COMMISSION OF THE EUROPEAN COMMUNITIES

COM(93) 381 final - SYN 471

Brussels, 22 September 1993

Proposal for a
COUNCIL DIRECTIVE
on investor compensation schemes

(presented by the Commission)

EXPLANATORY MEMORANDUM

A. General considerations

1. Origin of the proposal

On 10 May 1993 the Council adopted Directive 93/22/EEC on investment services in the securities field[1], the "Investment Services Directive". This Directive is a parallel text to the Second Banking Coordination Directive[2], which entered into force on 1 January 1993 and provides the single licence or "European passport" for credit institutions. The list of banking activities subject to mutual recognition annexed to the Second Banking Directive includes the full range of securities business. The Investment Services Directive, when it enters into force on 1 January 1996, will provide the equivalent "European passport" for non-bank investment firms, thereby allowing such firms also to operate on a cross-border basis, either by the free provision of services or through branches, on the strength of the authorization issued by and the prudential supervision carried on by the home State competent authorities.

Article 9 of the Commission's original investment services proposal[3], which was presented in January 1989, included investor compensation arrangements among the prudential rules to be drawn up and enforced by the Member States.

The basic requirement was that each investment firm was to be "a member of a general compensation scheme designed to protect investors who are prevented from having claims satisfied because of the bankruptcy or default of the investment firm".

While the general rule made the home Member State authorities responsible for drawing up and applying the prudential rules a distinction was made as regards compensation arrangements, pending further harmonization, between investment business carried out in another Member State on a services basis - where the home State regime was to apply - and business carried on through a branch in the host country - where that host State's arrangements were to apply.

The reason given in the Explanatory Memorandum for this distinction was that "some coordination of compensation funds, including the minimum amount available in each Member State to reimburse investors, will be necessary before the home-country regime can be applied to branches as well as to services business".

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(1) OJ No L 141, 11.6.1993, p. 27.
(2) Directive 89/646/EEC, OJ No L 386, 30.12.1989, p. 1.
(3) COM(88) 778 of 16.12.1988, OJ No C 43, 22.2.1989, p. 7.

The interim approach proposed by the Commission did not find support in the Council and there was wide support among the Member States for a rapid move to full home country control and therefore for early harmonization of investor compensation schemes. It was felt that since it was the home Member State authorities which issued the single licence to the investment firm and were responsible for the prudential supervision of all its activities, including those of its branches, it should be for the investor compensation scheme of the home State to bear the consequences of the failure of the firms in its charge.

However, there was a general agreement that the subject of investor compensation schemes raised a number of complex issues and that any attempt to resolve them in the context of the discussions on the Investment Services Directive might delay even further the adoption of that Directive which had originally been intended to enter into force at the same time as the Second Banking Directive, namely on 1 January 1993.

It was finally agreed not to cover the matter of investor compensation in the Investment Services Directive. As a result in the text adopted by the Council on 10 May 1993 Article 12 limits itself to a requirement that investors should be informed before doing business with an investment firm of any investor compensation arrangements which would be applicable to them. At the same time the Council took note of the Commission's statement that it would submit proposals on the harmonization of compensation systems covering transactions by investment firms by 31 July 1993 at the latest. The Council stated that it "will act on those proposal within the shortest possible time with the aim of bringing the systems proposed into effect on the same date as [the Investment Services] Directive".

This proposal for a Council Directive on investor compensation schemes constitutes the proposal which the Commission announced when the Investment Services Directive was adopted and represents the further harmonization already envisaged in the Commission's original proposal on investment services.

2. <u>Need for and purpose of investor compensation schemes</u>

Given proper supervision, the failure of an investment firm should be a relatively exceptional event. Failure should be all the more unusual after the prudential rules and the conduct of business rules laid down in Articles 10 and 11 of the Investment Services Directive and the requirements laid down in the Capital Adequacy Directive[4] are in force throughout the Community.

Article 10 of the Investment Services Directive, for example, will oblige Member States to require their firms to enforce sound administrative and accounting procedures and to make adequate arrangements to protect investors' rights over their money and securities. The Capital Adequacy Directive will oblige all investment firms holding the single licence to hold a certain level of minimum capital.

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(4) Directive 93/6/EEC, OJ No L 141, 11.6.1993, p. 1.

It might then perhaps be argued that Community action in the field of investor protection is unnecessary.

The Commission believes that there is a need.

To begin with, no system of supervision can ever be watertight and, however good the prudential rules may be, failures will sometimes occur. In particular, no rules can prevent fraud, although good supervision will expose it sooner rather than later.

Two cases of failure should be distinguished:

(a) Failure of the investment firm without fraud

In this first case, investors' securities held by the investment firm for safekeeping and administration or pending delivery to clients or pending disposal should not be at risk. Ownership of such securities remains with the investor, who should be able to recover them without undue difficulty.

On the other hand, clients' funds held by the investment firm, following the disposal of securities or pending the purchase of securities, may be impossible to recover if they become part of the mass of assets of a bankrupt firm. In that case the investor would simply have a claim in the bankruptcy proceedings. A compensation scheme should allow the investor to obtain some compensation without having to wait for the completion of those (normally lengthy) proceedings.

(b) Failure of the investment firm as a result of fraud

Any firm may have the misfortune to suffer occasional dishonesty on the part of an employee. The firm would normally make good any loss to clients immediately and might well have insurance covering such an eventuality. Any problems in such cases should be dealt with between the investor and the firm, with the involvement if necessary of the supervisory authority. There should be no need in such a case for the intervention of an investor compensation scheme.

On the other hand, the discovery by the competent authorities of serious fraud throughout a firm involving misappropriation of clients' assets would probably lead to its closure and winding-up.

If clients' money and/or securities had been misappropriated and if, as is likely in such cases, the firm's assets were insufficient to meet investors' claims there would be a role for the investor compensation scheme.

It could of course be argued that risk is an inherent part of any investment operation and that the investor should take due care in his choice of and relations with an investment firm. No one, after all is obliged to purchase investment services.

On the other hand, it is clearly difficult for the smaller investor in particular to gauge accurately the financial and management strength of an investment firm.

Furthermore, the knowledge that an investor compensation scheme is available can help maintain confidence in the markets and encourage smaller investor interest and involvement in them.

3. Main objectives of the proposal

The proposal pursues a number of related objectives.

First and foremost, it constitutes a necessary supplement to the single licence system based on home country control established by the Investment Services Directive.

Article 8a of the Treaty states that the Community shall adopt measures to establish the internal market. The Investment Services Directive is the central measure to that end for investment firms. The present proposal on investor compensation schemes is intended to facilitate the proper functioning of the single market.

The requirement to have an investor compensation scheme formed part of the Commission's original proposal for an Investment Services Directive. The Commission was conscious of the need to ensure investor protection and thus encourage the small investor in particular to invest in securities.

At the present time most of the Member States do have some investor compensation arrangements (these are summarized in the Annex) but these are often limited, covering for example the liabilities of stock exchange members only. The vast majority of the Member States do not have a scheme or schemes corresponding in scope to the wide range of services covered by the Investment Services Directive. Certain Member States have no investor compensation scheme at all.

In order to avoid causing confusion in the minds of investors and to give them equal confidence when dealing with non-domestic investment firms operating via branches or through the cross-frontier provision of services as when they deal with domestically incorporated investment firms it seems reasonable and indeed necessary to provide for some minimum investor compensation arrangements throughout the Community covering the case where an investment firm fails and is unable to return to investors the money or securities belonging to them.

There is a further danger that in the absence of some harmonization of investor compensation schemes Member States may feel justified, for reasons of investor protection, in requiring investment firms from other Member States providing services or operating through branches to belong to the host State compensation scheme where there is no home State scheme or the home State scheme is not considered to provide equivalent coverage.

Any such requirements and the need to demonstrate equivalence might well lead to serious practical difficulties for the operation of the single market and the exercise by investment firms of the right of establishment and freedom to provide services.

A Community Directive is the only available means for achieving the harmonization that is needed.

However, the proposed Directive only contains the minimum harmonization necessary to achieve the objectives being pursued. It would require Member States to have an investor compensation scheme or schemes. It would set a minimum Community level of compensation per investor, while allowing Member States to provide greater coverage if they so wish. Matters such as the basis on which schemes are organized and the precise financing arrangements would be left to the discretion of the Member States.

The Commission has followed a similar approach in its proposal for a Directive on deposit-guarantee schemes[5].

4. Summary of the justification of the proposal in the light of the principle of subsidiarity

   (a) What are the objectives of the proposed action with respect to the obligations placed upon the Community?

   Article 8a of the Treaty places the obligation on the Community to establish the internal market in accordance, inter alia, with Article 57(2) on which the current proposal, like the Investment Services Directive from which it derives, is based. The main aim is to facilitate the operation of the internal market for investment firms whereby such firms will be able to operate throughout the Community on the basis of a single licence issued by and subject to prudential control by the home country authorities. The need for some harmonization of investor compensation rules was envisaged in the Commission's initial proposal on investment services.

[5] COM(92) 188 final, OJ No C 163, 30.6.1992 and COM(93)...

(b) Is the action envisaged a matter of exclusive Community competence or one shared with the Member States?

The establishment and operation of investor compensation schemes are a matter of exclusive Community competence since only the Community can introduce an obligation for each Member State to have a scheme corresponding to the scope of the Investment Services Directive and providing a uniform minimum level of protection for investors.

(c) What means of action are available to the Community?

Only a Community directive laying down agreed minimum standards can achieve the desired objective.

(d) Are uniform rules necessary?

Apart from the basic minimum standards (e.g. minimum level and extent of cover, investor information), Member States are free to organize their investor compensation schemes as they wish. The scope thus left for national discretion is large.

5. Link with the deposit-guarantee proposal

As was stated earlier, a credit institution providing investment services qualifies as an investment firm under the Investment Services Directive.

Since the aim of the investor compensation proposal is to cover investors entrusting their money or securities to any investment firm, it is necessary to make proper provision for credit institutions providing such services.

At the same time the proposal for a Directive on deposit-guarantee schemes which is currently before the Council is intended to protect customers' cash deposits. The Commission originally proposed a harmonized minimum of ECU 15 000 but raised this amount in its amended proposal to ECU 20 000 at the request of Parliament.

However, in addition to taking deposits, banks may also buy and sell securities on behalf of their customers and may hold clients' securities on a temporary or long-term basis. Such securities would not appear on the bank's balance sheet.

In the event of a credit institution becoming insolvent, clients' securities held by it should not be at risk provided that the clients' title to such securities is clear. On the other hand, clients' securities could be at risk if there was a fraudulent misuse by the bank. This risk would clearly be outside the scope of the deposit-guarantee proposal and should be covered by the investor protection arrangements.

As a result, credit institutions engaged in deposit-taking and securities business will be obliged to pay for and offer to their clients two types of cover, which could of course be organized under a single scheme. However, as regards claims in respect of investors' money held by such credit institutions Member States should be given the freedom to determine themselves under which of the two Directives such claims should fall.

This is only possible if a similar level of cover is envisaged for the two schemes.

6. Choice of the minimum level of coverage

There are other reasons, apart from equality with the deposit-guarantee proposal, for considering the figure of ECU 20 000 as an appropriate level for the harmonized minimum investor compensation cover in the Community.

Although there are no useful figures available to give an idea of the average amounts of money or securities investors will have entrusted at any time to investment firms, as defined in the Investment Services Directive, it is clear that individual holdings of securities in investment accounts will tend on average to be greater than the amounts on deposit with credit institutions. Therefore if the future Directive is to fulfil its intended rule of protecting the small investor the minimum level of cover should be at least as high as that laid down in the deposit-guarantee Directive. At the same time a much higher minimum level would present considerable problems for those Member States which currently have no investor compensation scheme or offer a low level of protection.

It must also be borne in mind that the cost of investor protection is ultimately reflected in the cost of financial services and is thus met by the investor himself.

B. Commentary on the Articles

Article 1

Article 1 contains a number of definitions necessary for the purposes of the Directive.

Only one definition, that of "instruments", corresponds exactly to the definition in the Investment Services Directive.

The definition of "investment firm" is formulated so as to cover both bank and non-bank providers of investment services.

The definition of "investment business" covers both the core investment services listed in Section A of the Annex to the Investment Services Directive and also the one Section C (non-core) service, namely safekeeping and administration of securities, where there is potentially a danger of loss for the smaller investor.

The definition of "investor" is intended to make sure that compulsory investor compensation cover should extend only to those clients who have an investment business relationship with the investment firm. This is very important given that the investor compensation Directive builds on and should have the same scope as the Investment Services Directive. The definition of investor is extremely wide, covering all persons both natural and legal. The question of possible exclusions from the compulsory coverage is dealt with later in the Directive - in Article 3(2) and in the Annex.

Article 2

This is the core Article of the proposal.

It lays down that principle that there must be an investor compensation scheme or schemes in each Member State in which all investment firms carrying on investment business must take part.

This Article establishes the home country control principle in respect of investor compensation arrangements. The home country scheme must cover the investment business carried on by its domestic firms in other Member States, either through branches or via the cross-frontier free provision of services.

The entry into operation of the investor compensation scheme is triggered by an official decision in the firm's home Member State establishing that the firm is unable or likely to be unable to meet its commitments to its clients.

Although the decision may be taken in the context of winding-up proceedings, the payment of compensation must be independent of the progress of such proceedings.

Member States would of course remain free to take preventive action to stop an investment firm getting into a situation where it was unable to meet its obligations.

The investor compensation scheme must provide cover under three headings (indents in Article 2(2)). The first relates to money held by the investment firm, the second to instruments, essentially shares and bonds, physically held by firms on behalf of investors, and the third to instruments that are dematerialized (that is have no physical form) or are immobilized in (in other words never leave) a central securities depository and are administered by the investment firm. The third indent would also cover instruments such as swaps or forward interest rate agreements or derivatives contracts that have been arranged by the investment firm on behalf of clients, although such clients will tend not to be the smaller investors with whom the proposal is principally concerned.

Article 2(3) is intended to deal with the potential problem of money claims on an investment firm which is a credit institution. Given that it will normally be difficult to distinguish between ordinary bank deposits and money that is intended for the purchase of securities or is derived from their sale Member States should be allowed to decide for themselves whether such claims fall under the investor compensation Directive or the deposit-guarantee Directive.

Article 2(4) determines how the investor's claim is to be evaluated. As far as money is concerned, the value of the claim will always correspond to the amount of money the firm actually owes to the client. As regards securities the valuation should be that at the time the obligation to return them arises or the value at the time the failure of the firm is established. Subsequently of course the market value of securities may rise or fall. Such a risk is inevitable, but the compensation scheme has to be able to determine exactly its liabilities.

Article 3

The reasons for selecting ECU 20 000 as the harmonized community minimum level of investor compensation were set out in the General considerations.

A figure of that order will only be meaningful for the smaller investor. Provided that the smaller investor is covered, whether he be a natural or a legal person, Member States should be free to determine whether or not they wish to include other categories of investor. Current practice in the Member States differs widely in this respect.

Accordingly, the Annex to the Directive sets out a number of categories of larger investor which Member States may exclude from compulsory coverage if they so wish. Only larger companies may thus be excluded, small and medium-sized enterprises falling within the compulsory coverage of the investor compensation scheme.

Two of the optional exclusions relate to collective investment funds and pension funds.

This means that under the Directive Member States are given the option of deciding whether or not such funds should have a single claim on the compensation scheme as a single investor.

The management of collective investment funds is not one of the services covered by the Investment Services Directive.

However, a European passport for certain undertakings for collective investment in transferable securities (UCITS) was introduced by Directive 85/611/EEC[6] and the Commission has recently proposed the extension of that Directive to certain other types of UCITS [7].

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(6) OJ No L 375, 31.12.1985, p. 3.

(7) COM(93) 37 final, OJ No C 59, 2.3.1993, p. 14.

The Commission believes that the question of compensation arrangements for individual investors in UCITS should be considered, if necessary, in the context of the special arrangements applicable to such funds and in the light of the experience under the 1985 Directive, and not in the context of the investor compensation proposal designed to complete the single market for the investment services covered by the Investment Services Directive.

The management of pension funds does, however, fall within the scope of service No 3 (discretionary portfolio management) in Section A of the Annex to the Investment Services Directive. This same service can also be provided by credit institutions but also by life insurance undertakings.

However, the investment service under the Investment Services Directive is provided to the pension fund itself or to the trustees or persons otherwise responsible for the fund.

The Commission again believes that the protection of the individual members of pension funds is a separate and highly complex issue which goes well beyond the scope of the present proposal for a Directive arising out of the single market for investment services introduced by the Investment Services Directive.

Article 3(3) makes it clear that Member States are allowed to provide for compensation arrangements going beyond the minimum laid down in the Directive.

Article 3(4) allows Member States to require investors to bear a small proportion of any loss themselves. However, until the Directive minimum of ECU 20 000 is reached this enforced "coinsurance" may not exceed 10% of the loss. A similar approach has been advocated by the Commission it its proposal on deposit-guarantee schemes.

Article 4

Given that Article 3(3) allows Member States to provide compensation arrangements in excess of the Community minimum it may happen that branches of an investment firm (covered by the home State scheme) operate in a host Member State where the domestic scheme offers a higher level of coverage or covers additional categories of investors. To avoid confusion on the part of investors and to allow such branches to compete on equal terms this Article states that Member States must take steps to allow such branches to join, if they wish, the host scheme on a supplementary basis in order to bring their home State cover up to level available locally from domestic firms in the host Member State.

This possibility has also been advocated by the Commission in its deposit-guarantee proposal.

Article 5

This Article deals with the situation where an investment firm fails to respect the rules and obligations of its home State scheme or where a branch using the Article 4 option fails to respect the host scheme rules.

The competent authorities must be give appropriate discretion in dealing with this difficult, but unlikely, eventuality. In particular only the competent authorities which issued the firm's authorization can decide on its revocation.

If an investment firm or branch is excluded from a scheme investors must be ensured of cover while they decide whether or not to make alternative arrangements for their investments.

Article 6

Compensation is to be calculated and paid per investor rather than on a per account basis. Thus all the investments of a single investor with the head office and branches of an investment firm in the Community will be aggregated.

Given the increasingly international nature of investment business, money and instruments in any currency should be covered.

Article 7

It does not appear feasible to lay down a rigid timetable for the payment of compensation to investors in the event of the failure of an investment firm.

Where there is fraud or serious mismanagement the compensation scheme may well find that the firm's records are missing or unreliable. In such cases, it may take a considerable period of time to contact investors and establish their precise claims.

Accordingly, this Article simply states that an investor's claim should be settled rapidly - within a period of three months from the firm's failure provided that the eligibility and amount of the claim have been properly established.

The scheme should be allowed to require investors to present their claims within a period of six months of the firm's failure but this deadline should not be absolute when the investor has good reason for presenting a late claim.

Article 8

This Article lays down the obligation on investment firms to inform investors in their own language of the applicable compensation arrangements.

Article 9

This Article lays down a corresponding obligation on branches of firms with their head office outside the Community.

The provisions governing the establishment and operation of such branches are determined by each Member State. Such branches do not of course benefit from the single licence.

Article 10

This Article deals with the compensation scheme's subrogation rights.

Article 11

The investor compensation schemes Directive should enter into force on 1 January 1996, the same date as has been fixed for the implementation of the Investment Services Directive. This simultaneous entry into force is envisaged in Article 12 of the Investment Services Directive.

Article 12

This is a review Article. It would appear appropriate to carry out a review once some experience has been acquired of the operation of the single market for investment services and in particular of the operation of the harmonized minimum investor compensation arrangements provided for in this Directive.

ANNEX

INVESTOR COMPENSATION SCHEMES IN THE EEC

Country	Title, Constitution & Management	Membership	Financing/ contributions	Type of client covered	Coverage	Level of cover	Operation/intervention
FRANCE Investment firms	Fonds de garantie. Terms of operation fixed by the Conseil des Bourses de Valeur pursuant to Art. 6 of Law n° 88.70 of 22.1.88.	Compulsory for all sociétés de bourse.	Fixed by CBV.	Holders of a nominative account with a société de bourse.	Cash and securities, including common fund and SICAV units, but not precious metals.	Missing cash : max. FF 500000 per client (=ECU 76.000) Missing securities : max. FF 2.500.000 (=ECU 379.500) subject to overall ceiling of FF 200 million per failure. Press suggests 99% of accounts covered by above amounts.	Failure has to be established and published by the Société des Bourses Françaises. Clients have 3 months to present their claims.
GERMANY The banks are by far the largest suppliers of ISD investment services. The Freimakler and Kursmakler, for example, do not deal directly with the public.	Deposit Protection Fund of the Federal Association of German Banks.	Banks. Voluntary, subject to certain criteria being fulfilled.	Contribution on admission. Annual contribution of 0.3 per mille of deposits from non-banks.	All non-bank depositors.	Sustained deposit losses". Not defined, but covers all liabilities incurred by banks.	30% of bank's equity capital per client.	At discretion of Fund Committee. Law ensures investors' securities holdings cannot be touched in event of insolvency.
LUXEMBOURG	Stockbrokers guarantee fund - Caisse de Garantie des Agents de Change.	Voluntary. Membership limited to stockbrokers and members of the Stock Exchange or non-bank financial institutions whose principal activity is securities dealing.	Initial contribution of LF 500.000. Annual contribution based on customer deposits held. Deposits of 0-50 MLF = LF 30000 50-500 MLF=LF 50000 >500 MLF = LF100000	All customers of the agents de change.		Max. LF 250,000 per client (=ECU 6.200). Limit of 20% of the assets of the guarantee fund as at 31.12 of year preceeding the failure.	
PORTUGAL	No fund exists at present. A fund is planned, but no details available.						

Country	Title, Constitution & Management	Membership	Financing/ contributions	Type of client covered	Coverage	Level of cover	Operation/intervention
NETHERLANDS	No fund compensates investors directly. Two schemes exist :						
	1. Compensation scheme (omslagfonds) of de vereniging voor de Effectenhandel (VvdE). Run by a Foundation.	Company members of the VvdE.	Levy on all members based on revenue 2/3 from banks and brokers 1/3 from the "hoekman"	Compensation not paid direct to investors : covers deficits of member in event of default.	N/A	N/A	At discretion of the Foundation Board; onexchange business only.
	2. Guarantee Fund of Central Bank (DNB)	Compulsory for all credit institutions.	Collective guarantee system. Total amount payable apportioned in proportion to scale of business.	Private persons, associations or foundations not legal entities.	Cash accounts or deposited securities.	Max. FL 40000 per creditor (=ECU 18.200).	
BELGIUM	The law of 4.12.90 created the Caisse d'intervention des sociétés de bourse. The royal Decree of 2.1.91 established a 'fonds d'intervention' within the Caisse. Run by a Conseil d'administration.	Compulsory for all sociétés de bourse de droit belge.	One-off contribution base on capital or number of agents de change. Annual contribution based on turnover.			FB 2.5 million per creditor (=ECU 62.200). FB 0.5 million for cash deposits (=ECU 12.400). Max. of FB 200 million per failure and FB 250 million per year.	A société de bourse must have failed : faillite or concordat judiciaire. Preventive intervention also possible.
SPAIN	New rules concerning investor compensation are said to be under review.						
DENMARK	There is no compensation scheme in Denmark.						
UNITED KINGDOM	Investors compensation scheme established by SIB in 1988 under section 54 of the FSA. Run by a separate management company. Investors Compensation Scheme Limited.	Compulsory for members of the participating SROs and firms directly regulated by SIB.	By retrospective levy on scheme participants. Compensation costs levied in first instance on members of SRO (or SIB) where default occurred with provision for cross-contribution as appropriate.	Private clients and small businesses.	Losses must relate to UK investment business.	First £ 30000 100% cover next £ 20000 90% cover i.e. max. £ 48000 per claim (=ECU 61.100) Annual max. of £ 100 million.	Board must declare a firm in default before claims can be considered. ICS needs to have evidence of the firm's inability to pay claims. This normally, but not necessarily, means that liquidation or bankruptcy proceedings will have begun.
IRELAND	Stock Exchange Compensation Fund.	Members of the exchange.	Contributions called when necessary. Fund partially insured.	Basically private clients only, although non-professional investor corporate clients might recover (the system is discretionary).	Cash and securities.	Max. £ 48000 per client. Same basis as UK. Overall limit of £ 4.5 million. (Amounts in £ sterling).	Fund is discretionary. Operated by the Council of the ISE, under ISE Regulations.

Country	Title, Constitution & Management	Membership	Financing/ contributions	Type of client covered	Coverage	Level of cover	Operation/intervention
GREECE	Compensation fund for Brokers' transactions set up by Law 3078/54.	Compulsory for all stockbrokers and stockbroking companies.	Contribution paid by all new members.	Client individuals and institutions.	Transactions effected during a stock exchange session.	Creditors of a failed broker receive his share of the Fund, plus a further 20% of remaining fund if necessary. If a number of brokers fail simultaneously up to 80% of fund can be distributed.	Administrative Board of Fund appears to have discretion re fund intervention.
	A special fund covers incorporated stockbroking firms engaging in off-exchange business and underwriting.		Extra 15% of share capital exceeding DR 700.000.				
ITALY	Fondo Nazionale di Garanzia set up by Art. 15 of the SIMS Law of 2.1.1991. Detailed rules laid down in Decree of the Treasury Minister of 30.9.1991.	Compulsory for all intermediaries covered by SIMS laws.	Fixed contribution of (initally) Lit 1 million plus variable contribution based on volume of business.	All clients, except intermediaries authorized to deal for their own account or on behalf of third parties.	Cash claims and claims for the return of securities, provided they are recognized by the bodies responsible for the winding-up procedure.	Limit of 25% of each client's claim. Fund may not pay out more than 40% of its assets for any one failure.	Failure/insolvency of an intermediary.

Proposal for a
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THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 57(2) thereof,

Having regard to the proposal from the Commission[1],

In cooperation with the European Parliament[2],

Having regard to the Opinion of the Economic and Social Committee[3],

Whereas on 10 May 1993 the Council adopted Directive 93/22/EEC on investment services in the securities field[4], hereinafter referred to as "the Investment Services Directive"; whereas that Directive is an essential measure for the achievement of the internal market for investment firms;

Whereas the Investment Services Directive secures the essential harmonization that is necessary to secure the mutual recognition of authorization and of prudential supervision systems, making possible the grant of a single authorization valid throughout the Community and the application of the principle of home Member State supervision; whereas, by virtue of mutual recognition, investment firms authorized in their home Member States may carry on any or all of the services covered by the Investment Services Directive for which they have received authorization throughout the Community by establishing branches or under the freedom to provide services;

Whereas the protection of investors and the maintenance of confidence in the financial system is an important aspect of the completion of the internal market in this area;

Whereas the Investment Services Directive provides for prudential rules which investment firms must observe at all times, including rules the purpose of which is to protect as far as possible investors' rights in respect of money or instruments belonging to them;

Whereas, however, no system of supervision can provide a complete safeguard, particularly where acts of fraud are committed;

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(4) OJ No L 141, 11.6.1993, p. 27.

Whereas it is therefore important that each Member State should have an investor compensation scheme providing a minimum level of compensation at least to the smaller investor in the event that an investment firm is unable to meet its obligations to its investor clients; whereas such is not the case at present;

Whereas the Commission's initial proposal for an investment services directive[5] included in the list in Article 9 of prudential rules to be observed by investment firms and to be supervised by the home Member State's authorities membership of a general compensation scheme to protect investors; whereas, however, the Commission proposed that, pending further harmonization of compensation schemes, branches should be subject to the compensation scheme in force in the host Member State;

Whereas, however, this interim solution was rejected by the Member States in favour of a full home country approach, given the responsibility of the home Member State for issuing the authorization to investment firms and for their prudential supervision; whereas it was argued that application of the home country control principle required that the home State compensation scheme should cover the activities carried on in host Member States, through branches or via freedom to provide services;

Whereas it was the general view that the complex issues raised by the subject of investor compensation schemes could be adequately dealt with only in a separate proposal for a directive; whereas Article 12 of the Investment Services Directive does not require Member States to have an investor compensation scheme but merely requires that investors be informed of the compensation arrangements available, if any; whereas the Commission stated that it would submit proposals on the harmonization of compensation systems covering transactions by investment firms by 31 July 1993 at the latest;

Whereas the proper functioning of the internal market requires a degree of coordination in this area so that the small investor can purchase investment services from branches of Community investment firms or on a cross-frontier basis as confidently as from domestic investment firms, in the knowledge that a Community minimum level of compensation would be available in the event of the failure of the investment firm and its subsequent inability to return the investor's money or securities;

Whereas in the absence of such coordination host Member States may consider themselves justified for reasons of investor protection in requiring membership of the host State compensation arrangement when a Community investment firm operating via a branch or via freedom to provide services either belongs to no investor compensation scheme in its home Member State or belongs to a scheme which is not considered to offer equivalent protection; whereas any such requirement might create serious difficulties for the operation of the single market;

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(5) OJ No C 43, 22.2.1989, p. 7.

Whereas Council Directive .../.../EEC [on deposit-guarantee schemes][6] introduced minimum harmonization of deposit-guarantee arrangements for credit institutions; whereas credit institutions may in certain areas be in competition with specialist investment firms;

Whereas although most Member States currently have some investor compensation arrangements the vast majority do not have arrangements corresponding to the scope of the Investment Services Directive;

Whereas therefore all the Member States should be required to have an investor compensation scheme, or schemes, to which all investment firms holding the single licence under the Investment Services Directive should belong; whereas the scheme should cover money or instruments which are held by the investment firm in connection with the conduct of investment business and which, following the failure of the firm, cannot be returned to the investor;

Whereas the definition of investment firm includes credit institutions which are authorized to provide investment services; whereas such credit institutions should also be required to participate in an investor compensation scheme in respect of their investment business; whereas, however, in the case of investment firms which are credit institutions it may in certain cases be difficult to distinguish between deposits covered under Directive ../.../EEC [on deposit-guarantee schemes] and money held in connection with the conduct of investment business; whereas Member States should be given the possibility of themselves determining under which Directive such claims should fall;

Whereas Directive .../.../EEC [on deposit-guarantee schemes] allows Member States to dispense a credit institution from the obligation to belong to a deposit-guarantee scheme where that credit institution belongs to a system which protects the credit institution itself and, in particular, ensures its solvency; whereas, where such a credit institution is also an investment firm, Member States should also be authorized to dispense it from the obligation to belong to an investor compensation scheme;

Whereas the cost of investor protection has to be met by investment firms but is ultimately passed on to the investor; whereas therefore it is undesirable to introduce throughout the Community a very high level of protection; whereas in addition to encourage the investor to take due care in the choice of an investment firm it is reasonable to allow Member States to require the investor to bear a proportion of any loss; whereas, however, the investor should be covered for at least 90% of his loss until the compensation payment reaches the Community minimum;

Whereas a harmonized minimum level of compensation should be sufficient to protect the interests of the smaller investor in the event of the failure of an investment firm;

Whereas a similar level was proposed by the Commission in its amended proposal for a Council Directive on deposit-guarantee schemes;

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(6) OJ No L

Whereas the schemes of certain Member States currently offer higher levels of cover; whereas, however, it does not seem appropriate to require that those schemes should reduce the cover they offer;

Whereas the retention in the Community of schemes providing coverage which is higher than the harmonized minimum may lead on the same territory to disparities in compensation which are prejudicial to investors and unequal conditions of competition between national investment firms and the branches of firms of other Member States; whereas, in order to counteract these disadvantages, branches should be allowed to join the host country scheme on a supplementary basis so that they can offer the same level of cover as is offered by the scheme of the country where they are located;

Whereas the objective of this Directive is to ensure a minimum level of protection for small investors, including small and medium-sized enterprises, who have the greatest need of protection; whereas, however, Member States should be allowed to exclude from coverage certain other categories of investors who have a lesser need of such protection;

Whereas a number of Member States have investor compensation schemes under the responsibility of professional organizations; whereas other schemes may be set up and administered on a statutory basis; whereas this variety of status poses a problem only with regard to compulsory membership of and exclusion from the scheme; whereas it is therefore necessary to take steps to limit the powers of schemes in this area;

Whereas the investor should receive compensation without excessive delay once he has established a valid claim; whereas the compensation scheme itself should be allowed to fix a reasonable period during which claims should be presented; whereas, however, the fact that such a period has expired should not be invoked against an investor who for a good reason has not been able to present his claim on time;

Whereas investor information on compensation arrangements is an essential element in investor protection and must therefore also be the subject of a minimum number of binding provisions;

Whereas subject to Article 5 of the Investment Services Directive and Article 9(1) of Council Directive 77/780/EEC of 12 December 1977 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions[7], as last amended by Directive 89/646/EEC[8], Member States are free to decide whether and on what conditions to admit the branches of investment firms having their head office in third countries to operate on their territory; whereas such branches will not benefit from

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(7) OJ No L 322, 17.12.1977, p. 30.

(8) OJ No L 386, 30.12.1989, p. 1.

freedom to provide services by virtue of the second paragraph of Article 59 of the Treaty, nor from freedom of establishment in Member States other than the one in which they are established; whereas accordingly a Member State admitting such branches may decide to oblige or permit such branches to participate in the investor compensation scheme in place on their territory; whereas, however, it is appropriate that such branches should be required to inform their investment clients of whether or not they belong to any compensation scheme and of the extent and limits of any such coverage;

Whereas in conclusion a minimum harmonization of investor compensation arrangements appears necessary in order to complete the internal market for investment firms by giving investors confidence to deal with firms from other Member States as well as locally incorporated firms and by avoiding the difficulties that might arise from the application by host Member States of their uncoordinated domestic investor protection requirements; whereas a binding Community directive is the only suitable instrument to achieve the desired objective in the general absence of investor compensation arrangements corresponding to the coverage of the Investment Services Directive; whereas this measure restricts itself to the minimum harmonization that is required, allows Member States freedom to provide wider or higher coverage if they desire and also allows Member States considerable freedom as regards the organization and financing of investor compensation schemes,

HAS ADOPTED THIS DIRECTIVE:

Article 1

For the purposes of this Directive the following definitions shall apply:

1. "Investment firm" shall mean an investment firm authorized in accordance with Article 3 of the Investment Services Directive, or a credit institution the authorization of which, under Directives 77/780/EEC and 89/646/EEC, covers one or more of the investment services listed in Section A of the Annex to the Investment Services Directive;

2. "investment business" shall mean an investment service as defined in Article 1(1) of the Investment Services Directive and the service referred to in point 1 of Section C of the Annex to the Investment Services Directive;

3. "instruments" shall mean the instruments listed in Section B of the Annex to the Investment Services Directive;

4. "investor" shall mean a person who has entrusted money or instruments to an investment firm in connection with investment business.

Article 2

1. Each Member State shall ensure that an investor compensation scheme (or schemes) is established and officially recognized on its territory. No investment firm which it authorizes may carry on investment business unless it participates in such a scheme. The scheme shall provide cover to investors in respect of investment business carried on under freedom to provide services in other Member States and in respect of investment business carried on through branches set up by investment firms in other Member States.

   However, Member States may exempt a credit institution which is also an investment firm from belonging to an investor compensation scheme where that credit institution belongs to a system which protects the credit institution itself and in particular ensures its solvency, thus guaranteeing a protection for investors at least equivalent to that provided by an investor compensation scheme and which in the opinion of the competent authorities fulfils the conditions laid down in Article 2(1) of Directive .../.../EEC [on deposit-guarantee schemes].

2. The scheme shall provide cover to investors in accordance with Article 3 where a decision of the scheme or of the competent authorities or of a judicial authority in the home Member State has determined that an investment firm is unable or is likely to be unable to meet its obligations resulting from investors' claims relating to :

   - the repayment of money belonging to investors and held on their behalf in connection with investment business, or

   - the return to investors of any instruments belonging to them and physically held on their behalf in connection with investment business, or

   - the return to investors of any instruments belonging to them and administered or arranged on their behalf in connection with investment business.

3. Any claim under the first indent of paragraph 2 on an investment firm that is a credit institution which, in a Member State, would be subject both to this Directive and to Directive .../.../EEC [on deposit-guarantee schemes] shall be allocated to a scheme under one or other of these Directives as that State shall consider appropriate. No claim in respect of a single amount shall be eligible for compensation under both Directives.

4. The amount of an investor's claim shall be calculated on the basis of the amount of money or the market value of the instruments belonging to the investor which the investment firm is unable to repay or return at the time the obligation to make repayment or return the instruments arises or at the time of the decision referred to in paragraph 2.

Article 3

1. Member States shall ensure that the scheme provides for coverage of not less than ECU 20 000 per investor in respect of the claims referred to in Article 2(2).

2. Notwithstanding paragraph 1 Member States may provide that certain categories of investors shall be excluded from the coverage of the scheme or shall be granted a lower level of coverage. The categories in question are listed in the Annex.

3. Paragraphs 1 and 2 shall not preclude the retention or adoption of provisions which offer more comprehensive cover for investors, in particular by extending the categories of investors protected by the guarantee or by providing a higher level of compensation.

4. Member States may limit the cover provided for in paragraph 1 or that referred to in paragraph 3 to a specified percentage of the investor's claim. However, the percentage covered must equal or exceed 90% of the claim until the amount to be paid under the scheme reaches ECU 20 000.

Article 4

A branch of an investment firm authorized in another Member State may apply to join voluntarily a scheme covering the category of investment firm to which it belongs in the Member State in which it is established in order to supplement the coverage which its investors already enjoy by virtue of their obligatory coverage by the scheme referred to in Article 2.

Member States shall ensure that objective conditions relating to the membership of these branches form part of all investor compensation schemes.

Article 5

If an investment firm required by Article 2(1) to take part in a scheme or one of the branches granted voluntary membership under Article 4 does not comply with the obligations incumbent on it as a member of the scheme, the competent authorities which issued the authorization shall be notified and, in cooperation with the managers of the scheme, shall take all appropriate measures, including the imposition of penalties, to secure compliance by the investment firm with its obligations.

If, as a result of these measures, compliance by the investment firm, or branch thereof, with their obligations is not secured, the managers of the scheme may exclude the investment firm or branch, where national law authorizes such exclusion and with the explicit consent of the competent authorities.

In that case, the coverage of money or instruments belonging to investors and held by the investment firm or branch thereof at the date of exclusion shall be maintained for twelve months from the date of exclusion.

Article 6

1. The coverage referred in in Article 3(1), (3) and (4) shall apply to the aggregate amount of money and instruments belonging to the investor and held by the investment firm irrespective of the number of accounts, the currency and the location within the Community.

2. The share of each investor in a joint investment account shall be taken into account in calculating the coverage provided for in Article 3(1), (3) and (4).

   In the absence of special provisions the account shall be divided equally between the investors.

Article 7

1. Member States shall ensure that the scheme is able to meet an investor's claim within a maximum period of three months from the date of the decision referred to in Article 2(2) if the eligibility and amount of that claim have been established.

2. The compensation scheme shall be allowed to fix a period of not less than six months following the decision referred to in Article 2(2) during which investors may be required to submit their claims.

   However, the expiry of such a period may not be invoked by the scheme in order to deny the benefit of coverage to an investor who, due to absence or for any other good reason, has been unable to assert his claim under the compensation scheme in time.

Article 8

1. Member States shall ensure that the managers of the investment firm provide actual and potential investors with the information necessary for them to identify the investor compensation scheme in which the investment firm and its branches take part within the Community. The level of coverage under the scheme shall be made known to investors.

   Information shall also be given on request on the conditions governing compensation and the formalities which must be fulfilled in order to obtain compensation.

   Member States shall ensure that investors are informed where an investment firm is excluded from an investor compensation scheme in accordance with Article 5.

2. The information referred to in paragraph 1 shall be made available in the official language(s) of the Member State in which a branch is established or in which services are provided and shall be drafted in a clear and comprehensible form.

Article 9

1. Actual and intending investors at branches established by investment firms with their registered office outside the Community shall be provided by the investment firm with all relevant information concerning the compensation arrangements which cover their investments.

2. The information referred to in paragraph 1 shall be made available in the official language(s) of the Member State in which the branch is established in the manner prescribed by national law and shall be drafted in a clear and comprehensible form.

Article 10

Without prejudice to any other rights which it may have under national law, an investor compensation scheme which pays investors' claims shall be subrogated to the rights of the investors in the liquidation proceedings for an amount equivalent to its payment.

Article 11

No later than five years after the date mentioned in Article 12(1), the Commission shall present a report to the Council on the application of this Directive, accompanied where appropriate by proposals for its revision.

Article 12

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 31 December 1995. They shall forthwith inform the Commission thereof.

   When Member States adopt these provisions, these shall contain a reference to this Directive or shall be accompanied by such reference at the time of their official publication. The procedure for such reference shall be adopted by Member States.

2. Member States shall communicate to the Commission the text of the main laws, regulations and administrative decisions which they adopt in the field covered by this Directive.

Article 13

This Directive is addressed to the Member States.

Done at Brussels,

For the Council
The President

ANNEX

LIST OF THE CATEGORIES OF INVESTORS REFERRED TO IN ARTICLE 3

1. Investment firms as defined in Article 1(2) of the Investment Services Directive.
2. Credit institutions as defined in the first indent of Article 1 of Directive 77/780/EEC.
3. Financial institutions as defined in Article 1(6) of Directive 89/646/EEC.
4. Insurance undertakings as defined in Article 1 of Directive 73/239/EEC or Article 1 of Directive 79/267/EEC or undertakings carrying on the reinsurance and retrocession activities referred to in Directive 64/225/EEC.
5. Undertakings for collective investment in transferable securities.
6. Pension or retirement funds.
7. Other institutional investors.
8. Government and central administrative authorities.
9. Provincial, regional, local or municipal authorities.
10. Directors and managers of and members personally liable in the investment firm, holders of at least 5 % of the capital of the investment firm, members of the external auditing bodies who audit the accounts of the investment firm and investors with similar status in the other companies in the same group.
11. Close relatives and third parties acting on behalf of the investors referred to at point 10.
12. Other companies in the same group.
13. Investors who have on an individual basis obtained from the investment firm rates and financial concessions which have helped to aggravate the financial situation of that investment firm.
14. Companies which are of such a size that they exceed the criteria for drawing up abridged balance sheets laid down in Article 11 of Directive 78/660/EEC, as last amended by Directive .../.../EEC.

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