



# IADI Core Principles

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## Principles 17 & 18: Reimbursing Depositors and Recoveries

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# UK and deposit compensation

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- FSCS came into being on 1 December 2001
- Prior to the financial crisis FSCS's only experience of depositor payout was with small credit unions
- 2001-2008 – 36 credit union failures – cost to FSCS £3.5 million



# UK deposit compensation and the financial crisis

- Bradford and Bingley – September 2008
  - initial cost to FSCS £14billion to cover transfer of accounts
  - cost to HM Treasury £4billion – to cover non FSCS eligible accounts and all eligible balances over £35,000
- Kaupthing Singer and Friedlander – October 2008
  - initial cost to FSCS £2.5billion transfer of accounts
  - cost to HM Treasury £550 million – to cover eligible balances over £50,000
- Heritable Bank Plc – October 2008
  - initial cost to FSCS £500million transfer of accounts
  - cost to HM Treasury £50million – to cover eligible balances over £50,000

# UK deposit compensation and the financial crisis

- Landsbanki 'Icesave' – October 2008
  - cost to FSCS £1.2billion – Payout
  - £2.1billion in respect of coverage of the Iceland's Depositors' and Investors Guarantee Fund – Covered by HM Treasury
  - cost to HM Treasury - £643 million – to cover eligible balances over £50,000
- London Scottish Bank – November 2008
  - cost to FSCS £80million - Payout
  - cost to HM Treasury - £10 million – to cover eligible balances over £50,000

# UK deposit compensation and the financial crisis

- Dunfermline Building Society – March 2009
  - first failure under the new Special Resolution Regime.
  - HM Treasury funded transfer of business. Including deposits at a cost of £1.5billion
  - Costs of resolution to be met from recoveries from the assets and FSCS will contribute on a net basis towards any shortfall
- Verification in progress in respect of FSCS contribution towards transfer of deposits
- Total cost to FSCS of the banking failures £20billion





# Principle 17: Reimbursing Depositors

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‘The deposit insurance system should give depositors prompt access to their insured funds. Therefore, the deposit insurer should be notified or informed sufficiently in advance of the conditions under which a reimbursement may be required and be provided with access to depositor information in advance. Depositors should have a legal right to reimbursement up to the coverage limit and should know when and under what conditions the deposit insurer will start the payment process, the time frame over which payments will take place, whether any advance or interim payments will be made as well as the applicable coverage limits’.





# Principle 17 – supporting guidance

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- Access to the necessary depositor information before the bank is closed:
  - lessens the risk of record manipulation
  - Accelerates ‘audit’ of records
  - shortens the time for completing the reimbursement process
  - helps preserve public confidence
- Deposit insurance system should have the necessary systems and processes to undertake a timely preparatory review of troubled banks



# Principle 17: UK Approach

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**The deposit insurance system should give depositors prompt access to their insured funds:**

Number of options which give depositors immediate access to their funds where payout is not an option:

- Transfer of accounts
- Bridge Bank
- Temporary public ownership

# Principle 17: UK Approach

**The deposit insurance system should give depositors prompt access to their insured funds:**

- EU Deposit Guarantee Schemes Directive – 20 working days from 31 December 2010.
- UK target payout time of 7 days from 31 December 2010
- Deemed claim – no need for depositor to claim
- Single Customer View – banks must be able to provide aggregated credit balance for all eligible FSCS depositors in an electronic format to the FSCS within 72 hours of failure – implementation 31 December 2010
- Liquidity – need the funds to pay depositors – FSCS now has the power to borrow from the National Loans Fund (UK Government) – no limit
- What is the best way to get the funds to the depositor – cheque, pre-paid card, ATM's, electronic transfer. ....



# Principle 17: UK Approach

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- Banking Act 2009 - A bank liquidator has two objectives:
- Objective 1 is to work with the FSCS to ensure that as soon as reasonably practicable each eligible depositor –
  - has the relevant account transferred to another financial institution, or
  - receive payment from (or on behalf of) the FSCS
- Objective 2 is to wind up the affairs of the bank so as to achieve the best results for the bank's creditors as a whole
- Objective 1 takes precedence over Objective 2 but the bank liquidator is obliged to begin working towards both objectives immediately upon appointment

# Principle 17: UK approach

- **The deposit insurer should be notified or informed sufficiently in advance of the conditions under which a reimbursement may be required and be provided with access to depositor information in advance:**
  - Under the Special Resolution regime FSCS will advise the Resolution Authority (the Bank of England) whether payout is a viable option –cannot do this without early access to the failing banks customer records
  - The Financial Services Authority (FSA) may require authorised persons to provide information which may then be made available to the FSCS by the FSA
  - Proposal that FSCS will have direct involvement with the verification of a firms SCV file – on-site visits, sample checking etc

# Principle 17: UK approach

- Depositors should have a legal right to reimbursement up to the coverage limit and should know when and under what conditions the deposit insurer will start the payment process, the time frame over which payments will take place, whether any advance or interim payments will be made as well as the applicable coverage limits:
- Recent policy statement on consumer awareness of the FSCS set out the following objective:
  - to raise general consumer awareness of the FSCS and other arrangements in normal times;
  - for consumers to have information readily available on the compensation arrangements that will enable them to make informed decision (e.g. whether to diversify their deposits)
  - for consumers to have information readily available on the compensation arrangements during more stressed times; and
  - To achieve the above objectives in a proportionate way so consumers are not unnecessarily alarmed.



# Principle 17: Practical points

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- Continuity for deposits may not always be appropriate or possible . If reimbursing depositors DGS need:
  - Advance notice – impossible to deliver payout quickly without time to prepare and access to banks data
  - If the failure is cross-border or a fast-burn and payout is the only option – depositors must be told what is happening and when
  - ‘Aspirational’ timescale – important for depositors to know not all accounts can be paid immediately e.g. trust or client accounts. Important to set clear expectations and tell depositors what is happening



# Principle 18: Recoveries

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‘The deposit insurer should share in proceeds of recoveries from the estate of the failed bank. The management of the assets of the failed bank and the recovery process (by the deposit insurer or other party carrying out this role) should be guided by commercial considerations and their economic merits’.

# Principle 18: Recoveries

## Payout funded by FSCS levypayers

- Subrogation or assignment – depositor transfers their rights to the FSCS
- FSCS often the largest creditor and sits on the Creditors Committee
- Insolvency Practitioner acts as Administrator/Liquidator – to represent all creditors not just depositors – avoids conflict of interest
- ‘Rateable’ recoveries - The depositor receives the compensation payment up to the limit in the usual way. The recovery percentage (i.e. the percentage of assets recovered by the liquidator of the bank) would then be applied to the amount of the depositor’s original deposit over the FSCS limit
- Depositor preference considered by the Tripartite Banking Reform project but rejected – UK insolvency based on ‘pari-passu’ principle
- FSCS takes a ‘commercial’ approach to recoveries in the interests of levypayers





# UK – Special Resolution Regime

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- Special Resolution Regime (SRR) – introduced by the Banking Act 2009 – designed to achieve five high-level objectives:
  - to protect and enhance the stability of the financial systems of the UK
  - to protect and enhance public confidence in the stability of the banking systems of the United Kingdom
  - to protect depositors
  - to protect public funds
  - to avoid interfering with property rights in contravention of a Convention right (within the meaning of the Human Rights Act 1998).





## UK SRR – options available

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- Transfer shares in the bank, or all or part of the bank's business to a new private sector owner
- Publicly controlled bridge bank (to pave the way for a sale to the private sector)
- Take the bank into temporary public ownership
- All of the above are possible alternatives to the bank going 'into default' for the purposes of the FSCS which triggers depositor payout
- Key feature of the SRR that any appropriate costs incurred by the Authorities under the SRR can be recovered from the FSCS – capped at the costs the FSCS would have incurred in paying compensation
- Key point – above options may involve Government funding



# Principle 18: Recoveries – Special Resolution Regime

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- No least cost test in the UK
- FSCS can contribute to the cost of resolution at the outset or at the end of the resolution
- Where public funds have been used for resolution – other merits apart from the position of the deposit insurer may come into the equation
- Commercial considerations whilst influential may rank against other considerations



# Conclusion

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- Core principles in application require planning for failure
- Consideration of other options apart from payout
- Contingency planning and stress-testing vital for the deposit insurer, the market and the consumer - market and consumer confidence and financial stability
- Need access to information
- Need active dialogue with supervisory authority



# Conclusion

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- UK's recent experiences have highlighted the need for change:
  - Banking Act 2009 – resolution authority and new powers for FSCS
  - Changes to FSA rules – SCV, disclosure requirements, limits, removal of co-insurance
- Lessons learned – deposit insurers must learn from each failure and from the experiences of others



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# Thank You

