

ACT ON SECURITIES AND INVESTMENT SERVICES

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The Act on Securities and Investment Services aims to provide optimum protection for the clients of securities dealers and create the basic legislative conditions for ensuring the stability of the financial system. An important feature for accomplishing the afore-mentioned goal is the establishment of the Investment Guarantee Fund and the possibility for the Financial Market Authority to make use of effective supervisory tools.

GUARANTEE FUND

The purpose of the Investment Guarantee Fund (hereinafter the "Fund") is to make it possible to disburse the claims of clients of a securities dealer who has become incapable of discharging his obligations. The fact that a securities dealer is incapable of discharging his obligations is announced by the Financial Market Authority, in the event that a persistent shortage of liquidity of a securities dealer or the impossibility of removing a temporary lack of his liquidity are proven. The Financial Market Authority may announce this on its own initiative or on the basis of a notification from a securities dealer, where despite the application of his liquid resources, he is unable to perform his obligations vis-à-vis his clients within 48 hours.

From the day on which the client's assets have become unavailable through to the completion of payment of compensation, it is not possible to handle investment instruments and funds constituting the client's unavailable assets. It is also prohibited to assign claims against the securities dealer arising from the client's unavailable assets, as well as to set off any claims that the securities dealer and other persons have against each other. The securities dealer may not perform investment services or conclude other deals whereby the claims or his obligations to other persons would be increased.

The client's assets that are subject to statutory protection in terms of compensations to be paid are formed of funds and investment instruments which the securities dealer has received in order to provide the investment service and which constitute his obligation to the client, including the interest and other proprietary benefits associated with the commission of funds and investment instruments.

With a view towards preventing duplication in paying any compensations for the client's unavailable assets, it is explicitly set out in the Act that the client's assets are not made up of the client's funds received by the securities dealer that are maintained in the accounts protected under Act No. 118/1996 Z.z. on the Protection of Deposits and the Modi-

fication and Amendment of Certain Laws, as amended by subsequent legislation. This concerns cases where the securities dealer is a company holding a banking license.

Nevertheless, the Act sets out other exemptions excluding the funds and investment instruments from the protected client's assets, namely the following:

- a) anonymous assets, i.e., not all the personal data required for identification as stipulated by law is stated in the securities dealer's records;
- b) securities and investment instruments that a securities dealer is able to return to the client without causing harm to other clients (such as securities in the custody of the securities dealer).

Contributions Towards the Fund

The obligation to make contributions towards the Fund and to take part in the protection of clients concerns any securities dealer to whom the Financial Market Authority has granted authorization to perform investment services. Foreign dealers shall not contribute towards the Fund in the event that the client's assets accepted by them are protected or insured in the country of their registered office at least to the extent stipulated by the Securities Act.

The Act lays down three types of contributions that securities dealers must make to the Fund, namely:

- a) a one-off admission fee, the amount of which is set at SKK 5,000, 12,000 and 70,000, depending on the scope of the investment services that the securities dealer may perform under authorization granted by the Financial Market Authority;
- b) an annual fee determined according to the annual sum of fees charged to clients in return for the investment services provided, ranging from 0.1% to 3%; the amount also depends on the scope of the investment services that a securities dealer is authorized to provide;
- c) an extraordinary fee, which in a calendar year may not exceed 3% of the annual amount of fees charged to clients in return for the investment services provided.



Compensation for the Client's Unavailable Assets

An entitlement to compensation for the client's unavailable assets is only held by persons specified by law. These persons include:

- a) a natural person, including a natural person entrepreneur;
- b) a endowment, a non-investment fund, a non-profit organization providing generally beneficial services, a civic association or a condominium;
- c) a legal entity, with the exception of:
 - a bank, an insurance company, a pension fund, a management company, including the assets in a mutual fund, a securities dealer who is not a bank, a central depository, a securities exchange, a commodity exchange, a post office, a legal entity operating a lottery or other similar games, Eximbanka and a legal entity with a line of business similar to the above-mentioned institutions;
 - the state;
 - a legal entity established by virtue of law;
 - a legal entity that must have its statutory financial statements audited.

The rationale behind this exemption is for the Act to protect the client's assets through the payment of compensation in the event of their unavailability only to persons who are not of the nature of "professionals" in the financial market.

A client is entitled to compensation for his unavailable assets up to the maximum amount of 20 times the average monthly wage in the national economy. Three years after the accession of the Slovak Republic to the European Union, the maximum limit will, however, increase to EUR 20,000. A client may obtain no more than 90% of the value of his assets in the form of compensation for the unavailable assets.

The entitlement to compensation for the client's unavailable assets will not be granted in the event of time-barred investment instruments and deposits or the client's assets with a special relationship to the insolvent entity. Such persons may, for example, include:

- a) members of bodies of a securities dealer and persons closely related thereto;
- b) persons holding control over the securities dealer, as well as persons closely related thereto;
- c) an auditor.

Persons not entitled to compensation for the client's unavailable assets also include those persons who, through their criminal activity, have caused the securities dealer to become insolvent or have acquired the client's assets in connection with the laundering of proceeds from criminal activity for which they have been sentenced under a final judgment.

Factors Determining the Fund's Financial Policy

By law, the Fund has a limited range of sources of income, which consist of the fees paid by securities dealers, re-

turns from the application of funds, loans, and funds obtained upon the exercise of creditors' rights.

The Fund may manage the cash only within the scope specified by law, i.e., it may purchase Slovak government securities with a maturity of one year from the day of purchase, make a loan to a securities dealer under receivership or to the Deposits Protection Fund, repay loans provided thereto and pay the costs necessary to provide for its operation. These limitations imposed on the raising and handling of funds are designed to eliminate the risk from financial operations.

The Fund's Bodies

The Fund has three bodies, namely, the Fund's Board, the Presidium and the Supervisory Board. The supreme body of the Fund is the Fund's Board, which makes decisions on matters of strategic importance, such as:

- a) appoint and dismiss of the Presidium and the Supervisory Board;
- b) approving the general conditions for payment of compensations for a client's unavailable assets;
- c) approving the rules of procedure of the Board and the Presidium;
- d) approving the principles for remuneration of the Fund's employees;
- e) approving a loan to be made to a securities dealer in receivership;
- f) approving the annual report, annual statutory financial statements and the application of the Fund's resources;
- g) determining the level of annual fees and their due dates;
- h) disbursing compensation for a client's unavailable assets.

The Fund's Presidium is a statutory body which acts on behalf of the Fund. It is composed of three members who are the Fund's employees. The Supervisory Board is the Fund's auditing authority which oversees its financial management and activities

SUPERVISION

The Act specifies the scope of persons over whom the supervision is to be performed. They include securities dealers, investment services brokers, the central depository, issuers, persons making a public offer of securities, persons making a public offer of assets, and persons proposing take over bid, as well as the Fund. The supervision is also to be performed over the activities of other persons that are related to the activities and management of securities dealers or the central depository. The supervision over the activities of securities dealers and the central depository is performed not only on an individual, but also on a consolidated basis. Compliance with the law and the conditions set out in the authorization from the Financial Market Authority is subject to supervision.

There are a number of measures available to the Financial Market Authority, which it may enforce against persons subject to its supervision. The most important ones include

an obligation on the part of a securities dealer to present a so-called reorganization plan, the possibility of imposing a receivership upon a securities dealer and the revocation of an authorization.

Measures to Revitalize a Securities Dealer

The Financial Market Authority must prompt a securities dealer to take reorganization measures where the adequacy of his own funds falls below 8%. In such a case the Board of Directors of the securities dealer will be obligated to submit to the Financial Market Authority a reorganization program within 30 days of ascertaining the situation. The reorganization program must be approved by the Board of Directors and the Supervisory Board of the securities dealer. The Financial Market Authority will approve or reject this program within 10 days. The basic requisites of this program include:

- a plan for further capitalization;
- a plan containing projections with regard to the securities dealer's financial situation.

In addition to the presentation of a reorganization program, the measures to revitalize the securities dealer also consist of restriction or suspension of the payment of dividends, royalties and other fees to shareholders and members of the securities dealer's bodies, but also restriction or suspension of any increases in wages of the body members and employees of the securities dealer, as well as the introduction of the daily monitoring of the development of the financial situation and the restriction or suspension of the expansion of new business.

Receivership Over the Operation of a Securities Dealer

The Financial Market Authority is obligated to enforce a receivership over a securities dealer if the adequacy of his own resources has dropped below 4%.

The purpose of receivership is notably to remove substantial shortcomings in the management and activities of the securities dealer with the aim of stopping his financial situation from deteriorating, and to protect investment instruments held by the securities dealer, but also to adopt a reorganization program or perform acts directed at granting a bankruptcy petition or commencement of liquidation.

The receivership is performed by a receiver appointed by the Financial Market Authority which will conclude a contract with him setting out the receiver's powers. Within 30 days of introducing a receivership, the receiver must submit to the Financial Market Authority a project for reorganization of the securities dealer or a proposal for how to redress the situation. Subject to the consent of the Financial Market Authority, the receiver may suspend the handling of financial instruments, but for a period no longer than 30 days. If the general meeting agrees, the receiver may file a petition for composition. If a securities dealer is overdue, the receiver will file a bankruptcy petition automatically.

Revocation of Authorization to Provide Investment Services from a Securities Dealer

If the adequacy of a securities dealer's own funds falls below the threshold of 2%, the Financial Market Authority will be obligated to revoke the authorization to provide investment services from this securities dealer. The same will apply where a securities dealer's own funds fall below the minimum level of the registered capital set by law, but also where, within 6 months of granting authorization to provide investment services, the securities dealer has not commenced his operations or where he has obtained the authorization on the basis of false information, but also where he has been proclaimed by the Financial Market Authority to be incapable of performing his obligations to clients.

The Financial Market Authority may revoke the authorization to provide investment services from the securities dealer providing that he does not meet conditions based on which the authorization was granted to him, but also where the securities dealer does not comply with the rules of operation vis-à-vis his clients or where he does not meet his obligations vis-à-vis the Fund, or if he has changed his registered office without prior consent from the Financial Market Authority.

From the time of delivering the Financial Market Authority's decision concerning the revocation of his authorization to provide investment services, the securities dealer is not allowed to provide investment services except for those needed to settle any claims and obligations as a whole.

CONCLUSION

The Act on Securities and Investment Services aspires to create such a legislative environment that would eliminate negative phenomena in the activities of persons subject to supervision. The Act contains a number of instruments that make it possible to accomplish this ambition, starting from stringent requirements to obtain authorization to provide investment services, through demanding requirements with regard to the performance of activities by securities dealers, to the Financial Market Authority's empowerment to choose the most effective measures to reduce the risk of serious problems in the capital market.

It will, however, not be possible to accomplish the ambitions of this Act without the market players and their self-regulatory organizations, as well as the supervisory authority, that is, the Financial Market Authority, assuming an active role in co-creating an environment in which any breach of law and any instance of unethical business conduct, as well as exposing the clients of financial institutions to risk, is viewed as serious misconduct. The penalization of such an audacious person will consist of his being excluded from the ranks of decent professional financial institutions.