

**POLICY STATEMENT**

**(PS-02-2019)**



**SUBJECT: POLICY STATEMENT ON THE REPLACEMENT OF THE LEGAL FRAMEWORK GOVERNING THE OPERATION OF THE INVESTORS COMPENSATION FUND**

**DATE OF ISSUE: 13 MARCH 2019**

## PURPOSE OF PUBLICATION

The Cyprus Securities and Exchange Commission, publishes this Policy Statement in order to notify its decision in relation to the Consultation Paper (2017-02) for the replacement of the legal framework governing the operation of the Investor Compensation Fund.

The present document must be read in conjunction with Directive DI144-2007-15, CP (2017-02) and Directive DI 87-07.

Queries in relation to the content of this Policy Statement may be addressed to the Policy Department of the Cyprus Securities and Exchange Commission at [policy@cysec.gov.cy](mailto:policy@cysec.gov.cy).

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## 1. PURPOSE OF THIS POLICY STATEMENT

- 1.1. On 12 April 2017, the Cyprus Securities and Exchange Commission (“CySEC”) issued a [consultation paper](#) (“**CP 2017-02**”) to upgrade the legal framework governing the operation of the Investor Compensation Fund (“**ICF**”). CySEC called for feedback from all interested parties on the proposed amendments.
- 1.2. In total, eighteen (18) persons submitted feedback. However three (3) out of the eighteen (18) respondents represent a larger number of persons as organised bodies.
- 1.3. Having examined and considered the consultation feedback, CySEC [has introduced a Directive regarding](#) the operation of the ICF (**the “New ICF Directive”**) which has been finalised and published in the Official Gazette of the Republic.

### WHO THIS AFFECTS

- 1.4. The present Policy Statement concerns:
  - Cyprus Investment Firms (“**CIFs**”) providing any investment service (or exercising any investment activity), as set out in Part I of the First Appendix of Law 87(I)/2017;
  - CIFs also providing the ancillary services, described in paragraph (1) of Part II of the First Appendix of Law 87(I)/2017;
  - Investment Firms (other than CIFs) of an EU Member State, who are members of the ICF;
  - Investment Firms (other than CIFs), domiciled in a Third Country and which have a branch in the Republic of Cyprus and are members of the ICF;
  - Management Companies of Undertakings for Collective Investment in Transferable Securities (“**UCITS**”), providing one or more of the services described in Section 109(4) of the Open-Ended Undertakings for Collective Investment Law of 2012 (**the “UCITS Law”**);
  - Alternative Investment Fund Managers (“**AIFM**”), providing one or more of the services described in Section 6(6) of the Alternative Investment Fund Managers Law of 2013 (**the “AIFM Law”**).

## 2. SUMMARY OF COMMENTS AND CySEC's POSITION

The following sub-sections present a summary of the feedback responses submitted to CySEC, and outline CySEC's position under the New ICF Directive.

In order to obtain the full picture, the present Policy Statement must be read in conjunction with: 1) [Directive DI144-2007-15](#), 2) [CP \(2017-02\)](#) and 3) the [New ICF Directive](#).

### 2.1. SUMMARY OF COMMENTS IN RELATION TO QUESTION 1 OF CP (2017-02)

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#### Question 1

#### Do you agree with the amount of the initial contribution?

Under CP (2017-02) we proposed the increase of the initial contribution. The proposed initial contributions were set per service/activity provided, ranging from €10.000 to €35.000 per service.

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- 2.1.1. The majority of contributors agreed (or did not disagree) with the amount of the proposed initial contribution.
- 2.1.2. Limited instances were noted in which a contributor:
- i. Mentioned that they feel that the initial contribution remains low in spite of the proposed increase, especially in relation to the services of *"reception and transmission of orders in relation to one or more financial instruments"*, *"execution of orders on behalf of clients"*, and *"safekeeping and administration of financial instruments for the account of clients, including custodianship and related services"*.
  - ii. Disagreed partially with the amount of the proposed initial contribution, which was believed to be too high, and specifically with the amount proposed in relation to the services of *"dealing on own account"* and *"safekeeping and administration of financial instruments for the account of clients, including custodianship and related services"*.

- iii. Mentioned that they do not understand the reason why the proposed or existing members will have to pay the initial contribution prior to receiving the relevant authorization by CySEC. In addition to this, they posed a question as to whether the initial contribution paid, would be returned, in case that the application for authorization is rejected.
- 2.1.3. A number of contributors raised the question as to whether existing members would be requested to pay additional initial contributions. Some of the said contributors, expressed a disagreement with such an approach.

### **CySEC's POSITION**

- 2.1.4. The purpose of paying the initial contribution prior to being granted authorization is to ensure that initial contributions are paid on time.
- 2.1.5. Pursuant to the draft Directive, as this was put to consultation as per CP (2017-02) **(the "Draft Directive")**, the payment of the initial contribution will be performed only after the applicant has been instructed accordingly by CySEC. Applicants will not pay the initial contribution at the onset of applying for authorization, but only after the core criteria for granting authorization have been examined. Applicants will therefore be obliged to pay the initial contribution for their registration to the ICF, once they have received the written direction on the final steps for authorization from CySEC.
- 2.1.6. The Draft Directive, did not provide for the case in which CySEC received more information that resulted in CySEC ultimately rejecting an applicant, after they had paid the initial contribution. In such a case, it would be reasonable for the initial contribution to be returned to the applicant. However, the costs that may be incurred in relation to such transaction, will be borne by the applicant. As such, the relevant paragraph of the New ICF Directive has been amended accordingly, to include these provisions.
- 2.1.7. With regard to whether existing members will be requested to pay additional initial contributions, CySEC notes that the existing members have paid initial contributions on the basis of the legal framework, as that was in force at the material time and therefore will not be requested to pay additional initial contributions. It is provided that, in the case that an existing member applies for an extension of authorisation after the New ICF Directive comes into force, then the said member must pay the relevant new initial contribution as provided for in the New ICF Directive. It is further provided that, where the New ICF Directive provides for a lower initial contribution

than the one provided for at the time that the member paid that contribution, the difference in balance shall not be recoverable.

- 2.1.8. CySEC notes that the initial contribution, is a means of financing the ICF that already existed in the legal framework. CySEC acknowledges that this means of financing creates a cost to be borne by prospective members. To this end, although the initial contribution might contribute in the initial filtering of persons entering the market, it could also potentially act as a disproportionate barrier to entry, thus undermining competition. Despite the fact that a large number of contributors agreed with the increase of the initial contribution, CySEC noted that the persons who expressed this position are already members of the market and as such would be affected to a very limited degree.
- 2.1.9. Taking the above into consideration, as well as the fact that initial contributions are dependent on the onset of new companies in the market, and as such do not form the main means of financing of the ICF, CySEC has set the ICF contribution as per 2.1.10, below.
- 2.1.10. In particular, initial contribution has been set in the New ICF Directive as follows:

For investment services under Part I of the First Appendix of Law 87(I)/2017:

- Two thousand euro (€2.000) per investment service;
- Thirty five thousand euro (€35.000) for the ancillary investment services, described in paragraph (1) of Part II of the First Appendix of Law 87(I)/2017.

For top-up services under UCITS Law:

- Two thousand euro (€2.000) for the service provided for in article 109(4)(a) of the UCITS Law;
- Two thousand euro (€2.000) for the ancillary service provided for in article 109(4)(b)(i) of the UCITS Law;
- Thirty five thousand euro (€35.000) for the ancillary services provided for in article 109(4)(b)(ii) of the UCITS Law.

For top-up services under AIFM Law:

- Two thousand euro (€2.000) for the service provided for in article 6(6)(a) of the AIFM Law;
- Two thousand euro (€2.000) for the ancillary service provided for in article 6(6)(b)(i) of the AIFM Law;
- Thirty five thousand euro (€35.000) for the ancillary service provided for in article 6(6)(b)(ii) of the AIFM Law;
- Two thousand euro (€2.000) for the ancillary service provided for in article 6(6)(b)(iii) of the AIFM Law.

## 2.2. SUMMARY OF COMMENTS IN RELATION TO QUESTION 2 OF CP (2017-02)

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### Question 2

**Do you agree with the amount of the annual fee to cover administrative and/or other expenses arising in the context of the ICF's operation?**

**Under CP (2017-02), we proposed the introduction of an annual fee of €700 (to be paid by the members of the ICF), so that the ICF covers the administrative and/or other expenses arising in the context of its operation.**

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- 2.2.1. The majority of contributors agreed (or did not disagree) with the amount of the annual fee to cover administrative and/or other expenses, arising in the context of the ICF's operation.
- 2.2.2. Four (4) contributors disagreed. Some of those who disagreed had doubts as to the annual needs/expenses of the ICF.
- 2.2.3. In limited instances, persons who disagreed raised, among others, the following:
- i. The references to expenses should be accompanied by a budget, detailing the said expenses, and that, if the aim is the creation of a department within CySEC whose duties would be limited to the handling of all matters pertaining to the ICF, in the contributor's opinion, there is no reason for the payment of any fees, implying that this is a cost that should be borne by CySEC. If the aim is the creation of an independent agency, then, in the contributor's opinion, it is the ICF Administrative Committee that should decide whether to apply an administration cost (and not CySEC);
  - ii. That, in order to have an opinion on the said question, the costs of the ICF for the previous years should be made public. The commentator further posed doubts as to the annual costs of the ICF;
  - iii. That the operation of the ICF should be independent/separate from CySEC and that more responsibilities should be assigned to the Administrative Committee of the ICF.



## CySEC's POSITION

- 2.2.4. The ICF's operational needs are currently being met exclusively through CySEC, at a nominal cost. Due to the lack of resources for the ICF's expenses, the said cost is covered via the profit accrued by investing the contributions of the ICF's members. The predefined and authorised investment policy of the ICF, was stipulated in Directive DI 144-2007-15 and it is still part of the New ICF Directive.
- 2.2.5. CySEC resources (including human resources) are currently maximised to finance the ICF's continuous operation. The operational capacity and efficiency of the ICF, currently requires more dedicated specific resources.
- 2.2.6. Further to the above, the ICF must be in a position to cover contingent expenses that may surface, such as the cost incurred for the collecting, recording and assessing the claims of covered investors, in the event that the compensation procedure for a large member (e.g. a member with thousands of investors) is activated.
- 2.2.7. Taking the above into consideration, CySEC has decided to maintain the annual fee to cover the ICF's operational expenses at €700 annually for members who hold eligible funds and clients' financial instruments<sup>1</sup>. CySEC decided to set the fee at €100 annually, for members who do not hold eligible funds and clients' financial instruments, so that these members pay a nominal contribution.
- 2.2.8. In the New ICF Directive, CySEC also added a provision for the contribution of an additional fee to cover operational expenses, where the ICF's liquid assets to cover operational costs are insufficient.
- 2.2.9. The Administrative Committee of the ICF, may decide how to use any surplus (including maintaining a reserve for future needs), and to include the relevant information in the annual budget.

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<sup>1</sup> The term is defined in Annex I of the New ICF Directive.

## 2.3. SUMMARY OF COMMENTS IN RELATION TO QUESTION 3 OF CP (2017-02)

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### Question 3

**Do you agree with the new method of calculating the annual regular contribution?**

**Under CP (2017-02), we proposed a risk based approach in relation to the calculation of the annual regular contribution, taking into account the reliability of the statement of eligible funds and financial instruments, of the clients of the respective member of the ICF (which is the basis upon the fee is calculated) and the timing of the payment.**

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- 2.3.1. Respondents reached no consensus on this issue.
- 2.3.2. Those who disagreed raised, inter alia, the following issues:
- i. Suggested other ways of calculating the annual contribution, which, in their opinion took into account the relevant risks. Among others, there were suggestions for amending the basis of the calculation so that the type of services offered, the capital adequacy of members, and the type of financial instruments traded by members are taken into consideration. Some also proposed the creation of two separate Investors Compensation Funds, with members categorized by the financial instruments they trade.
  - ii. Mentioned that they consider the amount of annual fees to be excessive for the cases where 1) the statement of eligible funds and financial instruments has not been submitted within the intended deadlines or 2) the statement has been submitted but is not accompanied by an external auditor's report, or 3) where the external auditor's report has been submitted but contains qualifications/notes from the auditor. One contributor mentioned that the severity of the auditor's qualifications/notes should be taken into consideration.
  - iii. Mentioned that they cannot comprehend the rationale/usefulness of increasing the annual contribution to 0,005 of the clients' eligible funds and financial instruments, when at the same time there is an 80% reduction to the contribution, when this is settled before the intended deadline, which, in practical terms, re-converts the contribution to 1 per thousand.

- iv. Additionally, they expressed reservations in relation to the timeframe for submission of the statements of eligible funds and financial instruments (31 March), as this is before the auditing of financial statements, which is due on 30 April.

### **CySEC's POSITION**

- 2.3.3. The amendment to the way the annual contribution is calculated was not intended to alter the basis of the calculation to take other specific risks into consideration. These risks, emanating from the type of financial instruments traded by the members of the ICF, are currently under assessment.
- 2.3.4. The aim of the said amendment was to ensure that:
- The audited statements of eligible funds are submitted on time,
  - Where the external auditors identify problems, this would have an immediate and deterrent financial cost, so that members apply the appropriate due diligence in the preparation of the statement of eligible funds and clients financial instruments.
  - All amounts due are paid for on time, on the basis of incentives and disincentives. CIFs are incentivized to pay contributions as soon as possible.
- 2.3.5. If 1) the audited statements of clients' eligible funds and financial instruments are not submitted on time, or 2) the external auditors identify problems, or 3) the amounts due are not paid for on time, the annual contribution should be calculated on a deterrent basis.
- 2.3.6. CySEC has liaised with the Association of Certified Public Accountants of Cyprus ("**ICPAC**"), to ensure that there is uniformity and consistency with regard to the content, the quality and the structure of the auditing reports.
- 2.3.7. ICPAC provided the template reports based on the International Auditing Standard No. 805 (ISA 805), relating to an "*Unmodified Opinion*", a "*Modified Opinion – Except for Opinion*", a "*Modified Opinion - Adverse Opinion*" and a "*Modified Opinion- Disclaimer of Opinion*", which have been incorporated in the text of the New ICF Directive and form part of the regulatory framework. The Materiality Level, as this has been determined by the external auditor for the purposes of the said audit, must be included in the external auditor's report. The respective templates could be found [in the ICF's section on CySEC's website](#).

- 2.3.8. CySEC acknowledges that an audit across the entirety of the customer base bears an increased cost. It is therefore reasonable the members to carry out an audit on a sample basis. However, an opinion for an audit which was conducted on a sample basis, is affected by the materiality level. In view of the fact that the specific audit concerns the clients' eligible funds and financial instruments, which the members are required to safeguard in their entirety by Law, it should be ensured that there are sufficient safeguards in place.
- 2.3.9. Taking the above, as well as the comments received into consideration, CySEC has decided to include a provision in the relevant paragraph of the New ICF Directive, whereby:
- 2.3.10. Members of the ICF are obliged to submit to the ICF:
- The relevant "*Statement of misstatements*" in relation to the eligible funds and financial instruments of a member's clients, which the external auditor notified to that member in accordance with the International Auditing Standards and a briefing, in writing, signed by all members of its (the member's) Board of Directors, which will specify, which of the misstatements identified by the external auditor, have been corrected and which have not been corrected, and the total amount of uncorrected misstatements, and
  - The written confirmation requested and received by the external auditors of the member, in accordance with the International Auditing Standards, pertaining to the consequences of uncorrected misstatements, in relation to the eligible funds and financial instruments of the member's clients, and the summary of uncorrected misstatements, which have been attached to the respective written confirmation, and
  - The statement of eligible funds and financial instruments of covered clients, even in those cases where these are nil, also accompanied by the external auditors report.
- 2.3.11. The annual contribution is calculated as follows:
- Five per thousand (5 o/oo) of the eligible funds and financial instruments of a member's covered clients, with a discount of 80% when all deadlines are met, the external auditors expressed an "*Unmodified Opinion*" and, based on the audit they have conducted, there are no misstatements which have not been corrected.

- Five per thousand (5 o/oo) on eligible funds and financial instruments of a member's covered clients, without any discount, when all deadlines are met, the auditors express an "*Unmodified Opinion*" and, based on the audit they have conducted, there are misstatements which have not been corrected.
- When the audited statements of eligible funds and financial instruments are not submitted on time, accompanied by their external auditor's opinion, or where the auditors express a "*Modified Opinion – Except for Opinion*", or a "*Modified Opinion - Adverse Opinion*" or a "*Modified Opinion - Disclaimer of Opinion*", the annual contribution shall be the amount of one hundred thousand euro (€130.000), or an amount equal to one percent (1%) of eligible funds and financial instruments of the member's covered clients, for the last year, for which an audited statement of eligible funds and financial instruments was submitted, accompanied by an "*Unmodified Opinion*" of the external auditors, whichever amount is the highest.

2.3.12. The payment of the annual contribution, takes also into account the time of submission of relevant statements:

- The statement of eligible funds and financial instruments must be submitted by the 10<sup>th</sup> May each year, allowing for the completion of the audit of the annual financial statements. (Previously 31 March)
- The amount of the annual contribution due shall be notified in writing to the members of the ICF, by no later than 10 June. (Previously 30 April)
- The regular annual contribution shall be paid by 10 August of each year. (Previously 31 March)
- The discount shall be granted when the annual contribution has been paid by July 10 of each year. (Previously 15 May).

## 2.4. SUMMARY OF COMMENTS IN RELATION TO QUESTION 4 OF CP (2017-02)

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### Question 4

**Do you agree with CySEC being able to calculate the extraordinary contribution, per category or sub-category of members?**

**Under CP (2017-02), we proposed enabling CySEC to calculate the extraordinary contribution on a risk basis, by allowing it to calculate such contribution per category or sub-category of members.**

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2.4.1. Respondents reached no consensus on this issue.

2.4.2. Some of the contributors raised, inter alia, the following:

- That they maintain their reservations due to the fact that these categories or subcategories of members are not specified;
- Although the aim of the said provision is understandable, CySEC should seriously consider that such a categorization could potentially be disastrous for a certain category or sub-category of members in an adverse scenario;
- Where the members of the ICF are in compliance with the relevant legal framework, they don't believe that CySEC should place specific members in a category or sub-category, of *prima facie* riskier firms;
- That a formula for calculating the extraordinary contribution should be determined, and that the potential contributions of existing members should be defined;
- That the extraordinary contribution should not be based on eligible funds, but should instead be based on net profits;
- That it is the ICF that should be enabled to make the determination of the extraordinary contribution, and not CySEC;
- That the imposition of an extraordinary contribution could potentially affect the sustainability of members and that CySEC, through exercising its supervisory

role, must ensure that the need for paying an extraordinary contribution will not arise;

- That CySEC's aim, for the payment of the extraordinary contribution on the basis of risks borne by each category or sub-category of members, is better achieved with the creation of two separate funds.

### **CySEC's POSITION**

- 2.4.3. Directive DI 144-2017-15 did not determine the maximum limit of the extraordinary contribution. The maximum limit is expected to be determined at a later stage. Any determination of the extraordinary contribution to inadequate levels may lead to the inability of the ICF to pay the compensation due to investors in an adverse scenario, and therefore it is not deemed appropriate to limit the maximum extraordinary contribution amount at this stage.
- 2.4.4. The said provision aims to enable CySEC to calculate the extraordinary contribution by category or sub-category of members, in order for this to reflect the risk borne by each category or sub-category of members, rather than on a unified basis for all members, while also taking into account the interests and viability of the members of the ICF.
- 2.4.5. The creation of two Investors Compensation Funds would restrict access to funds, thus creating systemic risks for participants in one of the two funds. Therefore such a possibility would need to be thoroughly studied prior to a suggestion/implementation to that end.
- 2.4.6. Shifting the competence to impose and calculate the extraordinary contribution to the ICF, requires the availability of resources to meet operational needs, as well as to cover the cost for employing competent personnel by the ICF. Since at present the ICF has no accumulated resources for such a purpose, and operates exclusively with the services provided by CySEC, it is premature to consider such a possibility at this stage.
- 2.4.7. On the basis of the above, CySEC has decided to maintain the provision existed in the Draft Directive, which will allow it to calculate the extraordinary contribution by category or sub-category of members.
- 2.4.8. Furthermore, in order to ensure that there will be a minimum limit of liquidity for immediate payment, when the need for imposing an extraordinary contribution arises, CySEC has decided to add a provision, pursuant to which members are

required to keep a minimum cash buffer of 3 per thousand of the eligible funds and financial instruments of their clients as at the previous year, in a separate bank account, especially for the case that the need for an extraordinary contribution arises. Members are further obliged to submit [a standardised confirmation](#) signed by their internal auditor (or in the absence of an internal audit function due to legislative provisions, signed by their compliance officer), that attests to the fulfillment of the above obligation. This confirmation will be submitted for the first time in 2020. It is provided that the above is a minimum limit of special purpose liquidity, and not a limit of extraordinary contribution. The extraordinary contribution may surpass the above minimum limit, and members will be obliged to pay it.



## 2.5. SUMMARY OF COMMENTS IN RELATION TO QUESTION 5 OF CP (2017-02)

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### Question 5

**Do you agree with the exercise of discretion for the provision of reduced coverage to investors?**

Under CP (2017-02), we proposed exercising the discretion provided for in the European Directive 97/9/EC, pursuant to which the investors' compensation may be set to the minimum between €20.000 and 90% of the covered investor's claim.

The Recitals to Directive 97/9/EC provide the following rationale for this: *"Whereas in order to encourage investors to take due care in their choice of investment firms it is reasonable to allow Member States to require investors to bear a proportion of any loss; whereas, however, an investor must be covered for at least 90 % of any loss as long as the compensation paid is less than the Community minimum"*.

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2.5.1. The majority of contributors agreed (or did not disagree) with the exercise of the discretion for the provision of reduced coverage to investors.

2.5.2. Some contributors raised the following issues:

- That they understood that the maximum amount covered is reduced to €18.000 instead of €20.000.
- That, if it is decided to exercise this discretion, the list of exemptions of the Second Annex of the European Directive 97/9/EC must be included.

### **CySEC's POSITION**

2.5.3. With regard to the understanding of one contributor that the maximum limit of coverage is reduced to €18.000 instead of €20.000, it is noted that the maximum amount of cover will be, either the 90% of the cumulative covered claims of the covered investor, or the amount of €20.000, whichever is lower. Therefore coverage = Min (90% X claimed amount, €20.000). This means that, if the claim is for €50.000, the coverage will be €20.000, due to the fact that 90% of this claim, equals to €45.000. However, if the claim is for €10.000, the coverage will be €9.000 (Min (€10.000 X 90%, €20.000) = €9.000).

- 2.5.4. In relation to two contributors maintaining that if the said discretion is exercised, the list of exemptions of the Second Annex of the European Directive 97/9/EC must be included, it is noted that the Second Annex of Directive 97/9/EC, contains guidelines for voluntary participation of a branch of a Member State company in a host Member State Compensation Fund, and does not concern the reduced coverage of investors.
- 2.5.5. It seems that the said contributors meant to reference to the First Annex of the European Directive 97/9/EC, and referenced to the Second Annex inadvertently. However, the First Annex concerns a different discretion, specifically that of paragraph 2 of Article 4 of the European Directive 97/9/EC, and not the discretion mentioned herein, which derives from paragraph 4 of Article 4 of the European Directive. The discretion of paragraph 4 of Article 4, is not connected to the non-coverage or reduced coverage **of certain groups of investors**, as set out in paragraph 2 of Article 4.
- 2.5.6. The discretion of paragraph 2 of Article 4 of the European Directive 97/9/EC, has been exercised in Paragraph 24(1)(b) of the New ICF Directive, whereby the existence of a valid request from a covered customer is a condition for the payment of compensation, in conjunction with the definition of “*non-covered client*”.
- 2.5.7. The discretion of paragraph 4 of Article 4 of the European Directive 97/9/EC, refers to reduced coverage, in relation to the remaining customers, i.e. those not included in the First Annex of the European Directive 97/9/EC.
- 2.5.8. CySEC has decided to maintain the said provision of the New ICF Directive, with which the discretion of paragraph 4 of Article 4 of the European Directive 97/9/EC is exercised, for the provision of reduced coverage to investors.
- 2.5.9. CySEC clarifies that exercising the said discretion does not affect the definition of “*Eligible Funds and Financial Instruments of member’s clients*”, which will continue to be calculated as per Annex 1 of the New ICF Directive. The regular annual and extraordinary contributions will continue to be calculated on that basis as well.

## 2.6. SUMMARY OF COMMENTS IN RELATION TO QUESTION 6 OF CP (2017-02)

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### Question 6

**Do you agree with the exercise of discretion for the payment of compensation equal to the maximum coverage limit by the ICF to each co-beneficiary in the cases of a joint investment business?**

**Under CP (2017-02), we proposed exercising the discretion provided for in Directive 97/9/EC, pursuant to which the co-beneficiaries, in the case of joint investment business (as defined in Directive 97/9/EC and in the New ICF Directive), may be entitled to compensation, equal to the maximum coverage limit**

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- 2.6.1. The majority of contributors agreed (or did not disagree) with exercising the discretion for the payment of compensation equal to the maximum coverage limit by the ICF, to each co-beneficiary in the cases of a joint investment business.
- 2.6.2. Of those disagreeing, some argued that such an action will increase the eligible funds and financial instruments of investors (and hence the amount of the contributions they will pay), and that it will encourage the creation of joint accounts.

### **CySEC's POSITION**

- 2.6.3. The legal framework via which the provisions of the European Directive 97/9/EC were adopted at a national level, provided for the same treatment in cases where two or more natural persons have a claim, arising from joint investment business, on which such natural persons have rights, in the context of any relationship that may exist between those persons.
- 2.6.4. Therefore, the national legal framework that was in force provided for the payment of total compensation of a maximum of €20.000, for claims arising from joint investment business, irrespective of the relationship between the natural persons who have rights over the joint investment business.
- 2.6.5. However, at a stage following the publication of CP (2017-02), a disagreement arose between the ICF and two investors who had rights over joint investment activities (i.e. they were holders of a joint investment account), since they claimed compensation of a maximum of €20.000 for each account holder, over the joint

investment business. The said investors submitted a claim/complaint to the European Commission, which stated that the European Directive 97/9/EC only gives a discretion to Member States to cover a maximum of €20.000 for all beneficiaries of joint investment business, as if they were one investor, only in those cases set out in Article 8(2) of the European Directive 97/9/EC.

- 2.6.6. Specifically, the third subparagraph of Article 8(2) of European Directive 97/9/EC provides the following:

*“Member States may provide that claims relating to joint investment business to which two or more persons are entitled **as members of a business partnership, association or grouping of a similar nature which has no legal personality** may, for the purpose of calculating the limits provided for in Article 4 (1), (3) and (4), be aggregated and treated as if arising from an investment made by a single investor.”* (emphasis added).

- 2.6.7. It is noted that the coverage of claims in relation to joint investment business, has arisen since the creation of the ICF, and a decision on the basis of national legislation was issued and communicated to the said holders, i.e. that they would receive compensation of €20.000 jointly. However, it was later established that the approach was not in line with the provisions of Article 8 of European Directive 97/9/EC. The ICF therefore compensated the said persons on the basis of Article 8 of the European Directive (therefore, in that particular case, 20.000 per joint account holder), not on the basis of national legislation.

- 2.6.8. On the basis of the above, CySEC has amended the way it exercises the discretion of the third subparagraph of Article 8(2) of the European Directive 97/9/EC, in order to explicitly state those cases, in which claims relating to joint investment business, to which two or more persons are entitled **as members of a business partnership, association or grouping of a similar nature which has no legal personality**, may, for the purpose of calculating the limits of compensation, be aggregated and treated as if arising from an investment made by a single investor.

- 2.6.9. Members of the ICF will not be called to make retrospective contributions on the basis of revised statements of eligible funds and financial instruments.

## 2.7. SUMMARY OF COMMENTS IN RELATION TO QUESTION 7 OF CP (2017-02)

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### Question 7

**Do you agree with the non-refund of funds to ICF members?**

Under CP (2017-02), we proposed that the contributions of the members to the ICF, are not returned wholly or partially to the respective member, under any circumstances (under Directive DI 144-2017-15, the contributions were returned to the ICF members under certain circumstances)

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- 2.7.1. The majority of contributors disagreed with the non-refund of funds to ICF members.

### **CySEC's POSITION**

- 2.7.2. Generally, those disagreeing appear to perceive the contributions paid to the ICF as assets of their own, even though they do not have ownership over such funds, since if they are used to cover investors (as this is the purpose of the existence of the ICF), there will be no funds in their account/share to be returned.
- 2.7.3. Secondly, it appears that some members believe those funds should be returned when they are no longer members of the ICF, as they are no longer a contingent liability to the ICF. Such perception would make sense, if companies were called to maintain in their share with the ICF a high amount of eligible funds and clients' financial instruments. The amounts paid in the ICF are, in practice, disproportionate to eligible funds and each member's clients' financial instruments, since the total of funds contributed over time by all members, will be used when there is a need to compensate the covered clients of any member (i.e. not only the clients of the contributing member).
- 2.7.4. Based on the above, CySEC has decided that funds collected prior to the issuance of the New ICF Directive will continue to be kept in the accounts/shares of members, and any unutilized balance will be returned to the respective member after the member renounces its license and subject to the resolution of any pending complaints against the said member, as per the relevant provisions of Directive DI 144-2007-15. However, the funds collected under the New ICF Directive will not be returned. On that basis, the provisions of paragraphs 7 and 62 of the New ICF Directive have been added.

## 2.8. SUMMARY OF COMMENTS IN RELATION TO QUESTION 8 OF CP (2017-02)

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### Question 8

**Do you agree with the non-inclusion of provisions regarding the termination of payment of contributions by ICF members?**

**Under CP (2017-02), we proposed the removal of the provisions of DI 144-2007-15, pursuant to which the members were not obliged to contribute additional funds to the ICF, where their contributions reach certain limits**

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- 2.8.1. Opinions were divergent in relation to this issue, with a slight majority of contributors agreeing, or not disagreeing with the non-inclusion of provisions regarding the termination of payment of contributions by ICF members.

### **CySEC's POSITION**

- 2.8.2. The provisions concerning the termination of payment of fees undermine the ability of the ICF to collect sufficient resources. In particular, while the annual contribution amounts to one per thousand (0,001) of clients' eligible funds and financial instruments, in practice the amounts paid, range between one and three per ten thousand (0,0001 - 0,0003), as a result of the application of the provisions relating to the termination of payment of the annual contribution.
- 2.8.3. In view of the above, CySEC has decided that the New ICF Directive will not include any provisions regarding the termination of payment of contributions. Thus the members of the ICF will continue contributing to the ICF, irrespective of the amount of their cumulative contributions.

## 2.9. SUMMARY OF COMMENTS IN RELATION TO QUESTION 9 OF CP (2017-02)

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### Question 9

**Do you have any disagreement or comment on the remaining provisions of the Draft Proposed Directive?**

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2.9.1. Part of the contributors mentioned:

#### **COMMENT**

2.9.2. Members who don't hold funds or clients' financial instruments should not pay initial contribution.

#### **CySEC's POSITION**

2.9.3. CP (2017-02), explains the rationale of paying initial contributions by the said members or prospective members, as follows:

There are categories of members, that although there is an obligation to participate as ICF members, they pay no contribution due to the nature of the work they carry out (e.g. members that do not hold clients funds or assets). For the smooth operation of the ICF, all members should contribute thereto, limiting however, the contribution of members whose nature of work justifies that such contribution is kept to a minimum.

#### **COMMENT**

2.9.4. CySEC should provide a sample of the auditors' confirmation in relation to eligible funds and financial instruments.

#### **CySEC's POSITION**

2.9.5. CySEC has prepared templates of auditors' opinions, in cooperation with ICPAC, which form part of the applicable regulatory framework.

#### **COMMENT**

2.9.6. It would be better if a confirmation in relation to eligible funds and financial instruments of the member's clients was provided by the Board of Directors or the Compliance Officer or the Internal Auditor, instead of a statement being provided by the External Auditor, since the auditor's opinion bears a cost which will be then transferred to the investors (increase of charges).

### **CySEC's POSITION**

- 2.9.7. In order to preserve an adequate level of independence, it is not possible for the above-mentioned confirmation to be provided by the Board of Directors or the Compliance Officer or the Internal Auditor. It is noted that the provision of a statement from the Internal Auditor, was an obligation already borne by members prior to the issuance of the New ICF Directive. However, the New ICF Directive introduces the specialized type of audit on the basis of the International Audit Standard 805, for all members.

### **COMMENT**

- 2.9.8. Instead of providing for a discount if the contribution is paid within the set timeframe, a penalty should be charged when the said contribution is not paid within the set timeframe.

### **CySEC's POSITION**

- 2.9.9. CySEC considers that the approach taken in the Draft Directive, created the necessary incentives and disincentives for the timely payment of contributions. Therefore, it decided to maintain the relevant provisions as per the Draft Directive.

### **COMMENT**

- 2.9.10. The ICF should not be granted full access to personal data, since there are members in its Administrative Committee for which conflicts of interest arise.

### **CySEC's POSITION**

- 2.9.11. The relevant provisions already existed in Directive DI 144-2007-15. Therefore this is not a novel approach. Taking into consideration the fact that, market participants are members of the ICF's Administrative Committee, which may give rise to the risk of conflicts of interests, as well as the need for the ICF to access the necessary information, CySEC has noted the concerns expressed and solutions are currently under consideration.

### **COMMENT**

- 2.9.12. Members who don't hold clients' funds or financial instruments should not pay the annual contribution to cover administrative expenses.

### **CySEC's POSITION**

- 2.9.13. CP (2017-02), explains the rationale of paying annual contribution to cover administrative expenses as follows:



*The ICF needs to keep separate funds to cover administrative and/or other expenses incurred in the context of its operation so as not to affect the amount of the funds available for providing compensation to covered investors. This need is corroborated by the numerical increase of ICF members, which unavoidably leads to increased operational needs of the ICF.*

- 2.9.14. On the basis of the above, CySEC decided to set the annual contribution to cover administrative expenses at a lower amount, for those members of the ICF who do not hold client funds or financial instruments. Specifically, the said members will be required to pay an annual contribution to cover administrative expenses of €100 per annum.

#### **COMMENT**

- 2.9.15. It should be made apparent/clearer that the extraordinary contribution is paid only by members who hold funds and clients' financial instruments.

#### **CySEC's POSITION**

- 2.9.16. This is provided for in paragraph 11(2)(a) of the New ICF Directive (the same provision was included in the Draft Directive), in accordance with which, CySEC may set the amount of the extraordinary contribution as an amount to be paid by the members of the ICF, and set the maximum percentage to be paid by each member of the ICF, in relation to eligible funds and financial instruments of covered clients, for the immediately preceding year.

#### **COMMENT**

- 2.9.17. The section that provides that, while calculating the amount of extraordinary contribution and the deadline for payment, CySEC takes into consideration the interests and viability of ICF members is too general and a maximum amount needs to be set.

#### **CySEC's POSITION**

- 2.9.18. At present, the legal framework does not determine the maximum limit of the extraordinary contribution (as per the definition in the Directive). The maximum limit is expected to be determined at a later stage. Any determination of the extraordinary contribution to low levels may lead to the inability of the ICF to pay the indemnities due to investors in any adverse scenario, and therefore it is not deemed appropriate to limit the maximum extraordinary contribution amount at this stage.

#### **COMMENT**

- 2.9.19. It should be obligatory for the ICF to have an insurance policy and the premium should be covered by the ICF, and not be charged, in whole or in part, to ICF members.

### **CySEC's POSITION**

- 2.9.20. ICF funds are collected in order to be used to compensate investors (as defined in the Directive). The use of any part of this amount for the conclusion of an insurance policy, should be made on the basis of serious consideration of the options, the cover provided and the premium required.

### **COMMENT**

- 2.9.21. CySEC should make Company Liability and Indemnity Insurance obligatory, in relation to funds and clients' financial instruments, by setting minimum requirements and by assigning the performance of a special audit in relation to the compliance with those requirements set out by CySEC, to the Internal Audit function.

### **CySEC's POSITION**

- 2.9.22. CySEC has noted this suggestion and may examine it in the future.

### **COMMENT**

- 2.9.23. CySEC should provide predetermined material (sample documents), which will be given out to clients in relation to the ICF.

### **CySEC's POSITION**

- 2.9.24. The relevant Paragraph of the New ICF Directive, determines the information which the members must address to their clients. The creation of content which is in line with the provisions of the legislation, is an obligation that lies with the members.

### **COMMENT**

- 2.9.25. The remuneration of members of the ICF Administrative Committee should be set out.

### **CySEC's POSITION**

- 2.9.26. Members representing a public body or a public-sector body will not be remunerated.

### **COMMENT**

- 2.9.27. At least 70% of ICF funds, should be utilized toward the purchase of an insurance policy.

### **CySEC's POSITION**

- 2.9.28. ICF funds, are collected in order to be used to compensate investors. The use of any part of this amount for the conclusion of an insurance policy should be made on the basis of serious consideration of the options, the cover provided and the premium required. Therefore such a provision for the use of 70% of the funds toward the purchase of an insurance policy, cannot be implemented.

### **COMMENT**

- 2.9.29. The Paragraph setting out that 10% of ICF funds may be invested in shares or UCITS units should be deleted, and the ICF should be allowed to invest in bonds and deposit its funds into bank accounts.

### **CySEC's POSITION**

- 2.9.30. Despite the fact that, in practice, ICF funds are predominantly in bank accounts, CySEC agrees that the provision setting out that 10% of ICF funds may be invested in shares or UCITS units should be deleted, thus the New ICF Directive does not include the said provision.

### **COMMENT**

- 2.9.31. The legislative framework creates confusion because, although CySEC states that the members who do not hold funds or clients' financial instruments are exempted from participation, a member may provide the investment service of "*portfolio management*" and not act as a custodian.

### **CySEC's POSITION**

- 2.9.32. Members who do not hold funds or clients' financial instruments are not exempted from participation, but they are simply not called upon to pay annual or extraordinary contribution. Those contributions are calculated on the basis of eligible funds and clients' financial instruments.

### **COMMENT**

- 2.9.33. Enough time should be granted for the application of the New ICF Directive, so that members are in a position to deal with any issues that may arise as of the date the new Directive comes into force.

### **CySEC's POSITION**

- 2.9.34. The new ICF Directive coming into force will affect members' contributions for 2018, which will need to be paid in 2019.

#### **COMMENT**

2.9.35. The member's size should be taken into consideration.

#### **CySEC's POSITION**

2.9.36. The member's size is already taken into consideration, since it is reasonably expected that a larger company will have higher amount of eligible funds and financial instruments than a small company.

#### **COMMENT**

2.9.37. The arrangements result in an increase in operating costs that will be more burdensome for small companies.

#### **CySEC's POSITION**

2.9.38. The arrangements result in an increase in operating costs to all the members, however they are necessary for the orderly operation of the ICF. Larger companies will pay larger contributions, helping to proportionately allocate the cost-burden.

#### **COMMENT**

2.9.39. Two separate funds should be created, on the basis of financial instruments traded.

#### **CySEC's POSITION**

2.9.40. Whether the creation of two ICFs, involving specific categories of members is appropriate and/or feasible has yet to be determined.

#### **COMMENT**

2.9.41. The way in which the annual contribution is calculated should be amended.

#### **CySEC's POSITION**

2.9.42. CySEC draws your attention to its previous comment.

#### **COMMENT**

2.9.43. The ICF should act in a transparent manner, and should provide information on: the total amount of eligible funds and financial instruments of all member's clients; the ten members with the highest eligible funds and clients' financial instruments; and the cash held by the ICF at any given time.

### **CySEC's POSITION**

- 2.9.44. CySEC remains committed to providing adequate transparency to investors and CIFs in order for the appropriate conduct of business to be upheld. This information is communicated to the Central Bank of Cyprus, which is the Macroprudential Supervisor and the Resolution Authority of the Republic.

### **COMMENT**

- 2.9.45. The ICF should operate independently of CySEC.

### **CySEC's POSITION**

- 2.9.46. The ICF has several independent operational functions, including the ability to conclude employment contracts or provision of services contracts. Further responsibilities have also been transferred to the ICF Administrative Committee.

## **3. IMPORTANT ADDITION**

- 3.1. The New ICF Directive includes provisions to enable the transfer of unclaimed client funds (as these defined in the New ICF Directive), to the ICF, subject to strict conditions. The ICF members opting for such transfer should follow the procedure provided for in the New ICF Directive.