EFDI. EUROPEAN FORUM OF DEPOSIT INSURERS

ICS REGULATORY FRAMEWORK IN THE EU

PAPER 1

Prepared by the Investor Compensation Scheme Working Group (ICSWG).

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Contents

1. - Introduction.

This is the first paper in a three-part package of papers being prepared by the Investor Compensation Scheme Working Group (ICS WG) of the European Forum of Deposit Insurers (EFDI). The package of papers is:
Paper 1 – ICS Regulatory Framework in the EU.

Paper 2 – Exploring the 2010 Commission Proposals to recast the ICS Directive.

Paper 3 – Potential Improvements to the ICS Directive – A practitioner's perspective.

The objective of paper 1 is to summarise at a very high level the relevant EU regulatory pieces that define or affect the way EU ICS are regulated at EU level and discharge their function to cover entities, activities, clients and products. This paper will also identify the EU legislative institutions and EU supervisory body in the ICS sphere, and certain activities, reports and proposals prepared by those entities including powers available to them.

The audience for this paper is primarily EU focussed ICS practitioners, and those with an interest in understanding the ICS regulatory framework in the EU. The paper does not take positions on the ICS regulatory framework. The conclusion section seeks to aid readers with contextualising the ICS regulatory framework in some specific areas that came to the fore in the preparation of the paper. There may be other areas that practitioners or readers identify from their own experience, they will remain relevant and can be captured in future revisions and updates to the paper.

2. - Directive 97/9/EC on investor compensation schemes (ICSD).

The regulatory framework for Investors Compensation Schemes (ICS) in the EU is initially and basically set out in Directive 97/9/EC[1] (ICSD). No amendments have been made to this Directive since its publication. It is a Directive that presents a basic level of harmonisation of ICS and their operations.
The ICSD basically introduces the figure of ICS at EU level - although it already existed by then in a number of Member States. It establishes that there should be at least one ICS in each Member State that covers investment firms and banks, and establishes some elements of harmonisation (such as a minimum coverage of 90% of client loss subject to a 20,000 euros limit, possible coverage exclusions, regime of branches in other EU countries, subrogation and right of recovery of what has been paid, etc).

The scope of ICSD encompasses investment firms and banks authorised for investment services. While UCITS management companies (see Section 4.2) and Alternative Funds Managers (see Section 4.3) Directives refer to the ICSD application when these entities are authorised to provide investment services.

The ICS regulation was not integrated in the Investment Services Directive (Directive ISD, 22/1993/EEC) [2], that was enacted a few years before the ICSD.

However, the fact that the EU's basic ICS regulation - Directive 97/9/EC - has not been amended to date, does not mean that the different EU bodies have not paid attention to this figure, nor to its relevance and necessary evolution.

ICSD also foresees that in the case of banks covered by a Deposit Guarantee Scheme (DGS), Member States could opt that it is the latter that fulfils this function. Article 2, Section 3, states the following:

> *"Any claim under paragraph 2 on a credit institution which, in a given Member State, would be subject both to this Directive and to Directive 94/19/EC[3] shall be directed by that Member State to a scheme under one or other of those Directives as that Member State shall consider appropriate. No claim shall be eligible for compensation more than once under those Directives."*

There are some areas like the timeline to establish client loss, financing provisions, investment mandate, cross-border, etc…., that are not developed in detail on the ICSD.

In Paper 3, the EFDI ICS WG will enter into detail in this respect and will explain how practitioners may demand and require that some of these issues are properly regulated.

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[1] Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997, on investor-compensation schemes
2 Directive 93/22/EEC of the Council of 10 May 1993 on investment services in the securities field
3 Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes ("DGSD 1")

3. - EU authorities and regulators activity regarding ICS regulation after the ICSD.

3.1. - Oxera report (2005).

In **2005,** the European Commission published a study by **Oxera** on the level of implementation and profiles of ICS in the different Member States.[4] This was a comprehensive study that reviewed the level and approach of implementation and functioning of national ICS among member states.

3.2. - EC report (2005)

Following this report, the **European Commission published a report**[5] whose executive summary and recommendations showed that, although all Member States (the report focused on the initial 15 Member States at the time) had implemented the Directive, given the low degree of harmonisation, the different national ICS presented significant differences in a large number of aspects such as, the organisational structure and governance, relationship with regulatory authorities, relationship with deposit guarantee schemes, participation requirements for investment firms and type of investment firms participating, definition of investors covered, services and instruments covered, type of loss covered, limit of compensation, operational and claims processing mechanisms and funding mechanisms.

The report identified certain difficulties that the ICS were finding in carrying out their function, including delays in bankruptcy filings, notification to investors of insolvency, lack of information to calculate compensation and delays in the legal process to determine the amount of compensation.

The report stated that it was necessary to establish more rigorous systems for assessing the ICS' potential exposures to losses and the probabilities of occurrence of the events that could produce them.

Overall, it concluded that ICS provided important protection for investors, given that the evidence proved that other kind of protection (asset segregation, prudential regulation, supervision, etc.) sometimes failed. It concluded that national ICS played an important and complementary role in providing last resort protection to retail investors.

Likewise, it also pointed out some possible areas of improvement in EU ICS regulation, focusing on reducing delays in compensation processes, better funding and resilience of ICS, coverage of bad advice[6] and coverage of losses caused by sub-custodians or third parties.

4 Oxera. Description and assessment of national investor compensation schemes established under Directive 97/9/EC. Report prepared for the European Commission (DG Internal Market). January 2005.
5 Evaluation of the Investor Compensation Schemes Directive. DG Internal Market and Services.
[6] Bad advice and the resulting loss to an investor, when the entity becomes insolvent, is comparatively only covered by the UK's ICS, the Financial Services Compensation Scheme (FSCS).

3.3. - ICSD amendment proposal (2010).

The 2005 EC Report suggested different possible approaches to make progress at EU level on the issues identified: legislative response, communications or recommendations, or debate between Member States.

The European Commission (EC) published a proposal for a Directive in July 2010 (see COM (2010) 371).

This proposal represented a substantial modification with respect to the Directive of 1997. Specifically, it focused on proposing:

i. Alignment with MiFID services covered and classification of clients,
ii. Coverage by the ICS in the event of the insolvency of sub-custodians,
iii. Coverage of collective investment institutions (CIS)[7] in the event of losses arising from the unavailability of assets making up their portfolios,
iv. An increase in the maximum coverage to 50,000,
v. Elimination of the option for co-insurance (90% of loss),
vi. The obligation for ICS to have a minimum pre-funding,
vii. The establishment of a system of borrowing between EU ICS, and
viii. The possibility for partial compensation on one claim, so that at least part of the compensation payments should not be delayed for more than 9 months.

The proposals introduced significant new regulations not previously discussed or explained. Additionally, achieving high quality data proved not to be an easy task for the EC.

The European Parliament's Report on this Proposal took on board most of the proposed reforms including the establishment of minimum target fund levels and ex-ante funding, although it did not support CIS coverage, at least as long as the functions of the CIS depositary were not clarified at EU regulatory level.[8]

The European Parliament (EP) proposed increasing the maximum coverage to 100,000 euros, including coverage for bad advice; that Member States should inform the EC and ESMA about the data corresponding to the coverage of their national funds; and that the criteria for setting contributions should be linked to risk criteria. The EP supported the borrowing mechanism but proposed that it should not commence until such time as all ICS's were funded at the target fund level.

EU Member States had mixed reactions over various aspects of the proposal, including the target level (aligned on requirements made at the same time for deposits), the inclusion of UCITS as direct members of an ICS, the coverage of sub-custodians' failures, as well as bad advice.

EFDI ICS WG is preparing a paper exploring the 2010 proposals.

[7] This term seems to refer to any investment companies and investment funds in general
[8] The functions of UCITS (harmonised EU CIS) depository were finally fixed by the Directive 2014/91/EU ("UCITS V").

Following a lack of agreement among member states, in the end, the EC withdrew the proposed file in March 2015.

3.4. - Impact Assessment of Proposal for a Directive of the European Parliament and of the Council, amending Directive 1997/9/EC on investor-compensation schemes.[9]

This comprehensive document accompanied the proposal for amendment in the Directive. It reviewed different scenarios of changes and their impact. It also reviewed the problems and effects of functioning in national member-state ICS. It also provided some data for ICS and Member States in relation to investor protection, including examples of problematic compensation cases.

3.5. - Definition of ESMA role regarding ICS (2010):

The impulse of ICS EU regulation in 2010 was also reflected in the inclusion in the Regulation governing the creation and operation of ESMA[10] of an article 26 with the following wording:

Article 26. European regime for national Investor Compensation Schemes.

> *"1. The Authority shall contribute to the strengthening of the European system of national investor compensation schemes (ICS) through actions undertaken under the powers granted to it in this Regulation in order to ensure the correct application of Directive 97/9/EC, in order to ensure that national investor compensation schemes are adequately funded by contributions from the financial market participants concerned, including, where appropriate, financial market participants whose head office is in third countries, and that they provide a high level of protection to all investors in a harmonised framework across the Union.*
>
> *2. Article 16 concerning the powers of the Authority to adopt guidelines and recommendations shall apply to investor-compensation schemes.*
>
> *3. The Authority may develop regulatory and implementing technical standards, as specified in the legislative acts referred to in Article 1(2), in accordance with the procedure laid down in Articles 10 to 15.*
>
> *4. The review of this Regulation provided for in Article 81 shall, in particular, examine the convergence of the European regime of national investor compensation schemes."*

[9] Commission staff working document, impact assessment, accompanying document to the proposal for a Directive of the European Parliament and of the Council, amending directive 1997/9/EC on Investor-Compensation Schemes, {com(2010) 371}, {sec(2010) 846} https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52010SC0845&qid=1710254055091

[10] Regulation 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision 716/2009/EC and repealing Commission Decision 2009/77/EC.

So far, ESMA is not known to have carried out actions in accordance with the powers that this Article confers on it.

3.6. - EP Study on the feasibility of substitution of ICS by insurance policies (2012).

In **2012,** as part of the discussions held on the 2010 EU Commission's proposal, **the European Parliament** published in 2012 a study on alternatives to ICS and their impact.[11]

Although it is a long and complex study, its conclusions suggest that replacing ICS by insurance contracts would not guarantee the coverage ICS provide for a number of technical reasons.

4. - Other pieces of current regulation of reference.

The most relevant other pieces of regulation that concerns ICS, in some cases on a very directed and relevant way, are discussed in this section.

4.1. - MIFID II

i/ Entities covered by an ICS.

Article 14 of MIFID II states that:

> *"The competent authority shall verify that any entity seeking authorisation as an investment firm meets its obligations under Directive 97/9/EC at the time of authorisation."* [12][13]

Another example of the relevance that MIFID II gives to ICS is that article 3 requires that those entities that can be exempted from complying with certain MIFID II requirements at national level - one example of this would be entities that do not provide custody of financial instruments and cash services, that are only allowed to operate in their home Member State - still they must join an ICS (except if they can prove that they provide an equivalent protection)[14].

In addition, MiFID II requires that regulated market operators operating a Multilateral Trading Facility - as well as investment firms operating a Multilateral Trading Facility since MIFID I, which is also a novelty with respect to MiFID, join an ICS.[15]

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[11] Alternatives to Investor Compensation Schemes and their Impact Study. 2012

[12] Article 1, Section 3 letter a) of MIFID II declares article 14 applicable to credit institutions.

[13] This Article also introduces a specificity for structured deposits, but this exception does not alleviate the pressure for client protection, and the need to join a protection scheme:

> *"The obligation laid down in the first paragraph shall be met in relation to structured deposits where the structured deposit is issued by a credit institution which is a member of a deposit guarantee scheme recognised under Directive 2014/49/EU.[i.e., DGSD2]"*

[14] While the obligation to join an ICS did not suffer any exception in ICSD, MIFID I offered an optional national exemption for some investment firms from applying MIFID and ICSD. MIFID II reverted the move, leaving open a more limited exemption from applying ICSD.

[15] This follows from the wording of Article 5(2) in conjunction with Article 14 of MIFID II.

This is also the line that EU regulation has been following by requiring coverage by an ICS for UCITS Managers as well as for Alternative Investment Managers where these entities provide investment services to individual clients ("portfolio management" and others).[16] We will come back to this in more detail below (sections 4.2 and 4.3).

All in all, the idea, first established by ICSD, reaffirmed and extended by MIFID II, is that the obligation to join as ICS, except for a very limited optional national exemption established in ICSD, applies, beyond investment firms and banks providing investment services, to all market players providing investment services (such as portfolio management services) irrespective of their status or the type of clients they work with.

ii/ Clients covered by an ICS.

ICSD establish a list of clients that national regulations may exclude from cover. That means that all clients are covered except those excluded.

While there is a general approach to exclude professional and institutional clients, from coverage, the reality is that the potential groups of covered and excluded clients do not match the distinction between retail and professional clients under MIFID II.

iii/ Activities and instruments covered by an ICS

The ICSD refers in its article 1 to the then existing "ISD" Directive 93/22/EEC, on investment services in the securities field, to define concepts that frames the ICS coverage. These concepts are: "investment business" that refers to the concept of "investment service" in article 1 and then to Section A of Annex to Directive ISD, and "instruments" that refers to this concept as defined in Section B of the same Annex.

According to article 2 of the ICSD, the coverage of the ICS extends to money and "instruments" held, administered or managed, in connection with "investment business". However, after the repeal of the ISD, the enactment and repeal of MIFID I and the enactment of MIFID II, the coverage of the ICS is to be seen in relation with "financial instruments" and "investment services and activities" as defined in Annex I of MIFID II.

Directive 2004/39/EC[17] (MIFID I) Repeals Directive 93/22 and expressly states in article 69, that:

> *"References to Directive 93/22/EEC shall be construed as references to this Directive. References to terms defined in, or Articles of, Directive 93/22/EEC shall be construed as references to the equivalent term defined in, or Article of, this Directive."*

[16] For the former as required by Article 12(2) of Directive 2009/65 (MIFID II) and for the latter as required by Article 12(2) of Directive 2011/61 (AIFMD).

[17] Directive 2004/39/EU 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

Directive 2004/39/EC establishes the new concepts of "Investment services and activities" that substitutes the previous concept of "investment business" in Directive 93/22, and of "financial instrument" that substitutes the concept of "instruments" in Directive 93/22.

Directive 2014/65/EU (MIFID II) maintains these two concepts although with new content.

Article 94 of MIFID II expressly states that:

> *References to terms defined in, or Articles of, Directive 2004/39/EC or Directive 93/22/EEC shall be construed as references to the equivalent term defined in, or Article of, this Directive.*

According to the above, the extension of the coverage of an EU ICS refers to the "investment services and activities" and "financial instruments" in Annex I of the MIFID II Directive.

The implementation of these concepts from the Directive in different Member States domestic regulations could differ.

Article 39 of MIFID II deals with the provision of investment services by third-country branches in Member States. According to article 39 (f) such third-country branches must belong to an ICS authorised or recognised in accordance with the ICSD.

4.2. - UCITS managers providing investment services.

The Directive 2009/65[18] ("UCITS IV") reaffirms in its article 12 an obligation already established by previous Directive UCITS III (2001):

> *"Each management company (of UCITS) the authorisation of which also covers the discretionary portfolio management service referred to in Article 6(3)(a) shall:*
>
> *b) be subject with regard to the services referred to in Article 6(3) to the provisions laid down in Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor-compensation schemes."*

In article 6, section 3, this Directive allows member States to authorise UCITS managers, while not being investment firms, to provide some investment services and ancillary services such as some securities custody.

In particular this article states the following:

[18] Directive 2009/65/EU 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 IV has been amended by UCITS V in 2014, but with no change as regards to this obligation.

"Member States may authorise management companies to provide, in addition to the management of UCITS, the following services:

(a) management of portfolios of investments, including those owned by pension funds, in accordance with mandates given by investors on a discretionary, client-by-client basis, where such portfolios include one or more of the instruments listed in Annex I, Section C to Directive 2004/39/EC; and

(b) as non-core services:

(i) investment advice concerning one or more of the instruments listed in Annex I, Section C to Directive 2004/39/EC;

(ii) safekeeping and administration in relation to units of collective investment undertakings.

Management companies shall not be authorised under this Directive to provide only the services referred to in this paragraph, or to provide non-core services without being authorised for the services referred to in point (a) of the first subparagraph."

4.3. - AIFM providing investment services.

Directive 2011/61/EU[19](AIFM) follows a very similar approach regarding Alternative Investment Managers to that of Directive 2009/65 in respect of UCITS managers.
In particular, article 12 of this Directive states that:

"Each AIFM the authorisation of which also covers the discretionary portfolio management service referred to in point (a) of Article 6(4) shall:

(b) with regard to the services referred to in Article 6(4), be subject to Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor-compensation schemes (1)."

Article 6 (4) states that:

"Member States may authorise an external AIFM to provide the following services:

(a) management of portfolios of investments, including those owned by pension funds and institutions for occupational retirement provision in accordance with Article 19(1) of Directive 2003/41/EC[20], in accordance with mandates given by investors on a discretionary, client-by-client basis;

[19] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010

[20] Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision

(b) non-core services comprising: (i) investment advice; (ii) safe-keeping and administration in relation to shares or units of collective investment undertakings; (iii) reception and transmission of orders in relation to financial instruments."

Consequently, AIFM, which do not qualify as investment firms, but that are authorised to provide some investment services such as portfolio management and ancillary services such as some securities custody, must join an ICS.

5. - Other regulatory considerations regarding ICS operation or other relational fields.

5.1. - Recent Investment Firms prudential regulation.

Directive (EU) 2019/2034[21], *and Regulation (EU) 2019/2033*[22], establish a new prudential regulation framework for investment firms.
No specific provision in any of these two pieces of regulation affects the existing EU ICS regulation as described above.

However, a provision is contained requiring that any third country investment firm intending to provide services in the EU should inform the relevant host country authority about its ICS coverage.

This, again, reinforces the relevance that ICS coverage of EU investors has for the EU rule makers.

5.2. - Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR).

Regulation 648/2012[23] establishes, in article 48, some rules governing how Central Counterparties (CCP) may proceed to the transfer of assets and positions of clients of a clearing member (an investment firm or a bank) to other clearing members, or, proceed to the liquidation of such assets and positions.
All these CCP capacities will be triggered in case a clearing member of that CCP is in default according to that Regulation definition.

The Regulation provisions must be enforceable even in the case of a domestic insolvency proceeding is initiated regarding the relevant investment firm or bank.

[21] Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU
[22] Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014
[23] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories

Since any of these clearing members may be covered by an ICS or a DGS/ICS, these CCP capacities may well affect the way an insolvency situation of an ICS covered entity is managed and may raise questions as to what assets and positions, together with the relevant collateral, can be transferred to a third entity, thus potentially reducing the liquidation estate of the insolvent investment firm or bank.

While the Regulation does not contain any specific provision regarding any role for the ICS in this respect, its application may affect the operation of the insolvency situation and the final amount the ICS must pay out, potentially increasing it.

5.3. - MiCA.

Regulation (EU) 2023/1114[24] (MICA), governs the issuance of some crypto assets and the provision of services regarding these crypto assets.
This Regulation expressly states in articles 6, 19, 51 and 81 that these crypto assets are not covered by ICS.

But this legal provision does not achieve total clarity regarding the treatment of investment in crypto assets and ICS coverage. Some aspects will need attention and analysis in the next years in this respect. These are some examples:

1. While it seems clear that crypto assets are not covered by an ICS, it is foreseen in MiCA that when issuing a crypto asset, the White Paper that the issuer has to prepare should contain information regarding *"Where applicable, a description of protection schemes protecting the value of the asset-referenced token and compensation schemes;"* The extent of this provision remains unclear.

2. Within the type of entities that can provide services over crypto assets are included investment firms and credit institutions. Thus, these entities will be providing "investment services over financial instruments" under MIFID II that will be covered by the ICS and "services on crypto assets" that will not be covered by the ICS, potentially to the same clients. This could lead investment firms and banks and ICS to be accurate in their communications towards retail investors.

3. At the time, in the absence of specific regulation on this, an ICS might be covering indirect investment or indirect exposure through financial instruments to crypto assets according to the applicable regulation. This could be the case for instance for investment funds, derivatives, Contracts For Differences (CFD) or structured notes, whose investment or underlying assets are crypto assets, where they are legally considered "financial instruments" under the domestic MIFID II implementing rules. Thus, this will be mainly determined by the applicable regulation.

[24] Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31 May 2023 on markets in crypto-assets, and amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937

5.4. - Lack of provision of operation of ICS in case of a bank or investment firm resolution.

Neither **Regulation (EU) 806/2014[25],** nor **Directive 2014/59/EU[26]**, contain references to the operation of ICS coverage in a resolution scenario nor to the potential interaction between the ICS' coverage and the resolution measures that can be adopted.

The Directive contains a number of references to take into account regarding the participation of the entities in an ICS but not specifically on the ICS operation in a resolution case.

5.5. - Lack of an EU comprehensive regulatory approach for investment services providers insolvency and ICS operation in the EU.

The EU's regulatory approach to date differs from that of the US[27] and the UK[28], in the sense that there is a lack of comprehensive regulation of all the specific elements of the crisis of an institution that provides investment services[29] from the perspective of the protection of investors' financial interests.
A similar approach to that in the US and the UK, would regulate the most relevant issues that need to be considered in these cases in order to achieve a quick, efficient and ordered crisis management, providing all the parties involved, including ICS, but also courts, insolvency administrators, investors, supervisors, etc., a clear regulatory framework.

6. - Some potential initial conclusions.

This paper sets out the current EU regulatory framework as a general principle, utilising the definitions used by the EU regulation(s). The purpose of this section is to aid readers of the paper with contextualising the EU ICS regulatory framework and its evolution. The areas identified, 1) definition and denomination, 2) coverage, and, 3) governance and organisation, coupled with the examples utilised, came to the fore during the preparation of the paper.

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[25] Regulation (EU) No 806/2014 ("SRM") of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010

[26] Directive 2014/59/EU ("BRRD") of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council Text with EEA relevance

[27] Securities Investor Protection Act (SIPA) that creates the Securities Investor Protection Corporation (SIPC), the US ICS and regulates in detail the whole insolvency process together with the ICS implication and way of action.

[28] The Special Administration Regimen (SAR) applies to insolvent Investment Firms.

[29] There is no specific insolvency regime al EU level for this type of entities, which show specific risk profiles and specific ecosystem of entities involved such as Central Securities Depositories, Central Counterparties, brokers, sub-custodians, Master Agreements counterparties, etc.

Other areas that practitioners or readers may identify from their own experience will remain relevant and can be captured in future revisions and updates to the paper.

Notwithstanding that there are some applicable exemptions and subject to some national interpretations and discretions, broadly speaking the following entities should be a member of an EU ICS:

In accordance with ICSD (97/9/EC)

1. MiFID II (2014/65/EU) authorised investment firms, including;
    a. Market operators operating a Multilateral Trading Facility (MTF),
    b. Third-country branches providing investment services in Member States (subject to equivalence test),
2. Credit institutions, the authorisation of which enables the provision of MiFID II investment services,

In accordance with UCITS V (2014/91/EU)

3. Management companies, or UCITS managers authorised to provide investment services (such as individual portfolio management),

In accordance with AIFMD (2011/61/EU)

4. Alternative Investment Fund managers authorised to provide investment services (such as individual portfolio management).

However, the variety of texts, the changes of definitions and denominations over time, the diversity of national securities businesses, and the basic level of harmonisation set by the ICSD presented the opportunity for quite different governance structures, coverage, or even names for EU ICS to develop.

This is quite important for EU ICS, as they need to be clear, when working together, about what precisely they refer to.

The (non-comprehensive) examples below will illustrate all this.

Definitions and denominations:
While the legal definition of “investment firm” from an ICS perspective will capture categories 1 – 4 in Ireland, the word “investment firm” would generally be understood to refer to category 1 only, while category 2 would be known as banks, with categories 3 & 4 being generally referred to under the collective term of Fund Service Providers.

In France, UCITS managers were also seen as and called investment firms until 2018. The French regulation also uses the word “investment services providers”, not defined by EU texts, to designate all market participants above (except for the quite specialised market operators). This wording is also practised in Spain, while not at a regulatory level.

“Portfolio management” was first precisely defined as a discretionary and individualised management (Investment Services Directive, 1993). In 2004, MIFID dropped the mention of “discretionary and individualised”.

As a matter of fact, the old (1996) denomination of French UCITS managers, as "portfolio management companies", still in force, invites the thought that they are specialised in (individual) portfolio management activities which characterise investment firms, which they are not, and while their primary activity lies in collective management.

Coverage

While on the face of it, and according to an ICS WG Survey on this, it could be assumed, due to a basic level of harmonisation prescribed by the ICSD, that there may not be much difference among EU ICS in terms of client coverage.

Differences have developed regarding coverage. Some non-exhaustive examples are as follows:

1. As for the extent in which institutions under the same regulatory status are covered:
   While the EU regulation prescribes the membership of UCITS and AIF managers when they also provide individual portfolio management (prescription applied as such in Ireland for instance), in France, nearly all UCITS and AIF managers must join the ICS set for them.

2. As for the extent of covered activities.
   UCITS V prescribes that UCITS' managers activities are covered by an ICS as for their portfolio management and other services (advice, safe-keeping and administration). In France, the related ICS covers the loss of client's cash and securities, whatever the involved activities, including for the primary one, and even if the limits of their authorisation has been overpassed.

3. As for the extent of the coverage itself.
   Beyond the basic harmonised coverage limit itself and the possible use of a deductible, which differs from one ICS to the other, there may be two separate coverage limits for securities and associated cash, or a single coverage limit for both.

Governance and organisation

ICS are not necessarily unique in their own Member State. Separate ICS, depending on the categories of covered institutions, have been set in various EU jurisdictions.

Bulgaria, Finland or Ireland set a single ICS for all covered institutions. On the contrary, Spain displays two different ICS, under two separate entities, one for banks authorised for investment services (in relation with the deposit guarantee also managed by this entity), another one for all other covered institutions. France works with two different ICS compartments within the same entity, one for institutions directly prescribed to be members under ICSD (categories 1 to 2), the other for institutions prescribed to be members under UCITS V and AIFM (categories 3 and 4).

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ANNEXES:

I. - Oxera report (2005).

II. - EC Report 2005.

III. - 2010 Directive proposal.

IV. - Staff Document regarding the 2010 Directive proposal.

V. - Report of the European Parliament on the 2010 Directive proposal.

VI. - 2012 Report for the European Parliament.

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