

## **Appendix D: Compensation arrangements in other countries**

D.1 A number of other countries have compensation arrangements to provide some protection for consumers who suffer losses as a result of their dealings with providers of financial services. Most of these arrangements are limited to the provision of compensation to investors in securities, derivatives or futures markets who suffer losses due to the insolvency of intermediaries holding funds or securities on their behalf.

D.2 Arrangements of this kind are required in the European Union (EU) and are found also in the United States (the Securities Investor Protection Corporation) and Canada (the Investor Protection Fund). The rationale for these schemes appears to be to enhance trust, confidence and integrity in intermediary firms that hold funds on behalf of clients. They apply to losses arising from failures in undertaking financial transactions through a financial services provider rather than losses arising from financial advice. These regimes more closely resemble the market compensation regimes under Part 7.5 (including the National Guarantee Fund) rather than the compensation arrangements for licensees under Part 7.6 of the Corporations Act.

D.3 Within the EU, the investment compensation scheme directive requires member states to establish compensation schemes in relation to authorised investment firms supplying investment services.<sup>1</sup> The measures aim to protect investors against the risk of losses should an investment firm be unable to repay money or return financial instruments held on a client's behalf. The schemes protect investors' assets against the risk of fraudulent misappropriation, as well as administrative malpractice or operational errors. They do not protect consumers for losses arising from inappropriate investment advice.

D.4 The directive establishes principles, provisions and definitions but member states can implement the Directive to suit their domestic situations (including going beyond recommended standards). In practice, the schemes operating in member states vary considerably.

D.5 In July 2010, the European Parliament increased the level of compensation for investors under the directive from €20,000 to €50,000, and extended the scheme to protect them from fraudulent misappropriations where their assets are held by a third party.

D.6 The investment compensation scheme directive was modelled on the deposit guarantee schemes directive which sets minimum rules to compensate savers affected by the failure of a bank or credit institution.<sup>2</sup> Under this directive the deposit guarantee scheme provides a safety net for bank depositors, both individual and business, up to a cap of €100,000. The EU is reviewing the funding arrangements for the scheme and exploring contributions by banks on a pre and post funded basis, but

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1 Directive 97/9/EC: The Investment Compensation Scheme Directive.

2 Directive 94/19/EC.

based on the risk posed by individual banks, borrowings from other member state schemes, and contingencies.

D.7 The EU is consulting on the possibility of setting up Insurance Guarantee Schemes in all Member States.

D.8 In the United Kingdom, on the other hand, there is a single comprehensive compensation scheme that covers the activities of all financial service providers and is not limited to client losses of money or financial instruments held by an investment firm on a client's behalf.

D.9 The scheme includes a fund of last resort (the Financial Services Compensation Scheme (FSCS)) which pays compensation in specific circumstances if an investment firm is unable to meet a claim by a client.

D.10 The compensation arrangements in the EU, the United States, Canada and the United Kingdom all have the following features in common:

- a claim can only be made on the fund where the financial services provider is unable to meet a claim (for some schemes the provider has to be insolvent);
- a capping of the compensation payout;
- the funding of compensation from industry levies; and
- operation through a scheme which is independent of the regulator (although some schemes are accountable to the regulator).

There is a high level comparison of the schemes found in other countries in Table D.1.

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**Table D.1: Summary of overseas compensation schemes**

	United Kingdom	European Union	Canada	USA
<b>Scope</b>	<p>Firms offering financial services are required to hold minimum capital, professional indemnity insurance, or a combination of both to meet certain liabilities, including liabilities arising from compensation payments to their clients.</p> <p>In addition a scheme of last resort applies to client losses from services of deposit taking, insurance, home finance, investments, pensions and endowments.</p>	Client losses of money or financial instruments held by an investment firm on their behalf	Client losses of money or financial instruments held by an investment firm on their behalf	Client losses of money or financial instruments held by an investment firm on their behalf
<b>Grounds for claim</b>	Financial services firm unable to pay a client because it has stopped trading, is insolvent or has insufficient assets	Investment firm unable to return client's money or securities	Insolvent investment firm unable to return client's money or securities	Insolvent investment firm unable to return client's money or securities
<b>Applicant</b>	Retail clients and small business	Normally retail clients	All investors	All investors
<b>Compensation</b>	For investments, the maximum compensation is 100 per cent of the first £50,000	Minimum compensation per investor of at least 90 per cent of the first €50,000	Maximum compensation of \$1 million	Maximum compensation of \$500,000
<b>Funding</b>	Industry funding	Industry funding	Industry funding	Industry funding
<b>Governance</b>	Independent scheme accountable to regulator	Independent schemes accountable to regulators	Independent scheme	Independent scheme

