

Brussels, 21 JAN. 2011  
C/2011/194

Dear Speaker,

*The Commission would like to thank the House of Commons for its consideration of the Commission proposal on investor-compensation schemes {COM(2010) 371} which has as its underlying objectives to strengthen the protection of investors across the Union and their confidence in firms providing different services.*

*The proposal is now under negotiation within the ordinary legislative procedure in the European Parliament and the Council.*

*In its reasoned opinion, the House of Commons has expressed the view that the above mentioned Commission proposal does not comply with the principle of subsidiarity in the part concerning the introduction of a mutual borrowing mechanism among national compensation schemes. The House of Commons considers that the provision of a mandatory borrowing mechanism between the schemes could introduce moral hazard in investment services as there is a higher risk of a national scheme underwriting inappropriate, careless or risky investments when it knows that it can rely on a back-up source of credit. Therefore, that in order to achieve investor protection and confidence, there must be an incentive for compensation schemes to be adequately funded at national level; and it must be for central governments to ensure that an investor compensation scheme can fulfil its commitments.*

*We would like to underline that the Commission considers that the proposal already takes into account the concerns expressed by the House of Commons. As stated in paragraph 4.2 on subsidiarity and proportionality of the explanatory memorandum of the Commission proposal 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." The common rules introduced by the proposal aim to ensure such degree of harmonisation in the funding of the schemes in light of the existing differences at national level. The provision of a borrowing mechanism among national schemes forms part of these common rules and has been introduced as a last resort tool. Recital 17 of the proposal further stresses that "[t]he borrowing mechanism should not impinge any fiscal responsibility of the Member States. The borrowing schemes*

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*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.....To that end, European Securities and Markets Authority (ESMA) should confirm that the conditions of borrowing between investor-compensation schemes laid down in this Directive are fulfilled..."*

*Mutual borrowing is indeed subject to strict requirements. In particular, it is subject to the following rigorous conditions and is in any event a mechanism of lending of last resort:*

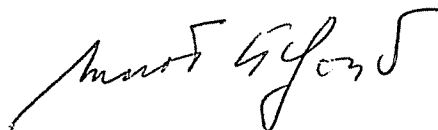
- compensation schemes have to collect their contributions, on an ex-ante basis, from market participants. When in concrete cases the funds collected ex-ante are not sufficient to cover the liabilities of a scheme, additional calls for contribution from entities covered under the scheme should be ensured. Only once these funding sources have been exhausted, the scheme may have recourse to borrowing from other compensation schemes;*
- on the side of lending schemes, only a portion of ex-ante funding collected from market participants in each compensation scheme has to be available for lending to the others (10%<sup>1</sup>);*
- the European Securities and Markets Authority (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<sup>2</sup>;*
- loans should be repaid to the lending schemes at the latest after 5 years since the request, and interest should accrue on the loans<sup>3</sup>;*
- 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<sup>4</sup>.*

*The proposal also addresses the risk of moral hazard since it introduces common principles for the funding of national schemes which should ensure similar funding conditions across the EU. Furthermore, the borrowing mechanism is consistent with the principle that the cost of financing the schemes should be born by market participants and not by taxpayers. In this respect, the mutual borrowing system allows market participants at EU level to contribute, on a purely temporary basis and for a limited amount, to temporary needs of compensation schemes in other Member States, without impinging the fiscal responsibility of Member States.*

*In the light of the above, while understanding the concerns of the House of Commons, the Commission is of the view that the proposal is fully consistent with the subsidiarity principle.*

*The Commission hopes that these clarifications address in a satisfactory manner the concerns expressed by the House of Commons.*

*Sincerely yours,*



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<sup>1</sup> Article 4a(8).

<sup>2</sup> Article 4b(3)

<sup>3</sup> Article 4b(2)(b)

<sup>4</sup> Article 4b(2), last sub-paragraph.