Financial services: investor-compensation schemes

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Directive 97/9/EC on investor-compensation schemes (ICS Directive or ICSD)aims toprovide a European passport to investment firms authorised in one of the Member States. It lays down prudential rules which investment firms must observe at all times, including organisational provisions aimed at preventing investment firms from using instruments and money belonging to investors.

The report recalls that the ICSD is modelled after Directive 94/19/EC on deposit-guarantee schemes (DGSD).The purpose of this is to grant a minimum protection to depositors in the event of the closure of an insolvent credit institution. But, whereas in the DGSD a protection is provided for deposits arising from normal banking transactions, money claims arising from investment business carried out with a credit institution can be covered according to the provisions of the ICSD.

This report complements the one prepared for the DGSD on the same subject. Under the terms of the ICSD, the Commission is required to report on the export prohibition clause and to discuss the opportunity to extend its validity beyond 1999, which is the purpose of this report.

A basic principle set out in the ICSD is that if an investment firm belongs to a scheme, the scheme will also cover its investors at branches set up in other Member States. This provision extends to investment-compensation schemes the general principle of “mutual recognition”. In other words, the home country provisions applied to the head office of an investment firm are extended also to its EU branches. The assumption is that these form, within the Internal Market, a single entity subject to single authorisation and centralised supervision of its activities. However, the Directive itself imposes two important exceptions to this principle:

-the first is that, at least during a transitory period, and in order to avoid possible market disturbances, a scheme offering a higher or wider protection must downgrade its cover at branches located in other Member States where ICS are less generous. This clause, known as “export-ban” or “export prohibition clause”, exists also for deposit-guarantee schemes;

-the second exception, known as the “topping-up” clause, is that an investment firm belonging to a scheme offering a lower or narrower protection will have the right to adhere to a host scheme in order to upgrade its cover at branches located in other Member States where ICS are more generous. A similar clause also exists for deposit-guarantee schemes.

Both clauses aim at avoiding unequal conditions of competition based on the cover offered to investors. The relevant difference is that the export prohibition clause reduces the level of protection for some investors, who would otherwise receive a higher protection, whereas the topping-up works in favour of an upgrade of the protection (though the decision to effectively increase the cover remains with the investment firm itself, which may decide not to join the host country scheme).

The export-ban clause represents a relevant exception to the principle of the Single Market for investment services, in that it discriminates between investors of the same investment firm in case of insolvency. In addition, it is estimated that market disturbances may be expected only for a short period of time. That is why the “export prohibition clause” is envisaged in the Directive only as a transitory measure and is due to expire at the end of 1999, unless the European Parliament and the Council decide otherwise, following a proposal from the Commission to extend its validity.

The Commission looks at various justifications for maintaining the export prohibition clause and at the justifications for not extending it.

The report states that the investor compensation schemes in Member States have now been harmonised according to the principles and objectives of the Directive. Against this background, it seems disproportionate to prolong the export prohibition clause in order to avoid market disturbances that nobody could estimate or specify and which seem highly unlikely to happen.

A prolongation of the export prohibition clause would mean that the protection for such a remote risk would be considered more important than the completion of the Single Market for financial services.

The Commission is aware that not all the Member States have implemented the ICSD early enough to have benefited from practical experience with the operation of its provisions. In this respect, the strong links between the ICSD and the DGSD should be considered.

First of all, because the ICSD is actually a transposition of the DGSD rules and principles in the securities field. Not only are the two directives complementary in some aspects (the 97/9/EC on investor-compensation schemes also applies to banks as far as investment services are concerned); they are also identical with regard to the articles concerning the cross-border provision of services. This is why any experience of problems or questions arising from the banks' side might be used to supply useful information for investment firms.

Secondly, European regulator should have a comprehensive picture of how the "twin" directives work. In this regard, it is important to keep in mind that, though the DGSD was approved in 1994 and the ICSD only in 1997, the deadline for the Commission to produce the reports on the export-ban clause is the same (31/12/1999).

Moreover, the Commission is of the opinion that consistency with the DGSD should be preserved. Here, on the basis of the report adopted by the Commission on DGSD, the export-ban clause is going to expire for deposit-guarantee schemes. It would be difficult to justify, after 1999, the "export-ban" clause in the ICSD and not in the DGSD. As far as customers' protection is concerned, considering that some schemes cover deposits and investors' claims, discrimination would be introduced between depositors and investors of the same foreign branch of an institution.

However, after the clause has expired, the Commission will closely monitor the evolution of the situation, with particular attention to serious market disturbances, on the basis of elements supplied by the national authorities of Member States according to their preferences. The Commission can then consider the possibility of proposing appropriate legislative measures.