Section 11 affords no defence to issuers for these statements and provides underwriters with established due diligence considerations.

Another negative aspect of the SEC's proposals is its approach to shelf offerings, which typically involve debt securities. By not allowing Form B to be used in shelf offerings, a significant portion of the securities market will be slowed considerably in its offering of such securities as compared with equity offerings using Form B. According to the SEC, approximately 30% of issuers currently eligible to use Form S–3 (and thus able to use a shelf registration) would not be able to use Form B (unless such offerings are made only to qualified institutional buyers, or 'QIBs').

Much criticism has also been directed at the SEC's proposed elimination of *Exxon Capital* transactions. *Exxon Capital* is a line of SEC no-action letters that allows Rule 144A offerings to QIBs to be followed by a registered exchange offer of identical securities. Domestic issuers typically use *Exxon Capital* for high-yield debt securities. Foreign issuers use *Exxon Capital* in cases of an initial public offering made outside the US followed by a registered exchange offer to US QIBs. By eliminating *Exxon Capital* (and therefore free marketability), issuers would be forced to register the initial offering. This would incur a greater cost for raising capital, especially for Form A issuers who must seek other forms of financing while waiting for SEC review of their filing.

The SEC requested that comments on its proposals be submitted by 5 April 1999. Interestingly, the SEC stated that its proposals were presented on a more tentative basis than in a typical release. Given that substantial public comment will be offered to the SEC in order to redress some of the problematic reforms mentioned above, it is likely that some of these proposals will be modified, perhaps dramatically. In any event, the proposals will not be implemented until after 31 March 2000, in order to decrease the possibility of Year 2000 problems.

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Ireland

New protection and its limits under the *Investor Compensation Act* 1998

by Blanaid Clarke

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As a result of the recent collapse of MMI, a Dublin stockbroking firm with estimated debts of £14m, the issue of investor compensation has become a particularly pertinent one in Ireland. This is the first collapse of an authorised investment business firm in Ireland since the introduction of the *Investor Compensation Act* 1998 last July. Clients owed money by MMI can, at least, be reassured by the fact that they should not be affected by the provisional liquidation, once it is established that their funds are in order. Prior to the introduction of the *Investor Compensation Act* 1998, a number of financial scandals had occurred, culminating in the collapse of the Taylor Group of investment companies in August 1996, with losses of almost £2.5m to investors. These investors have little chance of recovering their losses. Whilst legislation had been introduced the previous year providing for the authorisation and supervision of investment firms, additional measures were clearly required.

The idea of an EU investor compensation scheme has its genesis in the Investment Services Directive 93/22/EEC ('the ISD') which provided for the mutual recognition of authorisation and of prudential supervision systems, making possible the grant of a single authorisation valid throughout the EU and the application of the principle of home member state supervision. The ISD was implemented into Irish law in relation to stock exchange member firms by the *Stock Exchange Act* 1995 and in relation to other investment business firms, by the *Investment Intermediaries Act* 1995 ('the 1995 Act'). With the advent of a harmonised financial market, it became increasingly important to ensure that each member state should provide an investor compensation scheme guaranteeing a harmonised minimum level to investor protection. The Investor Compensation Schemes Directive 97/9/EC ('the directive') was subsequently introduced requiring member states to ensure that schemes are in place to provide a minimum level of compensation to investors, in the event of the failure of an investment firm in circumstances where the firm proves unable to refund to investors the money or securities belonging to them.

The directive was implemented into Irish law by the *Investor Compensation Act* 1998 ('the Act') which provides for compensation for clients of investment and insurance intermediaries where the firms themselves are unable to return money or investment instruments belonging to clients. Although the directive merely requires schemes to be in place for firms authorised in accordance with the ISD or, alternatively, in accordance with the two banking directives (Directive 77/780/EEC and Directive 89/646/EEC), the scope of the Act is wider as it applies to 'investment firms'. An 'investment firm' for the purposes of the Act is defined as:

(a) an authorised investment business firm, as defined in the 1995 Act;

(b) an authorised stock exchange member firm, as defined in the Stock Exchange Act 1995;

(c) a credit institution licensed in the state or a credit institution authorised under the banking directives to carry on investment services listed in the ISD; or

(d) an insurance intermediary.

Firms or persons who formerly fell into these categories until the revocation of their authorisation are also included.

One reason why the Act is more expansive than the directive is the inclusion of insurance intermediaries within its scope. These were included in the act because the government felt that it would be anomalous to introduce wide-ranging investor compensation arrangements which ignored the insurance sector, particularly when many intermediaries are involved in both insurance and non-insurance investment business. A second reason why the Act is more expansive than the directive is that the definition of an 'investment business firm' in the 1995 Act is broader than the definition in the ISD. The 1995 Act requires the authorisation of a wider group of firms than was strictly required by the ISD. The definition of an 'investment business firm' in the 1995 Act refers to any person (other than a stock exchange member firm) who provides one or more investment business services or investment advice to third parties on a professional basis. The term 'investment business services' refers to a wide range of services specified in the 1995 Act, a range which far exceeds the equivalent term 'investment service' in the ISD. A number of categories of firm are, however, excluded in the 1995 Act from the definition of an 'investment business firm'. For example, credit institutions which provide investment business services or investment advice without exceeding the terms of their authorisations under the two banking directives are excluded. Solicitors are also excluded in certain cases where they provide investment business services or investment advice in an incidental manner only and do not hold themselves out as being investment business firms.

A further category of firm expressly exempted from the requirements of the Act is an authorised investment business firm which is not 'an investment firm' within the meaning of the directive, which has been certified by the Minister for Finance under s. 446(2) of the *Taxes Consolidation Act* 1997 and which does not provide investment services to domestic investors. Section 446(2) allows the minister to give a certificate certifying certain trading operations of a company as 'relevant trading operations' for the purposes of s. 446. To qualify as a relevant trading operation, the operation must be carried out in the Customs House docks area and must contribute to the development of the Irish Financial Services Centre. It must also be within one of a number of specified classes of trading operation which include: the provision of services in relation to foreign currency services to non-residents; the carrying on of certain other specified services (including global money management, insurance, fund management and certain dealing) on behalf of non-residents; the provision of ancillary financial services for non-residents; dealings in commodity futures and options on behalf of non-residents and the development or supply of certain computer software.

The act appoints the Central Bank of Ireland ('the Bank') as the supervisory authority for investor compensation under the Act and the 'competent authority' in the state for the purposes of the directive. The Bank will be advised on compensation issues by the Investor Compensation Company Limited ('the Company') which is responsible for establishing and maintaining a compensation fund or funds to make payments to clients of investment firms. All investment firms, with the exception of certified persons who are entitled to participate in compensation schemes operated by approved professional bodies, must pay such contributions to the company as it specifies. In determining the contribution due from each of the firms, the company is required to ensure that it will be in a position to meet any reasonably foreseeable obligations under the Act and that the fund will have a sufficient balance to meet these obligations.

Where investment firms fail to comply with their obligations, the bank may give a written direction to the investment firm, its directors and managers requiring compliance or temporarily suspending the operation of all or some of its activities. An important effect of a direction is that while such a direction is in force, no winding-up proceedings may be taken and no receiver may be appointed or assets seized without the High Court's prior permission. Failure by an authorised investment business firm or a stock exchange member firm to comply with a direction, may lead to the bank applying to the High Court for an order confirming the direction or, more seriously, an order revoking the firm's authorisation. Where the investment firm is a credit institution, the bank will amend the firm's authorisation prohibiting it from providing the authorised investment services. Finally, where the investment firm is an insurance intermediary, the bank will inform the company and the firm itself of its non-compliance with its obligations under the Act.

A further method of ensuring the protection of investment clients is by imposing additional obligations on product producers. The 1995 Act requires the product producer to ensure that the intermediary to be appointed is a member of an approved representative body or a certified person or otherwise complies with that Act. A written appointment is a prerequisite to the acceptance of orders or the payment of commission. The Act now places an onus on the product producer, before making an appointment, to make reasonable inquires to ensure that any investment firm appointed has not had its authorisation revoked or has not been the subject of complaint to the company for failure to comply with its obligations under the Act. Where the bank has revoked the authorisation of an investment firm or informed the company that an insurance intermediary has failed to comply with its obligations under the Act, the Bank must also inform the relevant product producers from which the firm holds written appointments. The product producers must then cancel the written appointments of the investment firm and may not subsequently accept any orders transmitted by the firm or any moneys belonging to a client. Concerns were expressed that the public was not being adequately informed of the discontinuance of appointments and was continuing to trust its money to firms which had been deemed unsuitable. The Act thus introduces a new provision requiring the intermediary to publish a 'notice of discontinuance' in at least one of the newspapers circulating in the state within 14 days from the time of notification of discontinuance. Where a notice is not published, the product producer itself must ensure publication. The duration of this period has been criticised as excessive, allowing a fraudulent intermediary too much time to defraud. The acceptance of publication as sufficient if the newspaper is 'circulating in the state' has also been criticised. An intermediary could satisfy this requirement by publishing the notice in a provincial newspaper with a very local circulation figure. Yet, clearly, such an advertisement would not serve efficiently to inform all existing or potential investors.

The compensatable loss provided for by the Act is the lesser of 90% of the amount of an investor's net loss or 20,000 ECU, which is the minimum level set by the directive. The decision not to provide more than the minimum required has been the subject of much criticism. The government argued that it was necessary to strike a balance between 'the need to protect those investors who are least well placed to bear losses' on the one hand and, on the other, the principle of caveat emptor and the need to encourage investors to approach their investment decisions carefully. In addition, reliance was placed on the fact that experience in other countries demonstrates that approximately 80% of claims for compensation are for less than £20,000. The act also provides that certain losses will be irrecoverable. These include for example, moneys or investment instruments held by an investment firm of behalf of an excluded investor such as a professional client; moneys or investment instruments arising out of money laundering operations; or money or investment instruments entrusted to the firm at a time when the firm was not an authorised investment firm (unless the client was not aware and could not have been expected to be aware of this fact). In addition, the Act provides that where a claim is made in circumstances where a claim could also be made under the Deposit Guarantee Regulations, in respect of the same monies held by a credit institution, the bank will ensure that only one of the claims will be acceptable.

Investors are entitled to apply for compensation in two defined circumstances. The first is upon the determination of the bank that an investment firm is unable, due to its financial circumstances, to meet its debts and that there is no foreseeable opportunity of it being able to do so. The second is upon the making of ruling by the court which effectively prevent investors from recovering their funds from an intermediary for the time being. An example of such a ruling would be the appointment by the court of a liquidator to an investment firm. In these two circumstances, clients of the relevant investment firm must be notified and applications for payment invited within a specified time. Once notified by the administrator of the compensatable losses, the company or the approved scheme are obliged to make payments as soon as practicable and at least within three months. In exceptional circumstances, for example in the event of a major default, postponement of payment may be allowed.

The Act also provides for the subrogation of certain of the investors' rights. Where clients have been paid, the company or approved scheme will be subrogated to the rights of those clients in liquidation proceedings against the investment firm for the amount equal to their payments to the clients. The company or approved scheme will also be subrogated to the rights of those investors in respect of payments made under a bond held by the firm and any payments made under a professional indemnity policy. This means that if any money remains in the investment firm after a client has been compensated, the client will not be entitled to any of that money until the company or approved scheme has recovered what it paid out in compensation. At this stage, the client will be entitled to claim the balance due.

In keeping with the directive, the Act anticipates both 'home country control' and supplemental cover. In order to avoid the level or scope of coverage provided becoming an instrument of competition, until 31 December 1999, where the compensatable loss arises from the provision of investment business services by an authorised investment business firm in another member state, the level of coverage provided will not exceed the maximum level or scope offered by the corresponding scheme in the host member state. The possibility also exists that the level or scope of coverage offered in the home member state may be lower than that offered in the host member state. As a result, branches may choose to join their host country's schemes in order to supplement their cover. Where an Irish investment firm has established a branch in another member state and has joined a compensation scheme within that country, but fails to comply with the obligations imposed on it as a result of its membership of the other member state's scheme, the Act requires that the bank be notified and take all appropriate measures to ensure compliance. Where investment firms authorised in other member states have branches in the state, the act provides that they may join Irish compensation schemes but that they must meet the relevant membership obligations, including the payment of all contributions and other charges.

CONCLUSION

It seems apparent that, despite the existence of legislation providing for the authorisation and supervision of investment firms, it is simply not possible to avoid the failure of investment firms and the ensuing loss to investors. Such failure may be attributable to a myriad of factors including, for example, defaulting creditors, poor investments, economic recession or fraud. In order to maintain confidence in the market, it is imperative that some form of investor compensation be provided and the *Investor Compensation Act* 1998 serves this function. It must be emphasised, however, that the Act will not compensate investors who make unwise investment choices. In this regard, investors must be prepared to accept responsibility for their own investment strategies.

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