European Parliament: study on alternatives to investor compensation schemes and their impact

The European Parliament has published a study on alternatives to investor compensation schemes (ICS) and their impact.

The study deals with the question whether private insurance undertakings could fully or partially take over the risks from existing ICS. With full replacement, all damage caused to investors by four events (fraud, administrative malpractice, operational error and bad advice) would be taken over. With partial replacement, the insurance undertaking would only pay for damages up to a specific level (cap) or only related to a subset of these four risk events.

The main findings of the study are as follows:

- The introduction of the four events by the European Parliament into the directive adds an additional layer of complexity to the question whether ICS (or insurance undertakings) should compensate (or offer coverage) in a specific case. More clarity is necessary on the exact meaning of those events and on the allocation of the burden of proof. Without such clarity, private insurance supply is unlikely.
- Partial replacement of the ICS does not seem to be a viable option because it might impair the incentives of insurance undertakings, ICSs and investment firms. Moreover, problems in the damage compensation process are likely to be expected. This holds true in part also, if an ICS buys such partial insurance.
- Full (and mandatory) replacement of the ICS may improve risk assessment and risk controlling and the incentives of investment firms, but is likely to increase the costs of investor compensation, especially because insurance undertakings need data for actuarial risk assessments.