Deposit guarantee schemes

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PURPOSE: to propose self-regulatory improvements to deposit guarantee schemes.

CONTENT: the Deposit Guarantee Schemes (DGS) Directive (94/19/EC) obliges all Member States to set up compensation schemes for depositors. However, some Member States have introduced guarantee thresholds higher than the minimum EUR 20 000, and how the schemes function in practice is also not uniform across the EU. The Communication examines how this situation, combined with increased competition and integration in the EU banking market, affects the functioning of the current rules. These schemes are crucial to the EU's financial stability. But the different ways they work at national level can make fast and efficient crisis management difficult.

The objective of this Communication is to draw conclusions from the consultation process, to respond to the concerns expressed by stakeholders, to identify short-term and non-legislative ways of improving the functioning of the directive and to set out the Commission's policy towards deposit guarantee schemes in the coming years.

The consultation process has revealed differing opinions about whether the existing deposit guarantee arrangements are in need of change. Some stakeholders have argued that the existing framework should be changed because of: a) substantial differences between the guarantee level afforded to depositors (ranging from just EUR 14 481 in Latvia to EUR 103 291 in Italy); b) substantial differences in the manner by which schemes fund pay-outs to depositors.

Other stakeholders have argued against changes at the present stage, primarily due to the high costs entailed. They argue that the system functions relatively smoothly in the current environment, it is adequate for supervisory purposes and they do not agree that the existing arrangements create competitive distortions between markets.

The Commission therefore proposes to respond to results of the review process in two different ways. **Firstly it will seek to develop pragmatic and achievable approaches to identified problems** which do not require changes to the existing regulatory framework. **As a second step, it will examine more fundamental changes** which might require an overhaul of the current EU legislation on DGS.

Based on the results of a consultation launched in 2005, the Communication proposes a number of improvements that the EU banking industry could introduce by **'self-regulatory'** means, including: fine tuning "topping up" arrangements (where a bank branch in another Member State voluntarily joins the host country's deposit guarantee system); shortening the time it takes for schemes to pay out to depositors after a bank failure; and improving exchange of information between schemes The Commission does not consider it appropriate at this stage to consider introducing a de minimis clause since both co-insurance and *de minimis* rules are linked to the limitation of depositor protection and therefore should not be dealt with separately.

In light of the difficulties experienced in practice by one banking group to consolidate funds paid into different schemes into a single DGS, stakeholders' views were split on whether to amend the Directive and introduce rules about the transferability or refundability of paid-in DGS contributions. The Commission recommends that any new rules permitting transfer or refund of DGS contributions should neither weaken the fund in a way which would endanger its functioning nor lead to an inappropriate accumulation of risks. Even if it is currently not required by Community law, it would appear useful if credit institutions were properly informed whether or not national law foresees a partial or complete refund.

The Commission encourages Member States to make further efforts in the area of consumer information and advertising. As regards the definition of deposits and the scope of coverage, the Commission proposes to carry out a survey of savings products which are currently covered and the impact of any exclusion.

The Communication concludes that there is **currently no case for changing the current minimum guarantee level of EUR 20 000.** Research carried out by the Commission's Joint Research Centre (JRC) has provided evidence that the differences in deposit levels held by depositors across EU Member States remain too large - especially since the 2004 EU enlargement.

In addition, discussions are currently underway in a number of different forums about the efficiency of current supervisory arrangements. As DGS constitute an important component of the supervisory safety net intended to mitigate the effect of cross-border banking crises, further clarity is needed in particular on the question of the overall division of supervisory responsibilities and financial liabilities in crisis situations, before it can be decided whether more fundamental changes to the existing DGS arrangements might prove necessary

Only once burden sharing arrangements have been clarified, can the longer term issues be addressed:

- **DGS objectives**: clarification is needed about the role DGS are expected to play and on the balance that should be struck between pure consumer protection objectives and the extent to which DGS should be expected to contribute to the stability of the financial system;
- **DGS funding mechanisms**: an interim report produced by the JRC on this subject has shown that further harmonisation of funding mechanisms would imply a financial burden of EUR 2.5 billion to EUR 4.3 billion cumulatively over a period of 10 years for the banking sector in the six Member States that currently operate ex post DGS;
- **Risk-based contributions**: the Commission is in favour of risk based methods. If progress were made on funding mechanisms, then harmonising the method for contributions could follow;
- **Minimum coverage level**: the impact work in this area shows that, given the disparities in average deposits in Member States, the pursuit of truly harmonised conditions for the protection of deposits may not be achieved by simply fixing a common guarantee level for all countries given the wide economic disparities. Possible changes to the minimum level should only be contemplated in the much longer term;
- **Use of DGS funds**: the possibility to use the funds in a DGS to provide liquidity assistance to banks is worth further consideration, but depends on progress in the broader work on crisis management;
- **Cooperation between DGS, supervisors, central banks and governments**: legislative requirements setting out the need for enhanced cooperation could follow from the broader work on financial stability and evolution of supervision;
- **Reorganisation and winding up of credit institutions**: Directive 2001/24/EC will soon be reviewed by the Commission services. At least two issues are of importance for failures affecting DGS in more than one Member State and will be taken into account during the review process: – DGS should – after the failure – enjoy the same access to information as supervisory authorities in order to be in a position to recover their claims; and – equal treatment of DGS should be ensured, in particular with regard to the priority of claims.