Deposit guarantee schemes. Recast

2010/0207(COD) - 12/07/2010 - Legislative proposal

PURPOSE: to recast provisions on the Deposit Guarantee Scheme.

PROPOSED ACT: Directive of the European Parliament and of the Council.

BACKGROUND: events in 2007 and 2008 showed that the existing, fragmented DGS system has not delivered on the objectives set by Directive 94/19/EC on Deposit Guarantee Schemes (DGS), in terms of maintaining depositors' confidence and financial stability in times of economic stress. The current about 40 DGS in the EU, which cover different groups of depositors and deposits up to different coverage levels, impose different financial obligations on banks and therefore limit the benefits of the internal market for banks and depositors. Moreover, schemes have proved to be underfinanced in times of financial stress.

Directive 2009/14/EC was adopted as an emergency measure to maintain depositors' confidence, in particular by increasing the coverage level from EUR 20 000 to EUR 100 000 by the end of 2010. Directive 2009/14/EC contained a clause providing for a broad review of all aspects of DGSs.

The need to reinforce DGSs by presenting appropriate legislative proposals was reiterated in the Commission communication of 4 March 2009 Driving European recovery.

This proposal is part of a package on guarantee schemes in the financial sector, which also comprises a review of investor compensation schemes (Directive 97/9/EC) and a White Paper on insurance guarantee schemes.

IMPACT ASSESSMENT: altogether, over 70 different policy options were assessed. The main options identified as preferable are: (a) simplifying and harmonising the scope of coverage; (b) reducing the payout deadline to seven days; (c) ending the practice of setting off depositors' liabilities against their claims; (d) introducing an information template to be countersigned by a depositor and a mandatory reference to DGSs in account statements and advertisements; (e) harmonising the approach to the funding of DGSs; (f) setting a target level for DGS funds; (g) fixing the proportions of ex-ante and ex-post bank contributions to DGS; (i) introducing risk-based elements for bank contributions to DGS; (j) restricting the use of DGS funds for broader bank resolution purposes benefiting of all creditors of a bank; (k) having the host country DGS act as a single point of contact for depositors at branches in another Member State.

In terms of social impact, the proposal provides that, in the event of a bank failure, depositors are reimbursed up to EUR 100 000 by a DGS within seven calendar days. This will make the intervention of social welfare systems almost unnecessary.

LEGAL BASE: Article 53(1) TFEU.

CONTENT: the main elements of this proposal are:

- simplification and harmonisation, in particular as to the scope of coverage and the arrangements for payout;
- further reduction of the time limit for paying out depositors and better access for DGS to information about their members (i.e. banks);
- sound and credible DGSs that are sufficiently financed;
- mutual borrowing between DGSs, i.e. a borrowing facility in certain circumstances.

The elements of the review which, in the Commission's view, should not be subject to legislation are set out in the report accompanying this proposal (please see COM(2010)0369). The report and the proposal are part of a package on guarantee schemes in the financial sector, which also comprises a review of investor compensation schemes (see COD/2010/0199) and a White Paper on insurance guarantee schemes.

The main points are as follows:

Scope: the Directive now encompasses all credit institutions and all schemes, without distinction. All banks must join a DGS. This ensures that depositors always have a claim against a scheme and that all schemes must be soundly financed. Mutual guarantee schemes protect depositors by protecting the credit institution itself. Since all banks must now join a DGS, mutual guarantee schemes can either be recognised as DGSs and meet the requirements set out in Directive 2006/48/EC, or be set up separately. In this case, a dual membership of a bank in both schemes and the additional safeguard role of mutual schemes can be taken into account when the contributions to the DGS are set.

Definitions: deposits are now defined more clearly. Only entirely repayable instruments can be deemed deposits, not structured products, certificates or bonds. This prevents DGSs from taking unpredictable risks with investment products.

Supervision: all DGSs must now be supervised on a continual basis and they must perform regular stress tests of their systems. DGSs now have the right to obtain information from banks at an early stage in order to enable fast payout. Member States are now explicitly allowed to merge their DGSs. Credit institutions now have to be given one month's notice, not 12 months', before they can be excluded from a DGS.

Eligibility criteria and determination of the repayable amount: depositors' eligibility has been simplified and harmonised. Most discretionary exclusions have become mandatory, in particular the exclusion of authorities and financial institutions of any kind. On the other hand, deposits in non-EU currencies are covered under the law and so are the deposits of all non-financial companies. The coverage level of EUR 100 000 (to be implemented by end of 2010 under Directive 2009/14/EC) has not been amended. However, Member States may decide to cover deposits arising from real estate transactions and deposits relating to particular life events above the limit of EUR 100 000 , provided that the coverage is limited to 12 months.

It is now stipulated that interest due but not credited at the time of failure must be repaid, provided that the coverage level is not exceeded. Depositors must now be paid out in the currency in which the account was managed. Setting off claims against the depositor's liabilities is no longer permitted after an institution fails.

Payout: the DGS must now act to repay depositors within one week. Depositors do not need to submit an application. Any information they are given must be in the official language(s) of the Member State where the deposit is located. The Directive now stipulates that depositors' unacknowledged or unpaid claims against DGS can only be time-barred to the extent that the DGS's claims in the liquidation proceedings are time-barred. In order to meet such a short payout deadline, the competent authorities are obliged to inform DGSs by default if a bank failure becomes likely. Moreover, DGSs and banks must exchange information on depositors, domestically and across borders, unfettered by confidentiality requirements. Credit institutions must also be in a position to provide the aggregated deposits of a depositor ('single customer view') at any time.

DGS financing and borrowing between DGS: the Directive now ensures that DGSs' available financial means are proportionate to their potential liabilities. These financial means are safeguarded against potential losses by restrictions on investment similar to those for electronic money institutions under Directive 2009/110/EC and UCITS under Directive 2009/64/EC, taking into account the need for lower risk and higher liquidity. The financing of DGS will be based on the following subsequent steps:

- ***step 1:*** in order to ensure sufficient funding, DGSs must have 1.5 % of eligible deposits on hand after a transition period of 10 years (this is referred to as the 'target level'). If these financial means turn out to be insufficient in the event of a bank failure, the second and third steps below must be taken;
- ***step 2:*** banks must pay extraordinary ('ex-post') contributions of up to 0.5 % of eligible deposits if necessary. Consequently, ex-ante funds will account for 75 % of DGSs' financing and ex-post contributions 25 %;
- ***step 3:*** a mutual borrowing facility allows a DGS in need to borrow from all other DGSs in the EU, which, altogether, must, if needed, lend to the DGS a maximum of 0.5 % of its eligible deposits in need on short notice, proportionate to the amount of eligible deposits in each country. The loan must be repaid within five years and new contributions to the DGS must be raised to reimburse the loan. To secure repayment, the lending DGSs have the right to subrogate into the claims of depositors against the failed credit institution and these claims will rank first in the liquidation procedure of the credit institution whose failure depleted the borrowing DGS;
- ***step 4***: as a last line of defence against taxpayers' involvement, DGSs must have in place alternative funding arrangements, recalling that those arrangements must comply with the monetary financing prohibition laid down in Article 123 TFEU.

This **four-step mechanism** will become fully operational only after 10 years. In order to adapt the target level to schemes' potential liabilities, it will be recalibrated on the basis of covered deposits (i.e. taking into account the coverage level), but without diminishing the level of protection.

DGS funds should principally be used for paying out depositors. This, however, does not prevent their use for bank resolution purposes in accordance with state aid rules. However, to avoid the depletion of funds for the benefit of a bank's uninsured creditors, such use must be limited to the amount that would have been necessary to pay out covered deposits. Given that bank resolution and payout have different purposes, DGS funds should be ring-fenced already when the target level is build up, ensuring that the primary function of DGSs, i.e. deposit payout, is not impeded.

Risk-based contributions to DGSs: contributions from credit institutions to DGSs must be calculated according to their risk profiles in a harmonised way. In principle, contributions consist of both non-risk and risk-based elements. The latter will be calculated on the basis of several indicators reflecting the risk profiles of each credit institution. The proposed indicators cover the key risk classes commonly used to evaluate the financial soundness of credit institutions: capital adequacy, asset quality, profitability and liquidity. The data necessary to compute those indicators are available under existing reporting obligations.

Taking into account differences between banking sectors in Member States, the Directive ensures some flexibility by developing a set of core indicators (mandatory for all Member States) and another set of supplementary indicators (optional for Member States). The core indicators consist of commonly used criteria such as capital adequacy, asset quality, profitability and liquidity. Core indicators weigh 75 % and supplementary indicators 25 %. In general, the Directive requires that the total amount of contributions to be collected by DGS should first be determined in line with the target level for DGS funds; then the amount should be apportioned among DGS member banks according to their risk profiles. Consequently, the Directive provides incentives for sound risk management and discourages risky behaviour by clearly differentiating between the levels of contribution paid by the least and most risky banks (from 75 % to 200 % of the standard amount, respectively).

As to the non-risk element, the contribution base is the amount of eligible deposits, as is currently the case in most Member States. However, over time, covered deposits (i.e. eligible deposits not exceeding the coverage level) will become the contribution base in all Member States as they better reflect the risk to which DGSs are exposed. A full harmonisation of the calculation of risk-based contributions should be achieved at a later stage.

Cross-border cooperation: in order to facilitate the payout process in cross-border situations, the host country DGS acts as a single point of contact for depositors at branches in another Member State. This includes not only communication with depositors in that country (acting as a 'post box') but also paying out on behalf of the home country DGS (acting as a 'paying agent'). Agreements between DGSs will facilitate this function. Schemes have to exchange relevant information with each other. Mutual agreements will facilitate this.

Banks reorganising themselves in a way that causes their membership of one DGS to cease and entails membership in another DGS will be reimbursed their last contribution so that they can use these funds to pay the first contribution to the new DGS.

Depositor information: before making a deposit, depositors must now countersign an information sheet based on the template set out in the proposal, which contains all relevant information about the coverage of the deposit by the responsible DGS. Existing depositors must be informed accordingly on the statements of account. Advertising on deposit products must be limited to a factual reference to coverage by the DGS, in order to avoid using the DGS as a marketing argument. The regular disclosure of specific information by DGSs (ex-ante funds, ex-post capacity, results of regular stress testing) ensures transparency and credibility, leading to enhanced financial stability with insignificant costs.

New supervisory architecture: on 23 September 2009, the Commission adopted proposals for Regulations establishing the European System of Financial Supervisors, including the creation of the three European supervisory authorities and the European Systemic Risk Board. The new European Banking Authority should collect information on the amount of deposits, conduct peer review analyses, confirm whether a DGS can borrow from other DGSs, and settle disagreements between DGSs.

FINANCIAL IMPLICATIONS: the proposal has no implication for the Union's budget.