



December 2010
AK Position Paper

Position on the proposal of the European Parliament and the Council on reforming the Investor Compensation Scheme Directive (ICD) 97/9/EC

About us

The Federal Chamber of Labour is by law representing the interests of about 3.2 million employees and consumers in Austria. It acts for the interests of its members in fields of social-, educational-, economical-, and consumer issues both on the national and on the EU-level in Brussels. Furthermore the Austrian Federal Chamber of Labour is a part of the Austrian social partnership.

The AK EUROPA office in Brussels was established in 1991 to bring forward the interests of all its members directly vis-à-vis the European Institutions.

Organisation and Tasks of the Austrian Federal Chamber of Labour

The Austrian Federal Chamber of Labour is the umbrella organisation of the nine regional Chambers of Labour in Austria, which have together the statutory mandate to represent the interests of their members.

The Chambers of Labour provide their members a broad range of services, including for instance advice on matters of labour law, consumer rights, social insurance and educational matters.

Herbert Tumpel
President

More than three quarters of the 2 million member-consultations carried out each year concern labour-, social insurance- and insolvency law. Furthermore the Austrian Federal Chamber of Labour makes use of its vested right to state its opinion in the legislation process of the European Union and in Austria in order to shape the interests of the employees and consumers towards the legislator.

All Austrian employees are subject to compulsory membership. The member fee is determined by law and is amounting to 0.5% of the members' gross wages or salaries (up to the social security payroll tax cap maximum). 560.000 - amongst others unemployed, persons on maternity (paternity) leave, community- and military service - of the 3.2 million members are exempt from subscription payment, but are entitled to all services provided by the Austrian Federal Chambers of Labour.

Werner Muhm
Director

Executive Summary

The insolvency of an Austrian financial group in 2005 might cause about 10,000 investors to suffer losses from security investments - mainly attributable to malversations. This case alone demonstrates that planned reforms in the Investor Compensation Scheme Directive are generally welcome.

The AK requests accompanying measures to prevent compensation cases from occurring in the first place.

- The AK welcomes the intention postulated in the draft to increase investor protection and investor confidence in the EU.
- The AK welcomes the intention that the formulation of investor compensation schemes will be harmonised.
- The AK welcomes the widening of the area of application to a third party acting as custodian and to raise the level of compensation to Euro 50,000.
- The AK welcomes efforts to speed up the settlement of compensation cases.

- The AK welcomes the policy that investor compensation is to be financed by market participants.

- The AK requests accompanying measures to prevent compensation cases from occurring in the first place (prevention through institutionalised dialogue).

The AK position in detail

1. Increasing investor protection and investor confidence

The Investor Compensation Scheme Directive protects investors against the risks of fraud, irregular practices or operative mistakes, which result in the fact that an investment firm is not able to return to investors the monies or investment instruments belonging to them. The AK welcomes the intention that the Investor Compensation Scheme Directive will apply to all investment services and investment activities, which come under the Markets in Financial Instruments Directive (MiFID). Investors shall also be able to claim compensation if the investment firm infringes against its admission requirements, such as holding client assets. According to the current legal situation, Austrian investment firms are not allowed to be debtors of their clients and may therefore neither accept client money nor financial instruments. These circumstances require a banking licence and cannot occur if the investment firm operates correctly. In general, compensation is only possible if the license has been exceeded or in case the investment firm has acted against the rules of the license.

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tion Scheme Directive without having to examine the requirements attached to the admission of a firm in detail.

The AK considers the information duties of the investment firms included in the draft directive, according to which investment firms have to provide investors with information on the provisions of the investor compensation scheme in easily understood form to be important; in particular in respect of the level and extent of the cover provided by the compensation scheme. Information should also be provided as to which losses the investor compensation scheme had not been able to cover.

An AK survey conducted in November 2010 among 12 members (at random) of the overall 100 members (partners) of the Austrian investor compensation scheme (www.aew.at) shows that only about a third published (a more or less detailed) reference to their membership with the Austrian investor compensation scheme on their corporate homepage. Website visitors, who can be regarded as potential investors, are currently getting very little information as to whether an investment firm belongs to an investor compensation scheme. However, it would be desirable that existing and potential investors would have easy access to infor-

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This information requirement can be derived from the fact that different licenses (investment advice, portfolio management, acceptance and brokerage of orders, operation of a multilateral trading system) and different license scopes for providing investment services (investment firms, investment service companies) exist, which requires that the potential investor, preferably during initial contact - and not only when the contract is concluded - learns in easy understandable form whether an investment firm is member of an investor compensation scheme.

2. Harmonisation

The AK generally welcomes the efforts of the draft directive to harmonise the level of cover, payment modalities and deadlines as well as financing mechanisms. The AK also welcomes the invention in respect of harmonisation that there will be no "competition on investor compensation packages" between the individual Member States in the long run.

3. Scope and level of investor compensation in respect of the scope

The AK welcomes the widening of the scope of the directive, i.e. to extend the compensation claim to cases, where an investment firm, because of the inability to pay by a third party acting as a custodian, is not in a position to return financial instruments. Extending investor compensation to partners and shareholders of Undertakings for Collective Investment in Transferable Securities (UCITS) or to the UCITS depository or a third party that has been entrusted with UCITS assets is desirable from an investor's point of view.

On the level of compensation

The AK welcomes the cancellation of an excess clause, which in the opinion of the AK is not suited to motivate the small investor to take particular care in selecting an investment firm. **The AK generally welcomes a raise in the level of compensation.** The proposed compensation complies with the trend of the past years, according to which many investors, some with little experience, invested their redundancy payments or their entire savings - and these might even exceed the amount of Euro 50,000 Euro - in a single security product to bolster their private pensions.

4. Payout deadline, provisional payout of partial compensation

The AK basically welcomes a short payout deadline and the speedier processing of a compensation claim. However, the payout deadline of (maximal) 3 months from the time when the eligibility for and the level of compensation was established, is faced with the practical problem that in particular determining the eligibility for compensation resp. the legal certainty of the compensation case might take many years. An example would be the insolvency case of a security firm in 2005, which the Austrian Supreme Court (OGH) (only) decided and rated as a compensation case for the Austrian investor compensation scheme by mid 2010.

The AK welcomes the consideration that in case of delays, an advance, provisional partial compensation payment of at least a third of the claim can be made. However, it is questionable whether a provision is practical, which would entail that any advance, provisional partial compensation payment to the investor may be reclaimed if it transpires that the claim was not justified. Particular financially weak small investors, who relied on the compensation being basically justified, will find it difficult to repay the reclaimed amounts. The AK therefore requests measures, which will establish the legal certainty that compensation amounts, which have already been paid to investors, do no longer have to be reclaimed.

5. Financing mechanism

The AK welcomes the policy that investor compensation is to be financed by market participants. The AK also welcomes the principle, accordance to which the schemes are aimed at multilevel and no longer at one-dimensional financing. In the opinion of the AK, it should be examined whether major losses in smaller Member States (with - compared to other Member States - relatively few investment firms) may be compensated by multiple sources of funding, in particular the option to borrow (credit lines with banks, loans with other investor compensation schemes) and whether these loans are solely supportable, financeable and repayable by an investor compensation scheme. Apart from that, one has to consider a worst case scenario, where not only a major loss, but also a second large compensation case (also with thousands of wronged investors) might occur. A defined compensation scenario for investors resp. a financing model as a "last step" should exist for these unfavourable (extreme) cases.

6. Accompanying measures

On the prevention of compensation cases

The AK is in favour on focussing more on prevention work. The AK proposes that an **institutionalised dialogue**

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should take place between consumer protectors, authorities, supervisory authorities and investor compensation schemes. Current problems - in particular conspicuous providers, products or company structure - should be addressed in a defined dialogue framework and pursued if necessary or in case of doubt. Information on possible dysfunctional market practises to supervisory and investor compensation schemes could be made available within **the meaning of greater cross-border cooperation**. In particular, consumer protection associations and organisations - on the strength of their experience in advising consumers in financial service matters ("ear to the ground" regarding the small investor market) - could provide valuable hints.

More protection through compulsory indemnity insurance

One should add that small investors, in view of the large number of investment services and brokers of financial products, many of whom have highly different licenses to operate in the market, find it difficult to identify what type of consultant they are dealing with and what kind of conceded and

competencies as mandated by trade law, this consultant has. In practice, small investors generally subsume the various providers under the label of "financial advisor" or the "financial consultancy".

The AK is in favour of introducing compulsory indemnity insurance with adequate cover for finance brokers, so that the small investor can have confidence that any mistakes or gross errors of advice by his advisor or consultancy are covered by compulsory indemnity insurances of the latter.

Should you have any further questions
please do not hesitate to contact

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