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REVIEW OF DIRECTIVE 94/19/EC ON DEPOSIT GUARANTEE SCHEMES

Summary of the results of the public consultation in spring/summer 2009

The Commission launched the public consultation on 29 May, which ended on 27 July 2009, although contributions were taken into account until 14 August 2009. In total, 104 contributions were submitted, the majority of which (30) were made by banks (including credit unions and building societies) and bank associations. 27 contributions were received from public entities (including European and international entities such as the Committee of European Banking Supervisors, the European Central Bank, and the International Monetary Fund). 26 other associations (10 out of which were German industry associations) submitted contributions. 9 deposit guarantee schemes and associations replied to the questionnaire, as did 5 consumer associations and 7 citizens.

1. General (Q1)

An overwhelming majority (93%)¹ agreed that **the Directive should be reviewed**. Those who believed that nothing should be changed (almost all from Austria and Germany) claimed that the current system works well, recent changes should first be implemented and depositors should not be confused by too many changes.

2. Level of coverage (Qs 2-5, 23)

A clear majority (50%) was in favour of setting the level at **€100 000**. Only 20% of contributors preferred to maintain coverage at €50 000. They (most of them from Nordic or Central European countries) mainly argued that the costs for banks would not outweigh the rather marginal benefits. About half of the remaining contributors either suggested raising the level to between €50 000 and €100 000 or significantly higher (or even unlimited) coverage.

About 80% felt that **the single level of coverage should be set** to create a level playing field. By contrast, mainly German and Austrian stakeholders wanted to maintain mutual

¹ Where percentages or similar indications are used in this report, they are calculated on the basis of replies to a certain question, not on the basis of the total number of contributions..

and voluntary guarantee schemes in their countries. Some contributors suggested that Member States should be able to increase coverage during a financial crisis if necessary.

A few stakeholders (mainly from the Nordic countries and the UK) found cases of depositors **splitting up deposits**, mostly to avoid being caught out by the coverage limit. However, almost all contributors were against actively encouraging depositors to do so because this was seen as undermining depositor confidence in the banking sector, increasing costs for depositors and DGS, and counterproductive to financial stability.

A large majority believed that banks trading under different names should not receive **coverage per brand** but per bank. Most were afraid that banks would misuse coverage per brand by creating as many brands as possible, leading to confusion and rising costs for depositors and DGS. Instead of coverage per brand, many proposed that depositors be properly informed if a bank trades under different names and consequently, deposits under different brands would be aggregated in the event of failure. Only very few stakeholders (mainly UK building societies) were in favour of coverage per brand.

3. Exemptions from a fixed coverage level (Qs 6-8)

Only half of the respondents replied to the questions on whether certain cases should be **exempt** from a fixed coverage level. Out of those who responded, a slight majority (60%) was against any exemptions because it was perceived as running counter to harmonisation of the coverage level and confusing for depositors. Some also argued that a coverage level of €100 000 would render such exemptions obsolete. Most of those who argued in favour would like to see pensions or proceeds from house sales covered, due to potential hardship for depositors caught out by the limit.

Interest in **temporary high balances** was rather low. A clear majority of respondents (about two thirds) opposed covering this. They argued that covering temporary high balances would be complicated, a source of distortion to competition and would delay payout. Those in favour argued that depositors needed temporary protection for certain inevitable situations (e.g. real estate transactions, pension deposits, etc.) to avoid the risk of having to live off public welfare. Detailed suggestions regarding the possible duration and situation of coverage were mainly made by the UK, which is considering introducing such protection.

Regarding the question as to whether or not **mutual and voluntary guarantee schemes** should be subject to fixed coverage, responses were split. Those in favour of treating such schemes equally to DGS cite distortion to competition. Proponents mainly came from Member States without such schemes. Those against (mainly Austrian and German stakeholders) argued that they played an important role in financial stability, were an important aspect of competitiveness and are based on private law.

4. Scope of products to be covered (Qs 9-11)

About two thirds of respondents were in favour of covering **structured deposits**. They argued that, for the sake of transparency and simplicity, all products with the typical features of deposits should be covered. Opponents to comprehensive coverage cited the market risk incurred by structured deposits that goes beyond the mere risk of bank failure as the only risk normally covered by DGS. Some opponents considered structured deposits as investments that should only be covered by Investor Compensation Schemes

(ICS). The overwhelming majority was in favour of harmonising coverage of structured deposits and many stakeholders requested a clear definition of this.

Regarding the coverage of **debt certificates**, a slight majority was against including them in the scope of deposit protection. Their main arguments were that securities should only be covered by ICS and that they are usually not redeemable before maturity, meaning that - other than for immediately withdrawable current or savings accounts - a run on banks caused by debt certificates would be unlikely. Some contributors suggested covering only registered certificates but not bearer certificates since the existence of a secondary market would render deposit protection unnecessary. Proponents of including certificates into the Directive cited the need for a simple and transparent definition in the interest of depositors and highlighted their role as easily accessible savings products with a certain importance in their country. The overwhelming majority was in favour of harmonising coverage of such products. Some stakeholders requested a clear definition of debt certificates.

About three quarters of respondents were in favour of coverage for **non-EU currencies**. Some argued that in a globalised world, such accounts may be justified where some members of families live abroad or enterprises need them for dealing with non-EU countries. Others highlighted the need for a simple and transparent regime in the interest of depositors. Opponents emphasised the currency risk inherent in the investment features of such deposits, which they feel warrants excluding them from deposit protection.

5. Eligibility of depositors (Qs 12-17)

Nearly all respondents were in favour of a **general harmonisation of eligibility criteria** for depositors and most gave the need for a level playing field as the main reason. However, respondents were split as to whether to include all depositors or to make the existing discretionary exclusions mandatory. Proponents of the former approach cited simplicity and a comprehensive coverage for depositors and underlined that, since complicated assessments of eligibility were not needed, payout would be accelerated. Those in favour of the latter approach stressed that most Member States made use of most exclusions, which means the impact would be negligible. A few respondents wanted to maintain discretion, citing differences between markets in Member States.

Nearly all respondents suggested excluding **financial institutions** since they should be considered professional enough to be able to judge the risk of a bank, and in any case coverage of €100 000 would seem insignificant. Some associations of investment funds felt that they should be covered to avoid distorting competition.

A clear majority was in favour of excluding all kinds of **authorities**. The main arguments were that taxpayers' money should not be covered by privately-financed DGS and authorities should be expected to behave reasonably in a crisis, thus minimising the risk of a bank run. Some suggested covering only local authorities because a coverage of €100 000 would be significant to them.

Among those who responded, a slight majority proposed excluding **depositors with a relationship with the failed bank**, citing their potential liability for failure. Opponents stressed that individual liability should be determined in court and not by a time-consuming assessment at DGS level, that a global exclusion of 'friends and family' would have the effect of a collective punishment regardless of individual responsibility

and thus would be unfair, and that this category of depositors is so small that excluding it would have a negligible impact.

Nearly all respondents were in favour of excluding **anonymous depositors** since such deposits are forbidden under EU money laundering legislation.

The majority suggested maintaining coverage for **small and medium-sized enterprises** (SMEs) and excluding larger enterprises since they deemed €100 000 relevant to smaller companies. Apart from the many contributors who preferred to maintain the current regime, only very few suggestions were made on how to distinguish between the two groups. Some contributors suggested excluding all enterprises to prevent time-consuming eligibility assessments during the payout procedure. A few contributors would like to significantly increase coverage for SMEs while others argued that protection could be extended to all enterprises, since a coverage level of €100 000 would be less relevant to large enterprises.

6. Structure and mandate of DGS (Qs 18-21)

An almost equal number of respondents replied with ‘not at all’, ‘not yet’ and ‘yes’ on whether a **pan-EU DGS** should be introduced. Proponents argued that a pan-EU scheme would be more efficient than the current fragmented framework, would enhance consumer confidence, ensure harmonisation, achieve a single market, remove competitive distortions and save administrative costs. Those principally in favour of a pan-EU DGS but preferring a postponed introduction underlined that, at first, pan-EU banking supervision would have to be established and clear burden-sharing rules set between Member States. These arguments were also raised by opponents, but some anticipated breaches of the principles of subsidiarity and proportionality and were afraid of moral hazard (i.e. weaknesses in the banking supervision of certain Member States would be paid for by banks from other Member States).

A majority of those in favour of introducing a pan-EU scheme preferred a **network of DGS**. A nearly equal number of contributors preferred a **single entity** or a ‘**28th regime**’. Proponents of a single scheme underlined its simplicity and efficiency in comparison with any other solution while those favouring a network or a 28th regime pointed out that it would be easier to introduce and could be a first step towards gradually implementing a single scheme.

In reply to the question of which banks should be encompassed by a pan-EU DGS, the majority suggested extending it to all banks to avoid distorting competition or destabilising national schemes. Among the remaining contributors there was no clear consensus as to whether a pan-EU scheme should be limited to cross-border banks in general or only to large cross-border banks. Opponents to including all banks argued that domestic cases would not have to be dealt with by a pan-EU scheme.

A slight majority was in favour of maintaining DGS as mere **pay boxes** due to the need to avoid interference with other actors in the financial safety net and the risk of depleting DGS funds. The majority of respondents in favour of **extending the mandate** to bank resolution activities preferred to leave this decision at the discretion of Member States, since each Member State has a different set-up of crisis management. However, it was widely acknowledged that all Member States must have bank resolution powers.

7. Depositor information (Q22-25)

Most (about two thirds) of respondents agreed to develop a **template for standardised information** (possibly annexed to the Directive) to ensure that all depositors in the EU get the same or similar information. Those against developing a template at EU level felt that it would not be tailored to specific local financial markets and would be rather costly compared to potential benefits. Some respondents argued that there is a need for both standardisation and flexibility and suggested developing at EU level only a set of minimum information to be communicated to all depositors in Member States, while additional information would be added depending on the specific situation of a local market or the level of financial literacy of depositors in a given Member State.

There are mixed views on **when and how depositors should be informed**. Although most (40%) respondents preferred retaining the current approach, many (30%) were in favour of making reference to information on DGS on account statements and/or requiring depositors to countersign information on DGS before entering into a contractual relationship. Less support (15%) was expressed for making reference to such information in advertisements, especially if mandatory. In general, requests were made to keep information brief and clear and to strike a balance between raising depositor awareness and costs for industry.

Views were rather split regarding **information on a bank failure**. Almost a half of those who responded believed that the current approach is right and the home country DGS - which has all relevant data - should continue to inform depositors when their bank fails. One third of respondents thought that the host country DGS - because of its proximity to local depositors, language factor, etc. - should inform depositors at branches in another Member State. But many respondents from both groups were in favour of bilateral agreements between home and host country DGS (stipulating technical aspects, division of tasks, etc.).

8. Payout delay and modalities (Qs 26-34)

A clear majority of respondents (over 60%) were against **further reducing the payout delay**, but many (almost 30%) were in favour of shortening it to one week (with a few suggesting an even shorter period). Those opposed to reducing the payout delay were generally in favour of retaining the current approach (4-6 weeks from the end of 2010) and argued that it has not been implemented yet and practical experience is needed before deciding whether to shorten it further. They also felt that 4-6 weeks was already ambitious, and a shorter period would be unrealistic and may undermine the credibility of the system. By contrast, proponents of a shorter payout delay argued that it would increase confidence as it is important for depositors to have as fast access to their funds as possible to avoid a run on banks. Proponents argued that a very short payout deadline was feasible and cited the US practice (2-day payout delay), but opponents stated that comparison with the US was not relevant since the FDIC is based on different principles than the EU DGS. Both proponents and opponents agreed that the actual speed of payout depends on DGS access to relevant bank data and data quality.

With regard to some **alternative (or supplementary) solutions** that aim to reduce the payout delay (e.g. **transfer of deposits** to another bank or **emergency payout** (e.g. €10000 within 3 days), respondents were quite equally divided - slightly more in favour of one or both of the above solutions (roughly 50%) than against them (40%). Those in

favour argued that the above solutions would avoid hardship. An emergency payment (suggested as €3000 or €5000) would mean less pressure to further shorten the payout delay. However, opponents indicated that an emergency payout would complicate the payout procedure (both technically and legally), may require as much work as a complete payout (thereby duplicating work and increasing administrative burden and costs). Lastly, some respondents would prefer the so-called ‘Swiss model’ (payout from existing liquidity — requiring priority of depositors in insolvency proceedings).

Regarding **payout modalities**, a clear picture emerged in all aspects. First, a clear majority of respondents (70%) were in favour of calculating the payout delay in **calendar days** to ensure consistency across Member States and enhance consumer understanding. Next, with reference to **the currency of payment**, half of the respondents supported the suggestion that deposits should be paid out in the same currency as they were paid into, regarding this solution as the clearest and simplest. Other solutions - payments in the local currency of the home DGS or leaving it to the discretion of Member States - were supported by fewer respondents (roughly one fifth in each case). Lastly, as regards **interest payment**, a clear majority of respondents (more than 60%) were in favour of paying interest that has not been credited at the time of failure or until insolvency proceedings are opened (as a fair solution), while others (about a quarter) would prefer leaving it to the discretion of Member States.

Practically all respondents supported **simplifying and/or harmonising eligibility criteria**. A large majority supported **‘tagging’ eligible depositors** when an account is opened and regularly updating this information on account statements (only a few were against it). More respondents were in favour of introducing a **de minimis rule** than those against (about 60% to 35% respectively). Those in favour agreed that deposits below €10 would not have to be paid out. It was argued that, on the one hand, the de minimis rule has clear practical benefits but on the other, there is a trade-off with depositor confidence (e.g. for accounts of low-income people and children). Not many respondents expressed a view on **payout under reserve of later reclamation** (with post-payout verification of claims), half of whom was in favour and half against.

Respondents gave clear but rather mixed views on **set-off arrangements**. In general, most (60%) were in favour of discontinuing set-off for the payout of depositors or significantly limiting it (e.g. only to claims that have fallen due or are delinquent). They argued that abandoning set-off would enable faster payout and avoid confusing depositors. They also deemed it unfair that depositors may be left without means for day-to-day living if their liabilities exceed assets at a failed bank. These issues were considered to undermine depositor confidence in the system and increase the risk of a run on banks. However, many contributors (more than 35%) believed that the current approach (unlimited set-off at national discretion) should be retained, mainly due to different insolvency regimes in Member States.

No clear picture emerged on the **application for reimbursement**. Respondents were fairly equally divided between those in favour of DGS payments made only after applications are received from depositors (about 45%) and those in favour of payments by DGS on their own initiative (about 55%). It was argued, on the one hand, that automatism could help speed up payout, but on the other, that it could have a high error rate.

A clear majority of respondents (70%) supported **involving DGS at an early stage**, notably in cases likely to trigger DGS. Some contributors (about a quarter) preferred to

maintain the current approach. As argued by the proponents of early DGS involvement, this is important so that the schemes have all necessary data to start the payout procedure and are ready to take all necessary steps when failure is declared to meet a shorter payout timeframe. A half of respondents agreed that, in order to **improve information exchange between DGS and banks**, DGS should have access to relevant bank records when the schemes are notified by the competent authorities, while others (about a quarter) were against. More respondents were in favour of establishing a common interface between DGS and banks to ensure quick and convenient exchange information, but believed it should be restricted to the minimum necessary and subject to confidentiality provisions. Some felt that this interface may give rise to significant IT costs.

Lastly, regarding the **capability of DGS to handle payout situations effectively**, there was unanimous agreement to keep the current approach, which requires **stress testing**. Most respondents also supported regular **peer reviews** among DGS. Some warned that repeating stress tests every year was time consuming and costly, while the value of information was limited. There was no agreement among contributors on **regular disclosure of key information by DGS** (e.g. the amount of ex-ante funds, their workforce, result of stress tests, etc.). Of those who expressed their views on this issue, slightly more were against, arguing that disclosure may be counterproductive and undermine depositor confidence.

9. Cross-border cooperation (Qs 35-36)

A minority of respondents (about 15%) supported maintaining **topping up** and did not regard it as problematic. Most contributors (about 50%) were against, since it proved to be very complicated, difficult to implement, confusing for depositors, and slowed down the speed of payout. It was also argued that topping up requires long negotiations and detailed agreements between DGS and have proved to be inadequate and undermine depositor confidence. Many respondents (about 35%) indicated that problems related to topping up would be overcome if a fully harmonised coverage level were adopted in the EU. If, however, topping up is retained (e.g. in the absence of a fixed coverage level), it should be mandatory rather than voluntary - but only about 15% of respondents expressed a view on this issue. Even fewer contributors (about 10%) indicated a preference for host or home topping up, more of whom were in favour of the latter.

A large majority of respondents (more than 75%) were in favour of the suggestion that a host country DGS would act as a **single point of contact for depositors at branches** in the host country, while the others were against and/or preferred the home country DGS to contact depositors at branches. Those who supported the above option, however, were split on the role of the host country DGS – some of them believed it should be limited mainly to post-box services and advice in the host country's language, while others would extend it to acting as a paying agent for the home country DGS. Respondents indicated that it would be more convenient for depositors to have a local point of contact and receive information in their language but that the host country DGS has practically no relationship with branches of foreign banks.

10. Financing DGS (Qs 37-39)

A large majority of respondents (about 70%) were in favour of **ex-ante funding** as a basis, some of whom believed should be mandatory. A minority of respondents (less than

15%) were in favour of solely **ex-post funding** (those from Member States with ex-post systems – UK, AT, NL, IT). Proponents of ex-ante funding indicated several advantages of this system: ensuring a level playing field by removing distortion of competition between banks paying and not paying contributions, addressing moral hazard and unfairness stemming from riskier banks de facto subsidised by safer ones, fostering depositor confidence, avoiding pro-cyclicality, and speeding up payout. Opponents argued that ex-ante funding was an inefficient use of financial resources, is not always counter-cyclical, may be very costly for Member States with ex-post systems, and – together with the recent and planned CRD amendments – may lead to higher capital requirements for banks.

There were rather mixed views on a **target level for ex-ante funds**, with many more respondents in favour than against (roughly two thirds to one third). Not many indicated whether a target level should be mandatory or voluntary, but almost all who did preferred to make it mandatory. Proponents of a target level argued that it would remove distortions to competition and increase financial stability and confidence in the financial system. Opponents argued that too much transparency on funding should be avoided as it may undermine depositor confidence.

With reference to the suggestion that a target level could be set as a certain percentage of deposits, some respondents stated that a target range may be more appropriate than a precisely specified funding level (e.g. 5% of insured deposits). Only a few suggestions were made on how high this target level should be, e.g. the level necessary to cover 4-5 smaller banks or 2-3 medium-sized banks. In general, respondents pointed out the difficulty in setting a target level, but that it should be carefully calibrated (bearing in mind that no DGS can afford to cover deposits of the largest banks).

Most respondents agreed that a **maximum contribution level** would be desirable since unlimited contributions may be very burdensome for healthy banks and could undermine their overall position. A maximum level for annual contributions of banks would help avoid excessive pro-cyclicality (notably during periods of crisis).

A large majority of respondents (above 70%) were in favour of **risk-based contributions** to DGS, although others (more than 20%) were against this proposal. Proponents emphasised that risk-based contributions would create incentives for more prudent behaviour of banks and improve their risk management, thereby contributing to financial stability. They were also needed to mitigate moral hazard and free riding problems (subsidising riskier banks by safer ones). Opponents were afraid that risk-based contributions would mean double penalisation for banks (since they may already be penalised by supervisors if do not comply with capital requirements), and imposing a higher contribution on banks – if made public – might send a bad signal to depositors and cause a run on banks. They also felt that such contributions may result in pro-cyclical effects.

No single view emerged as to whether risk-based contributions should be harmonised or not, mandatory or optional. But there was agreement that they should be simple and flexible to take into account specific situations in Member States. It was emphasised that they should be consistent with the supervisory regime (to avoid duplicating work, they could be calculated on the basis of risk assessments or bank ratings set by supervisors or rating agencies). The following indicators to calculate risk-based contributions were suggested: capital adequacy/solvency, liquidity, profitability, high exposure, loan portfolio quality, etc. According to some respondents, the recently published JRC report

(and, in particular, the proposed Multiple Indicators Model)² could serve as a starting point for discussion on potential calculation methods for risk-based contributions. Moreover, it was suggested that the CEBS could provide guidelines on this (bearing in mind the need to improve the convergence of supervisory and DGS practices).

Practically all respondents agreed that **additional financing sources** – both short- and longer-term – should be allowed if needed by DGS. They suggested that sources could include loans or repayable subsidies from state budgets, central banks or large commercial banks, government guarantees, bonds, etc. (one respondent opposed borrowing from central banks as this contradicts Article 101 of the Treaty).

11. Other issues to be dealt with (Qs 1 and 40)

The following issues are examples of the many other items requested for inclusion in the current review:

- Clarification of the relationship between DGS and ICS;
- Reintroduction of co-insurance;
- Conversion of non euro zone currencies into euros with regard to coverage level;
- Handling of deposits held on behalf of several depositors (e.g. trust accounts);
- Harmonisation of the legal status (public/private) and the DGS number in Member States;
- Investment rules for ex-ante DGS funds;
- Taxpayer's contribution to DGS funding;
- Excluding high-risk banks from DGS;
- Smooth transfer of contributions if banks leave one DGS to join another.

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² For more details, see the JRC report *Possible models for risk-based contributions to EU Deposit Guarantee Schemes*, http://ec.europa.eu/internal_market/bank/docs/guarantee/2009_06_risk-based-report_en.pdf.