafter "unit holder");"

(c) Point 7 is replaced by the following:

"7. 'competent authorities' means the authorities defined in Article 4 (1) 22 of Directive 2004/39/EC and in Article 2(1) ( h) of Directive 2009/65/EC of the European Parliament and of the Council (\*).

Where this Directive refers to the [ESMA regulation] investor-compensation schemes shall, for the purpose of this regulation, be considered competent authorities under Article 2(3) of the [ESMA regulation];

\* OJ L 302, 17.11.2009, p. 32."

(d) The following points 8 to 11 are added:

"8. 'UCITS' means an undertaking as defined in Article 1(2) and (3) of Directive 2009/65/EC;

9. 'depository' means in relation to UCITS activities, an institution as defined in Article 2(1)(a) of Directive 2009/65/EC;"

10. 'third party' means, in relation to investment business, an institution with whom an investment firm has deposited financial instruments held by it on behalf of its clients as referred to in Article 17 of Directive 2006/73/EC or with whom such an institution has sub-deposited the financial instruments; in relation to a UCITS business, an institution with whom a UCITS depository has entrusted assets on behalf of the UCITS;

11. 'low-risk assets' means asset items falling into one of the categories set out in the first and second category of Table 1 of point 14 of Annex I to Directive 2006/49/EC of the European Parliament and of the Council(\*) but excluding asset items defined as qualifying items in point 15 of that Annex.

\* OJ L 177, 30.6.2006, p. 201."

(e) The following paragraph 2 is added:

"2. The provisions of this Directive applying to investment firms shall apply to management companies authorized in accordance with Directive 2009/65/EC, where their authorization also covers the services listed in Article 6(3), of that Directive."

(2) Article 2 is amended as follows:

(a) The first subparagraph of paragraph 1 is replaced by the following:

"1. Each Member State shall ensure that within its territory one or more investor-compensation schemes are introduced and officially recognized. Except in the circumstances envisaged in the second subparagraph and in Article 5(3), no investment firm authorized in that Member State or UCITS authorized in that Member State may carry on investment business or carry on activities as a UCITS, unless it belongs to such a scheme."

(b) Paragraph 2 is replaced by the following:

"2. A scheme shall provide coverage for investors in relation to investment business in accordance with Article 4 where one of the following conditions is met first:

- (a) the competent authorities have determined that an investment firm appears, for the time being, for reasons directly related to the financial circumstances of the investment firm or the financial circumstances of any third party with whom financial instruments have been deposited by the investment firm, to be unable to meet its obligations arising out of investors' claims and has no early prospect of being able to do so,
- (b) a judicial authority has made a ruling, for reasons directly related to the financial circumstances of the investment firm or the financial circumstances of any third party with whom financial instruments have

been deposited by the investment firm, which has the effect of suspending investors' ability to make claims against the firm or the firm's ability to make claims against the third party.

Member States shall ensure that competent authorities make the determination referred to in point (a) of the first subparagraph as soon as possible and in any event within 3 months, after first becoming aware that an investment firm has failed to meet its obligations arising out of investors' claims."

(c) The following paragraphs 2a, 2b and 2c are inserted:

"2a. The coverage referred to in paragraph 2 shall be provided in accordance with the legal and contractual conditions applicable for claims arising out of an investment firm's inability to perform either of the following:

- (a) repay money owed to or belonging to investors and held on their behalf in connection with investment business;
- (b) return to investors any instruments belonging to them and held, administered or managed on their behalf in connection with investment business,

Member States shall ensure that the schemes provide coverage where financial instruments or monies are held, administered or managed for or on behalf of an investor, irrespective of the type of investment business being carried on by the firm and of whether or not the firm is acting in accordance with any restriction set out in its authorisation.

2b. A scheme shall also provide coverage for UCITS unit holders in accordance with Article 4 where either of the following conditions is met first:

- (a) the competent authority has determined that a depositary or a third party to whom the assets of the UCITS are entrusted is unable to meet its obligations to a UCITS, for the time being, for reasons directly related to the financial circumstances of the depositary or the third party and has no early prospect of being able to do so;
- (b) a judicial authority has made a ruling, for reasons directly related to the financial circumstances of the depositary or any third party to whom assets of the UCITS are entrusted, which has the effect of suspending the UCITS' ability to make claims against the depositary or the third party.

Member States shall ensure that the competent authorities make the determination referred to in point (a) of the first subparagraph as soon as possible and in any event within 3 months, after first becoming aware that a depositary or a third party to whom the assets of the UCITS are entrusted has failed to meet its obligations arising out of the UCITS' claims.

2c. The coverage referred to in paragraph 2b shall be provided in accordance with the legal and contractual conditions applicable for a claim by a UCITS unit holder for the loss of value of the UCITS unit due to the inability of a depositary or a third party

to whom the assets of the UCITS have been entrusted, to perform either of the following:

- (a) repay money owed to or belonging to the UCITS and held on its behalf in connection with UCITS activities,
- (b) return to the UCITS any instruments belonging to it and held or administered on its behalf in connection with UCITS activities."

(f) Paragraph 3 is replaced by the following:

"3. Any claim referred to in paragraph 2a on a credit institution which, in a given Member State, would be eligible both under this Directive and Directive 94/19/EC shall be dealt with under Directive 94/19/EC. No claim shall be eligible more than once under those directives."

- (3) Article 3 is replaced by the following:

*"Article 3*

Claims arising out of transactions in connection with which a criminal conviction has been obtained for money laundering, as defined in Article 1 of Directive 2005/60/EC of the European Parliament and of the Council(\*), or arising out of conduct that is prohibited under Directive 2003/6/EC of the European Parliament and of the Council(\*\*), shall be excluded from any compensation under investor-compensation schemes.

\* OJ L 309, 25.11.2005, p. 15.

\*\* OJ L 96, 12.4.2003, p. 16."

- (4) Article 4 is amended as follows:

- (a) Paragraph 1 is replaced by the following:

"1. Member States shall ensure that schemes provide for coverage of EUR 50 000 for each investor in respect of the claims referred to in Article 2(2a) or (2c).

Members States which provide for coverage of more than EUR 50 000 at the time of adoption of this Directive, may maintain that level of coverage for no longer than 3 years from the date for the transposition of this Directive. After that date, those Member States shall ensure that the level of coverage is EUR 50 000.

Member States who convert the amounts expressed in euro into their national currency shall initially use in the conversion the exchange rate prevailing on the date of entry into force of this Directive.

Member States may round off the amounts resulting from the conversion, provided that such rounding off does not exceed EUR 2500.

Without prejudice to the fourth subparagraph, Member States shall adjust the coverage levels converted into another currency to the amount referred to in this paragraph every five years. Member States may make an earlier adjustment of coverage levels, after having consulted the Commission, following the occurrence of unforeseen events such as currency fluctuations.

- (b) The following paragraph 1a is inserted:

"1a. The Commission may adjust by means of delegated acts the amount referred in paragraph 1, taking into account the following parameters:

(a) inflation in the Union, on the basis of changes in the harmonised index of consumer prices published by the Commission;

(b) average amount of funds and financial instruments held by investment firms on behalf of retail investors."

- (c) Paragraph 2 is replaced by the following:

"2. A Member State may provide that certain investors shall be excluded from coverage by schemes for claims referred to in Article 2(2a) or (2c) or shall be granted a lower level of coverage. Those exclusions shall be as listed in Annex 1. "

(d) Paragraph 4 is deleted.

- (5) The following Articles 4a and 4b are inserted:

*"Article 4a*

1. Member States shall ensure that schemes have in place adequate systems to determine their potential liabilities. Member States shall ensure that compensation schemes are adequately financed in proportion to their liabilities.
2. Member States shall ensure that each scheme establishes a target fund level of at least 0.5% of the value of the monies and financial instruments held, administered or managed by the investment firms or UCITS that are covered by the protection of the investor compensation scheme. The value of the covered monies and financial instruments shall be calculated every year as at 1 January.

The Commission shall adopt, by means of delegated acts in accordance with Article 13a and subject to the conditions of Articles 13b and 13c, measures to determine the method to calculate the value of monies and financial instruments covered by the protection of the investor compensation schemes in order to determine the target fund level to be established by the schemes and to modify the target fund level taking account of the developments in financial markets.

3. The target fund level shall be financed prior to and irrespective of the occurrence of any event relevant under Article 2(2) or (2b). Member States shall ensure that the level of funding for each scheme is reached within a ten-year period after the entry into force of this Directive and that each scheme adopts and complies with an appropriate planning in order to fulfil this objective.

Contributions collected to reach the target fund level shall only be invested in cash deposits and low-risk assets with a residual term to financial maturity of 24 months or less, which can be liquidated within a time limit not exceeding one month.

4. Member States shall ensure that the schemes may make additional calls for contribution to the members of the scheme in case the target fund level is insufficient to meet the payment of the compensation claims referred to in Article 9(2). Those additional contributions shall not exceed 0.5% of the covered monies and financial instruments as referred to in paragraph 2 of this Article. Those additional contributions shall not jeopardise the stability of the financial system of the Member State concerned and be based on affordability criteria.
5. Member States shall ensure that schemes have in place adequate alternative funding arrangements to enable them to obtain short term funding to meet claims against the scheme once the pre-funded amount has been exhausted. Those arrangements may include borrowing facilities from commercial banks. They may also include borrowing facilities from public institutions provided that those facilities are based on commercial grounds.
6. Member States shall ensure that the cost of financing schemes is ultimately borne in relation to investment business by the investment firms or third party custodians covered by the scheme and in relation to UCITS activities, by UCITS or their depositaries or third parties who are covered by the scheme. Regular contributions by members shall be raised annually.

7. Member States shall annually inform the ESMA of the target fund level, as referred to in paragraph 2, and the level of funding, as referred to in paragraph 3, of the schemes in their Member State. This information shall be confirmed by the competent authorities and shall, accompanied by this confirmation, be transmitted within 30 days from the end of each year to the ESMA.

Member States shall ensure that the information referred to in the first subparagraph is published on the web-site of the Schemes at least on an annual basis.

8. Member States shall ensure that 10% of the ex-ante funding amount of the schemes referred to in Article 4a (2) is available for lending to other schemes under the conditions established in Article 4c.

The Commission may amend, by means of delegated acts in accordance with Article 13a and subject to the conditions of Articles 13b and 13c, the percentage of the ex-ante funding amount to be made available for lending to other schemes, taking into account the developments in financial markets.

9. The Commission shall adopt, by means of delegated acts in accordance with Article 13a and subject to the conditions of Articles 13b and 13c, measures to determine:

- (a) the method to determine the potential liabilities of schemes as referred to in paragraph 1;
- (b) the alternative funding arrangements as referred to in paragraph 5 that schemes must have in place to be able to obtain short term funding if necessary;
- (c) the factors to be considered in assessing the ability of additional contributions as referred to in paragraph 4 to not jeopardise the stability of the financial system of a Member State;
- (d) the criteria to determine the contributions by entities covered as referred to in paragraph 6.

10. In order to ensure uniform conditions of application of paragraph 7, subparagraph 2, the European Securities and Markets Authority established by Regulation .../... of the European Parliament and of the Council(\*) [ESMA] (hereinafter referred to as "ESMA") shall develop draft technical standards to specify the details of the information to be published by the schemes.

ESMA shall submit the draft technical standards referred to in the first subparagraph to the Commission by 31 December 2012.

The Commission may adopt the draft technical standards referred to in the first subparagraph in accordance with the procedure laid down in Article 7e of Regulation .../.... [ESMA].

#### *Article 4b*

1. A scheme shall have the right to borrow from all other schemes referred to in Article 2 within the Union provided that all of the following conditions are met:

- (a) the borrowing scheme is not able to fulfil its obligations under Article 2 (2a) or (2c) because of previous payments made to fulfil those obligations;
- (b) the situation referred to in point (a) of this subparagraph is due to a lack of funds as referred to in Article 4a(3);
- (c) the borrowing scheme has made recourse to additional contributions referred in Article 4a(4);
- (d) the borrowing scheme undertakes the legal commitment that the borrowed funds will be used in order to pay claims under Article 2 (2a) and (2c);
- (e) a scheme that has not repaid a loan to other schemes under this Article shall neither borrow from nor lend to other schemes;
- (f) the borrowing scheme shall state the amount of money requested;
- (g) the borrowing scheme informs without delay the ESMA and states the reasons why the above conditions are fulfilled and the amount of money requested.

The amount referred to in point (f) of the first subparagraph shall be determined as follows:

[amount of claims to be paid under Article 2(2a) and 2(2c)] – [level of funding as referred to in Article 4a(7)] + maximum amount of additional contributions referred to in Article 4a(4)]

The other schemes shall act as lending schemes. For this purpose, Member States in which more than one scheme is established shall designate one scheme acting as the lending scheme of this Member State and inform the ESMA thereof. Member States may decide if and how the lending scheme is reimbursed by other Schemes established in the same Member State.

2. The loan shall be subject to the following conditions:

- (a) subject to the limit established in the following subparagraph, each scheme shall lend the amount proportionate to the amount of covered monies and financial instruments in each scheme without taking account of the borrowing scheme. The amounts shall be calculated pursuant to the latest information referred to in Article 4a (2);
- (b) the borrowing scheme shall repay the loan at the latest after 5 years. It may repay the loan in annual instalments. Interest shall be due only at the time of repayment;
- (c) the interest rate shall be equivalent to the marginal lending facility rate of the European Central Bank during the credit period.

The total amount lent to each borrowing scheme shall not exceed the 20% of the total amount of the funds available at Union level for lending as referred to in Article 4a (8).

3. ESMA shall confirm that the requirements referred to in paragraph 1 have been met, state the amounts to be lent by each scheme as calculated pursuant to paragraph 2(a) and the initial interest rate pursuant to paragraph 2-(c) as well as the duration of the loan.

ESMA shall transmit its confirmation together with the information referred to in paragraph (g) to the lending Schemes. They shall receive this confirmation and information within 15 working days. The lending schemes shall, without delay but at the latest within further 15 working days after reception effect payment of the loan to the borrowing scheme.

4. Member States shall ensure that the contributions levied by the borrowing scheme are sufficient to reimburse the amount borrowed and to re-establish the target level fund as soon as possible and at latest within a ten-year period after the reception of the loan.
5. In order to facilitate an effective cooperation between investor-compensation schemes, the schemes, or, where appropriate, the competent authorities, shall have written cooperation agreements in place. Such agreements shall take into account the requirements set out in Directive 95/46/EC of the European Parliament and of the Council (\*\*).

ESMA shall be notified of the existence and the content of the agreements referred to in subparagraph 1. It may issue opinions on such agreements under Articles [6(2)(f) and 19 of the ESMA regulation]. If competent authorities or schemes cannot reach an agreement or if there is a dispute about the interpretation of such agreement, ESMA shall settle disagreements pursuant to [Article 11 of the ESMA regulation].

The absence of the agreements referred to in subparagraph 1 shall not affect the claims of investors under Article 2(2a) or (2c).

\* OJ L ...

\*\* OJ L 084, 26/03/1997, p.22.

- (6) Articles 5 and 6 are replaced by the following:

*"Article 5*

1. If an investment firm, UCITS, depositary or third party required by Article 2(1) to belong to a scheme do not meet their respective obligations incumbent on it as a member of that scheme, the competent authorities which issued the investment firm authorization or the UCITS authorization shall be notified and, in cooperation with the compensation scheme, shall take all measures appropriate, including the imposition of penalties, to ensure that the investment firm, UCITS, depositary or third party meets its obligations.
2. If the measures referred to in paragraph 1 fail to secure compliance on the part of the investment firm, UCITS, depositary or third party, the scheme may, with the express consent of the competent authorities, give not less than 12 months' notice of its intention of excluding the investment firm, UCITS, depositary or third party from

membership of the scheme. The scheme shall continue to provide the coverage referred to in Article 2(2a) and (2c) in respect of investment business or UCITS activities carried on during that period. If, on expiry of the period of notice, the investment firm, UCITS, depositary or third party has not met its obligations, the compensation scheme may, again having obtained the express consent of the competent authorities, exclude it.

3. An investment firm, UCITS, depositary or third party, excluded from an investor-compensation scheme, may continue to carry on investment business, its UCITS activities or be entrusted with investors' and UCITS financial instruments under the following conditions:
  - a) before its exclusion, it had made alternative compensation arrangements ensuring that investors and UCITS would enjoy cover that is at least equivalent to that offered by the officially recognized scheme and that the characteristics of such alternative compensation arrangements would be equivalent to those of the officially recognized scheme;
  - b) the competent authority responsible for the authorization of the investment firm or UCITS, has confirmed that the conditions referred to in letter a) are met.
4. If an investment firm or a UCITS the exclusion of which is proposed under paragraph 2 is unable to make alternative arrangements which comply with the conditions imposed in paragraph 3, the competent authorities which issued its authorization shall:
  - (a) with respect to the investment firm for which it has issued the authorization, withdraw the authorization without delay;
  - (b) with respect to the UCITS it has approved, withdraw the authorization without delay.
5. Where a depositary or a third party, the exclusion of which is proposed under paragraph 2 is unable to make alternative arrangements which comply with the conditions imposed in paragraph 3, it shall not be allowed to be entrusted with investors' or UCITS assets."

#### *Article 6*

After the withdrawal of an investment firm's authorization or UCITS' authorization, the coverage referred to in Article 2(2a) and (2c) shall continue to be provided in respect of investment business transacted up to the time of that withdrawal."

- (7) Articles 8 and 9 are replaced by the following:

#### *"Article 8*

1. The cover provided for in Article 4(1) and (3) shall apply to the investor's aggregate claim on the same investment firm or the same UCITS under this Directive irrespective of the number of accounts, the currency and location within the Union.

2. Each investor's share in joint investment business shall be taken into account in calculating the cover provided for in Article 4 (1) and (3).

In the absence of special provisions, claims shall be divided equally amongst investors.

Member States may provide that claims relating to joint investment business to which two or more persons are entitled as members of a business partnership, association or grouping of a similar nature which has no legal personality may, for the purpose of calculating the limits provided for in Article 4(1) and (3), be aggregated and treated as if arising from an investment made by a single investor.

3. Where an investor is not entitled to the sums or securities held, the person who is entitled shall receive the compensation, provided that that person has been or can be identified before the date of the determination or ruling referred to in Article 2(2) and (2b).

If two or more persons are entitled, the share of each under the arrangements subject to which the sums or the securities are managed shall be taken into account when the limits laid down in Article 4(1) and (3) are calculated.

#### *"Article 9*

1. The compensation scheme shall take appropriate measures to inform investors of a determination or ruling referred to in Article 2(2) and (2b) and, if they are to be compensated, to compensate them as soon as possible. It may fix a period during which investors shall be required to submit their claims. That period may not be less than five months from the date of the determination or ruling referred to in Article 2(2) and (2b) or from the date on which that determination or ruling is made public.

The fact that that period has expired may not be invoked by the scheme to deny coverage to an investor who has been unable to assert his right to compensation in time.

2. The scheme shall be in a position to pay an investor's claim as soon as possible and at the latest within three months of the establishment of the eligibility and the amount of the claim.

In exceptional circumstances a compensation scheme may apply to the competent authorities for an extension of the time limit. No such extension may exceed three months. Competent authorities shall inform immediately the European Securities and Markets Authority of any extension granted to any compensation schemes and the circumstances justifying such extension.

Member States shall ensure that compensation schemes may participate in insolvency or judicial procedures that may be relevant in establishing the eligibility and the amount of a claim.

The third subparagraph shall be without prejudice to schemes being able to adopt other methods to determine the eligibility or amount of a claim.

If final payment has not been made within nine months of the determination or ruling referred to in Article 2(2) or (2b), Member States shall ensure that the scheme provides, within three months of that determination or ruling, for a provisional payout of partial compensation of not less than one third of the claim based on an initial assessment of the claim. The balance shall be paid out within the period set out in the first subparagraph of this paragraph after the eligibility and the amount of the claim are finally established. Member States shall ensure that the scheme has the means to recover amounts provisionally paid out if it is established that the claim was not eligible.

The Commission shall adopt, by means of delegated acts in accordance with Article 13a and subject to the conditions of Articles 13b and 13c, measures to determine the procedure to deal with investors' claims and the technical criteria to calculate the loss of value of a UCITS as a result of the events mentioned under Article 2(2b) and (2c).

3. Notwithstanding the time limit laid down in the first subparagraph of paragraph 2, where an investor or any other person entitled to or having an interest in investment business has been charged with an offence arising out of or in relation to money laundering as defined in Article 1 of Directive 2005/60/EC or is the subject of action for contravention of Directive 2003/6/EC, the compensation scheme may suspend any payment pending the judgment of the court or determination of a competent authority."

- (8) In Article 10, paragraph 1 is replaced by the following:

"1. Member States shall ensure that each investment firm or UCITS takes appropriate measures to make available to actual and intending investors the information necessary for the identification of the investor-compensation scheme of which the investment firm or UCITS and its branches within the Union are members or any alternative arrangement provided for under the second subparagraph of Article 2 (1) or Article 5 (3). Investors shall be informed of the provisions of the investor-compensation scheme or any alternative arrangement applicable, including the amount and scope of the cover offered by the compensation scheme and any rules laid down by the Member States pursuant to Article 2(3). That information shall be made available in a readily comprehensible manner.

Information shall also be given on request concerning the conditions governing compensation and the formalities which must be completed to obtain compensation.

The information provided shall be fair, clear and not misleading and in particular shall explain the situations and claims covered by the relevant compensation scheme and how it applies in cross border situations. The information provided should also give examples of situations and claims not covered under the scheme."

- (9) Article 12 is replaced by the following:

*"Article 12*

1. Without prejudice to any other rights which they may have under national law, schemes which make payments in order to compensate investors shall have the right

of subrogation to the rights of those investors in liquidation proceedings for amounts equal to their payments.

2. In the case of a loss due to the financial circumstances of a third party that holds financial instruments belonging to an investor in relation to investment business, as referred to in Article 2(2), schemes which make payments in order to compensate investors shall have the right of subrogation to the rights of the investor or investment firm in liquidation proceedings for amounts equal to their payments.
3. In the case, provided for in Article 2(2c), of losses due to the financial circumstances of a depositary or third party to whom the assets of the UCITS have been entrusted, schemes which make payments in order to compensate UCITS unit holders shall have the right of subrogation to the rights of the UCITS holder or UCITS in liquidation proceedings for amounts equal to their payments.
4. If the third party that holds financial instruments belonging to an investor in relation to investment business or the depositary or third party to whom the assets of the UCITS have been entrusted are located in a third country in which the judiciary system does not allow the scheme to subrogate to the rights of the investment firm or the UCITS, Member States shall ensure that the investment firm or the UCITS return to the scheme amounts equal to their payments in case they receive any amount in the liquidation proceedings."

- (10) The following Articles 13a, 13b and 13c are inserted:

*"Article 13a*

1. The powers to adopt the delegated acts referred to in Article 4a(2), Article 4a(8), Article 4a(9) and Article 9(2) shall be conferred on the Commission for an indeterminate period of time.
2. As soon as it adopts a delegated act, the Commission shall notify it simultaneously to the European Parliament and to the Council.
3. The powers to adopt delegated acts are conferred on the Commission subject to the conditions laid down in Articles 13b and 13c.

*Article 13b*

1. The delegation of power referred to in Article 4a(2), Article 4a(8) Article 4a (9) and Article 9(2) may be revoked by the European Parliament or by the Council.
2. The institution which has commenced an internal procedure for deciding whether to revoke the delegation of power shall endeavour to inform the other institution and the Commission within a reasonable time before the final decision is taken, stating the delegated powers which could be subject to revocation and the reasons for a revocation.
3. The decision of revocation shall put an end to the delegation of the powers specified in that decision. It shall take effect immediately or at a later date specified therein. It

shall not affect the validity of the delegated acts already in force. It shall be published in the *Official Journal of the European Union*.

#### *Article 13c*

1. The European Parliament and the Council may object to the delegated act within a period of two months from the date of notification. At the initiative of the European Parliament or the Council this period shall be extended by one month.
2. If, on expiry of that period, neither the European Parliament nor the Council has objected to the delegated act it shall be published in the *Official Journal of the European Union* and shall enter into force at the date stated therein.

The delegated act may be published in the *Official Journal of the European Union* and enter into force before the expiry of that period if the European Parliament and the Council have both informed the Commission of their intention not to raise objections.

3. If the European Parliament or the Council objects to the adopted delegated act, it shall not enter into force. The institution which objects shall state the reasons for objecting to the delegated act.
- (11) The following Article 14a is inserted:

#### *"Article 14a*

The Member States may conclude cooperation agreements on exchange of information with the competent authorities of third countries in accordance with Article 63 of Directive 2004/39/EC and Article 102 of Directive 2009/65/EC."

19. Annex I is amended as follows:

(a) Point 1 is replaced by the following:

"1. Professional investors referred to in points 1 to 4 of section I of Annex II of Directive 2004/39/EC on markets in financial instruments."

(b) Points 2, 3 and 8 are deleted.

#### *Article 2* *Transposition*

1. Member States shall adopt and publish, by [*twelve months after the entry into force of this Directive*] at the latest, the laws, regulations and administrative provisions necessary to comply with this Directive. They shall forthwith communicate to the Commission the text of those provisions and a correlation table between those provisions and this Directive.

They shall apply those provisions from [*eighteen months after the entry into force of this Directive*] except for provisions transposing Article 4b that shall be applied from 31 December 2013.

When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

2. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

*Article 3*  
*Entry into force*

This Directive shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

*Article 4*  
*Addressees*

This Directive is addressed to the Member States.

Done at Brussels,

*For the European Parliament*  
*The President*

*For the Council*  
*The President*