

INVESTOR COMPENSATION FUND

Information Brochure

- Investor Compensation Fund for clients of Cypriot investment firms

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Contents

A.	Scope and Disclaimer.....	2
B.	General.....	2
C.	The Object of the Fund.....	3
D.	Who is entitled to bring a claim?.....	4
E.	Procedure for decision to commence the compensation payment process.....	5
F.	Invitation to submit compensation applications.....	6
G.	Determination of the amount of compensation.....	7
H.	Evaluation of alleged compensation claims.....	7
I.	Determination of the amount of compensation.....	8

A. Scope and Disclaimer

This information leaflet has been written to inform investor-clients of MeritKapital Limited (MK) about the cover and compensation available to them under the Investor Compensation Fund (the 'Fund') which has been established pursuant to the Investment Firms Laws 2002- 2004 and consequent Regulations.¹

In [] 2006 MK became a member of the Fund.

In this leaflet our objective is to outline in summary the provisions of the law relating to the Fund and the compensation payable to clients under this Fund. Although we have taken every care to ensure that to the best of our knowledge we have given a detailed and accurate description of the provisions of the law, MeritKapital can accept no responsibility or liability as a consequence of any inaccuracies or omissions contained in this informative leaflet and we recommend that those of our clients interested further in the Fund refer directly to the laws governing the Fund², copies of which we will be happy to provide upon request.

B. General

The Fund is a private law legal entity, set up with the object of securing the claims of covered clients against members of the Fund through the payment of compensation, which is made subject to the fulfilment of certain preconditions and the existence of a well-founded claim by the client against a member of the Fund.

The Fund is managed, administered and represented by a five-member Administrative Committee which is designated for a term of three years.

MK is a member of the Fund because it provides its clients one of the covered services, namely the management of investment portfolios in accordance with mandates given by investors on a discriminatory, client-by-client basis where such portfolios include one or more of the following financial instruments:

- *Transferable Securities and shares in collective investment undertakings*
- *Money-market instruments*
- *Financial-futures contracts including equivalent cash-settled instruments*
- *Forward interest rate agreements*
- *Interest rate, currency and equity swaps*
- *Options to acquire or dispose of any of the financial instruments described above including equivalent cash-settled instruments. This category includes in particular currency and interest rate swaps.*

¹ Namely, the Establishment and Operation of an Investor Compensation Fund of Clients of CIFs Regulations 2004

² At the time of writing these laws are The Establishment and Operation of an Investor Compensation Fund of Clients of CIFs Regulations 2004 and the Investment Firms Laws 2002 - 2004

C. The Object of the Fund

The object of the Fund is to secure any claims of covered clients (See Section D below) against members of the Fund and the Fund exists to compensate covered clients (See Section D below) for any claims arising from the failure by a member of the Fund to fulfil its obligations regardless of whether that obligation arises from legislation, the client agreement or from wrongdoing on the part of the member of the Fund.

A failure to fulfil its obligations consists of the following:

- 1. A failure to return to a covered client (See Section D below) funds owed to them or funds which belong to them but are held by a member of the Fund, directly or indirectly, in the framework of the provision by the member of the Fund to the client of a covered service³ and which the client has requested that the member of the Fund returns in exercise of their relevant right; or*
- 2. A failure to hand over to a covered client (See Section D below) financial instruments which belong to them and which the member of the Fund holds, manages or keeps on its account, including the case where the member of the Fund is responsible for the administrative management of the said financial instruments.*

The payment of compensation which will be initiated where:

- 1. The member of the Fund is unable to meet client claims provided that this inability is resultant from its financial circumstances which show no realistic prospect of improvement in the near future; or*
- 2. A judicial authority has on reasonable grounds directly related to the financial circumstances of the member issued a ruling with the effect that investors ability to lodge claims against it are suspended.*

A well founded claim by the client against the member must exist.

³ MeritCapital Financial Services Limited provides the covered service of managing of investment portfolios in accordance with mandates given by investors on a discriminatory, client-by-client, basis where such portfolios include one or more financial instruments (as defined in Section B of this brochure).

D. Who is entitled to bring a claim?

All MeritKapital clients are covered by the Fund unless they fall within the following categories⁴:

1. *The following categories of institutional and professional investors*
 - (a) *Investment Firms*
 - (b) *Legal entities associated with MK and, in general, belonging to the same group of companies*
 - (c) *Banks*
 - (d) *Cooperative credit institutions*
 - (e) *Insurance companies*
 - (f) *Collective investment organisations in transferable securities and their management companies*
 - (g) *Social insurance institutions and funds*
 - (h) *Investors characterised by MK as professionals*
2. *States and supranational organisations*
3. *Central, federal, confederate, regional and local administrative authorities*
4. *Enterprises associated with MK Managerial and Administrative staff*
5. *Shareholders of MK whose participation directly or indirectly in the capital of the member of the fund amounts to at least 5% of its share capital, or its partners who are personally liable for the obligations of the member of the Fund, as well as persons responsible for the carrying out of the financial audit of the member of the Fund as provided by the Law, such as qualified auditors*
6. *Investors having in enterprises connected with MK and in general of the group of companies to which MK belongs, positions or duties corresponding to the ones listed in paragraphs 5 and 6 above*
7. *Second-degree relatives and spouses of the persons listed in paragraphs 5, 6 and 7 as well as third parties acting for the account of these persons*
8. *Apart from investors convicted of a criminal offence pursuant to the Prevention and Suppression of Money Laundering Activities Law of 1996 - 2000, investor-clients of MK responsible for facts pertaining to MK that have caused its financial difficulties or have contributed to the worsening of its financial situation or which have profited from these facts*
9. *Investors in the form of a company which due to its size is not allowed to draw a summary balance sheet in accordance with the Companies Law or a corresponding law of a Member State.*

⁴ Note that in cases where paragraphs 5, 6, 7 and 8 listed apply then the Fund will suspend payment of compensation and will inform the interested parties of this accordingly, until it reached a final decision as to whether the case applies.

E. Procedure for decision to commence the compensation payment process

As mentioned above, where it is shown that:

1. *The Cyprus Securities and Exchange Commission (CySec) has determined by Resolution that a member of the Fund is unable to meet client claims provided that this inability is resultant from its financial circumstances which show no realistic prospect of improvement in the near future; or*
2. *A judicial authority has on reasonable grounds directly related to the financial circumstances of the member issued a ruling with the effect that investors ability to lodge claims against it are suspended and that a well-founded claim by a client exists then the compensation payment procedure will be initiated.*

The above pre-conditions will be presumed where:

1. *The member of the Fund submits to CySec a written statement declaring its failure to fulfil its obligations towards its clients*
2. *The member of the Fund files an application for liquidation in accordance with the provisions of Part V of the Companies Law*
3. *CySec has revoked or suspended the member of the Fund's authorisation to provide investment services and ascertains that the member of the Fund is not expected to be in a position to fulfil its obligations toward its clients in the near future for reasons which do not concern a temporary lack of liquidity which can be dealt with immediately*

CySec will decide whether the member of the Fund is unable to meet client claims either ex officio or upon request submitted to it by a covered client (See Section D) of the member of the Fund or other competent supervisory authority and any other person with a legitimate interest.

The member of the Fund may be requested by CySec to set out its views on the decision within a short deadline, which cannot be less than three working days.

CySec is obliged to issue its decision on the commencement of the compensation payment procedure by the Fund within a reasonable timeframe. It will publish the decision in the Official Gazette of the Republic and on its website (www.cysec.gov.cy)

CySec may extend by up to three months the issue of its decision as to whether to commence the compensation payment procedure in the event that there is lack of certainty on whether the failure by the member of the Fund to fulfil its obligations is reversible or not and in particular when such failure is mostly due to a liquidity problem faced by the member of the Fund which can reasonably be expected to be settled.

CySec will reach its decision considering the guarantee of the smooth operation of the capital market and upon weighing the interests of the clients and the member of the Fund.

It is possible for CySec to prohibit a member of the Fund from disposing of specific assets, with the object of securing the interests of the clients and in general its lenders or to take other appropriate measures to attain this objective.

F. Invitation to submit compensation applications

Upon issuing a decision to commence the compensation payment process, CySec will publish, in at least three national newspapers, an invitation to the covered clients to make their claims. In that invitation a procedure for submission of the relevant applications, a deadline for submission and the content will be outlined. The publication should at least contain:

- 1. the name and address of the headquarters of the member of the Fund to whom the covered client compensation process has been activated through the Fund;*
- 2. the deadline for the submission of compensation applications, which cannot be less than five months and greater than nine months from the last publication;*
- 3. the mode and address for submission of applications;*
- 4. the address at which investors may be informed about the exact content of the applications to be submitted, and get the relevant form provided by the Fund.*

CySec, the Cyprus Stock Exchange and any interested members will enter the publication on their website during the entire period for the submission of applications. Failure of these persons to do this shall not result in a nullity of the process, but it will result in the imposition of sanctions.

In exceptional cases the Fund with a notice published in accordance with the publicity conditions outlined above, may extend the deadline for the submission of applications by up to three months.

If a covered client, by no fault of its own, was neither informed about the invitation to submit compensation applications and as a result was not in a position to submit within the deadline in the application then the deadline is interrupted.

Indications that the covered client has an impediment for which he is not responsible (forming a reason for interruption of the deadline for submission of a compensation application) will include:

- 1. proved absence of the covered client abroad for a period which includes at least half of the deadline for the submission of a timely application;*
- 2. illness confirmed by a doctor that forms a serious impediment for the submission of an application for a period which includes at least half of the deadline for the submission of a timely application;*
- 3. the client's stay in a correctional institution for a period which includes at least half of the deadline for the submission of a timely application.*

Where there is a reason to interrupt the deadline, a covered client may not submit a compensation application after eight months of expiry of the deadline.

If a client relies on one of the above reasons for interruption, then he will need to submit a solemn declaration stating the reason for which he was not able to claim compensation at the time, attaching the necessary supporting evidence.

G. Content of the compensation applications

Applications must be made in writing and they must include:

- 1. The name of the claimant.*
- 2. The address, telephone number, fax number and email address of the claimant.*
- 3. The client code that the claimant had for the member of the Fund.*
- 4. Particulars of the covered services agreement between the Fund and the claimant.*
- 5. The type and the amount of the alleged claims of the claimant.*
- 6. The exposition of the particulars from which the alleged claims of the claimant and their amount are derived.*

In the newspaper publications the Fund may ask for further information to be included in the compensation application.

H. Evaluation of alleged compensation claims

The Fund will appoint at least one qualified auditor and at least one lawyer with knowledge on capital market issues, who will evaluate claims submitted to the Fund and recommend either their acceptance in total or in part or their rejection.

These persons will have access to the books of the member of the Fund and they are obliged to exhibit confidentiality against any third party as to the information coming to their knowledge in the exercise of their duties (provided that this obligation is disregarded in order to render possible the exercise of their duties so far as CySec is concerned).

The Administrative Committee will take control where:

- 1. The claimant falls within the category of covered clients.*
- 2. The application was submitted in time.*
- 3. The claimant has not been convicted of a criminal offence pursuant to the Prevention and Suppression of Money Laundering Activities of 1996–2000.*
- 4. The conditions contained in the Law and the Regulations for the valid submission of compensation applications are fulfilled.*

If the above conditions are not fulfilled then the application will be rejected. Applications may also, at the discretion of the Administrative Committee, be rejected for one of the following reasons:

- 1. If the claimant has used fraudulent means to secure payment of compensation by the Fund, particularly if he knowingly submitted false evidence.*
- 2. The damage suffered by the claimant substantially derived from concurrent negligence or offence on its behalf in relation to the damage it suffered and to its underlying cause.*

I. Determination of the amount of compensation

The Administrative Committee will take into consideration the recommendations of the qualified auditor and lawyer on determining the amount of compensation for each covered client claimant.

The Fund may demand at any time from a covered client that he returns the compensation paid if it finds out subsequently that there was in fact a reason to reject the application.

The company's books will be used together with supporting evidence to ascertain the claims of a member and the amount payable will be calculated in accordance with the legal and contractual terms governing the relation of the client with the member of the Fund subject to set-off rules.

The valuation of financial instruments pertaining to compensation payable is based on their value at the day:

- 1. of publication of a court ruling with the effect of suspending the investors ability to lodge claims against the member of the Fund; OR*
- 2. of the day on which the Resolution of CySec is made determining that the member of the Fund is unable to fulfil duties arising from its client claims.*

The calculation of compensation payable will derive from the sum of the total established claims of the covered client arising from all covered services provided, regardless of the number of accounts of which it is a beneficiary, the currency and the place of provision of these services.

If the claim exceeds €20,000 then the claimant is only entitled to receive a maximum of the equivalent of €20,000, converted into Cypriot Pounds.⁵

Upon completing the valuation the Fund will issue minutes listing the clients which are compensation beneficiaries and the amount of compensation each of them is due to receive. This information will be communicated to CySec and to the Member of the Fund within five working days. Each of the listed clients will then be informed within fifteen days from the issue of the minutes.

A claimant will have ten days from the communication of the decision to appeal to CySec, justifying sufficiently its alleged claim. Should the CySec find errors or inaccuracies as to the evaluation carried out by the Fund then it may demand the Fund corrects the payable compensation.

The Fund is obliged to pay each covered client- claimant the compensation due to him by deposit into his bank account within three months from sending the minutes mentioned above to the CySec.

The payment by the Fund entails a subrogation of the Fund to the rights of the compensated covered client against the member of the Fund for an amount equal to the compensation payable to it.

⁵The average exchange rate is used as fixed by the Central Bank on the day of issue of either (i) publication of a court ruling with the effect of suspending the investors ability to lodge claims against the member of the Fund; OR (ii) of the day on which the Resolution of the CySec is made determining that the member of the Fund is unable to fulfil duties arising from its client claims as the case may be.