EU Directive

DEPOSIT GUARANTEE SCHEMES

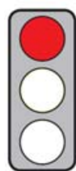
Status: 11 October 2010

Centrum für Europäische Politik

MAIN ISSUES

Objective of the Directive: Deposit guarantee schemes in Europe are to be harmonised, the repayable amount is to be capped and mutual borrowings are to be introduced as a mandatory obligation.

Affected parties: Depositors, credit institutions and deposit guarantee schemes.



Pro: –

Cons: (1) Restricting the maximum repayable amount to 100,000 Euro is counterproductive and cannot be justified by financial market stability.

(2) Obligatory mutual borrowings between deposit guarantee schemes have a destabilising effect.

(3) The repayment period of 7 days is unrealistically short.

CONTENT

Title

Proposal COM(2010) 368 of 12 July 2010 for a **Directive** of the European Parliament and of the Council on **Deposit Guarantee Schemes** (recast)

Brief Summary

- **Scope: "Eligible deposits"**
  - The Member States' deposit guarantee schemes (DGS) protect the bank deposits of depositors in the event of a bank insolvency. They are to strengthen the depositors' confidence in the safety of their money and to avoid bank runs.
  - "Eligible" are deposits which must be paid back by a bank at their par value.
    - Foreign currency accounts (e.g.: dollar accounts) are also protected (Art. 5 (4)).
    - Not protected are deposits of public authorities, banks, investment firms, insurance companies, investment funds and pension funds (Art. 4 (1)).
  - The Directive's requirements are directed at all statutory, "contractual" and institutional protection schemes recognised as DGS (Art. 1 (2)).
- **Coverage level: "Covered deposits"**
  - As of 2013, the DGS cover the eligible deposits of each depositor up to a maximum of Euro 100,000 at each credit institution ("covered deposits"; Art. 5 (1)). Thus the Commission wants to avoid that in the event of a crisis, depositors transfer large volumes of their monies to countries with a higher deposit guarantee level, as this would further aggravate the crisis (Recital 11).
  - Hitherto existing national coverage amounts of more than Euro 100,000 must be reduced to Euro 100,000 by the end of 2014 (new Art. 5 (1) and (2); Art. 6 (4); Art. 20 (3)).
  - Higher coverage levels are admissible for deposits which:
    - derive from private real estate transactions or
    - fulfil what is defined by national law as "social considerations", which are linked to events such as marriage, divorce, invalidity or decease (e.g. payout of a lump-sum insurance amount in the event of invalidity).

    However, this applies only to a period of 12 months, starting at the date of the credit entry of the amount and/or entry of event. Moreover, the statutory DGS must not be financially burdened by such pay-outs. (Art. 5)
- **Repayment of deposits**
  - The DGS must repay deposits which are "unavailable" (Art. 7 (1)). This is applicable when (Art. 2 (1), lit e):
    - the competent supervision authority determines that the bank concerned is "unable for the time being" to repay the deposit or
    - a court determines that the bank concerned cannot repay the deposit, which results in "suspending the depositors' ability to make claims against it".
  - As of 2014, the repayment of unavailable deposits must be effected within 7 days (Art. 7 (1)).
  - The depositor does not have to make an application (Art. 7 (2)).
  - Any communication between the depositor and the DGS must take place in the official language of the Member State in which the deposit is situated (Art. 7 (3)).
  - Instead of repaying deposits, DGS may also deploy their financial means pre-emptively in order to avoid the insolvency of a bank. However, this is admissible only for as long as the DGS have at least 1% of the covered deposits available. (Art. 9 (5))
- **Financing and liquidity of DGS**
  - All banks must pay regular contributions to the DGS twice a year. The total amount of the annual contribution must not exceed 1% of the eligible deposits. (Art. 9 (1) and 3)

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- As of 2021 the following requirements apply to DGS' financial means:
  - The Member States fix the amount of the target level. Each DGS must, however, have at least 1.5% of the eligible deposits available as a reserve (Art. 2 (1) lit h in conjunction with Art. 20 (1) sub-para. 1).
  - Should reserves fall below 1%, the semi-annual contribution of the banks must be at least 0.25% of the eligible deposits (Art. 9 (1) in conjunction with Art. 20 (1) sub-para. 1).
  - No bank must provide more than 5% of the financial means of the DGS (Art. 9 (2) in conjunction with Art. 20 (1) sub-para. 1).
  - If the DGS is not sufficiently financed to repay deposits to the full amount, banks must pay extraordinary contributions not exceeding 0.5% of their covered deposits (Art. 9 (3) in conjunction with Art. 20 (1) sub-para. 1).
- The DGS must be able to find "alternative" short-term funding, e.g. through the capital market (Art. 9 (6)).

► **Risk-based contributions by banks to DGS**
- How much a bank must contribute to the financial means of its DGS is based on the bank's risk profile. This is calculated by the competent national supervision authority according to the following criteria: amount of eligible deposits, capital adequacy, asset quality, profitability and liquidity of a bank. (Annex I and II).
- Contributions move within a flexible range: The contributions vary from 75% of the amount in the case of "low" risk to 100% for "medium risk" and up to 200% for "high" risks. (Art. 11 (1))
- For acknowledged "institutional DGS" – such as the joint liability scheme of German savings banks and the security measures of the German cooperative banks – "Member States" may in accordance with the respective risk profile prescribe lower contributions of at least 37.5%. (Art. 11 (1) Sentence 2)

► **Obligation for mutual borrowing**
- As of 2021, a DGS that can no longer fulfil its obligations may request a credit from all European DGS if (Art. 10 (1)):
  - it has already levied extraordinary contributions by its member banks (Art. 9 (3), see above);
  - it is not repaying another credit at the same time, and if
  - the total amount of all loans by this DGS does not exceed 0.5% of its eligible deposits.
- The allocation of this credit over national DGS goes by their national share in the total eligible deposits in the EU. DGS which have already borrowed funds themselves are exempted from this rule. (Art. 10 (1) and (2) lit. a).
- Loans must be repaid within five years at the latest. Their interest rate must be equivalent to the marginal lending facility rate of the European Central Bank during the credit period (Art. 10 (2)).

► **Cross-border co-operation**
- Deposits made at branches of a credit institution authorised in another Member State ("home Member State") must be repaid first by the DGS of the state in which the branch is located ("host Member State") (Art. 12 (2) Sentence 1).
- The DGS of the home Member State reimburses the DGS in the host Member State. To that end, the DGS enter into written "cooperation agreements". The European Banking Authority (EBA) settles disputes in a binding manner. (Art. 12 (2) Sentence 2 and 5)

► **Information and advertising**
- Credit institutions are obliged to inform their depositors as to which DGS they belong and must refer to deposits not covered by DGS (Art. 14 (1) Sentence 1 and 2).
- The Advertising of credit institutions with their affiliation to a DGS is confined (Art. 14 (5)).

► **Supervision**
- The national supervisory authorities are responsible for the recognition and supervision of DGS in their Member States (Art. 3 (1) and (5)).
- Each credit institution must be affiliated to a recognised DGS. If not, it must not accept deposits. (Art. 3 (1))
- The "resilience" of DGS must be tested by means of stress tests before 2014 and at least every three years after that – more often "when the circumstances require it". (Art. 3 (6))

Changes Compared to the Status Quo

► The Directive replaces Directive 94/19/EEC.

► Until now, Member States could exempt credit institutions from membership in a statutory DGS. This exemption applied where credit institutions were affiliated to a community of solidarity ("Institutional Guarantee Scheme"). In Germany this applies to saving banks ("Sparkassen") and cooperative banks ("Volksbanken"). In future, such institutional systems are admissible as an alternative to statutory DGS only if the criteria of the Directive – e.g. the maximum coverage amount of Euro 100,000 – are fulfilled.

► To date, EU rules provided for a minimum amount of Euro 100,000 for deposit guarantees as from 2011. In future, the protection of all systems – also those which are non-statutory – may not exceed Euro 100,000. German private banks currently promise a guarantee of 30% of the liable equity capital. Saving banks and cooperative banks are liable for each other ("institutional guarantee"), which means for the depositor – as long as institutional guarantee is financially viable – unlimited protection.

- To date, only deposits in the respective national currency were covered by a deposit guarantee. In future, deposit guarantees are to protect also foreign currency accounts.
- To date, unavailable deposits had to be repaid by the deposit guarantee scheme within 20 working days. In future, repayment is due within 7 days.
- To date, there have been no European rules on the financing of national deposit guarantee schemes or on the mutual borrowing of loans between deposit guarantee schemes.

Statement on Subsidiarity by the Commission

According to the Commission, only EU action can ensure that cross-border operative credit institutions are subject to comparable deposit guarantee requirements. Only then can a "level playing field" be established. EU action prevents unnecessary costs in cross-border deposit repayment and contributes to the further integration of the internal market.

Policy Context

With the aim to restore depositors' confidence in the safety of their deposits, the Council and the European Parliament adopted the Directive 2009/14/EC during the financial crisis. The Directive provided for an EU-wide increase in minimum coverage first to Euro 50,000 and then – by the end of 2010 – to Euro 100,000. Issues such as the EU-wide harmonisation of the financing of deposit guarantee schemes and the establishment of a European deposit guarantee scheme were postponed to 2010.
Both in the Directive and in the impact assessment, the Commission favours capping the coverage level at Euro 100,000. However, the internal market commissioner Barnier has meanwhile hinted that he may possibly deviate from this plan. This is in light of the current discussion regarding whether or not the voluntary protection by German private banks and the savings and cooperative bank sector, whose deposit guarantee schemes go beyond this, may remain in effect.
In Germany, the *Bundestag* and the *Bundesrat* are opposed to reducing the repayment amount. At the beginning of October, they filed a subsidiarity complaint, a procedure newly introduced by the Lisbon Treaty. If, by 14 October, one third (9 of 27) of the national parliaments in the EU vote in favour of it, the Commission must reassess its proposal. The Swedish Parliament has already voted against the project; Austria is about to join the Swedish vote. Still open is the situation in France, the Czech Republic, Hungary and Slovakia.

Legislative Procedure

12 July 2010	Adoption by Commission
Open	Adoption by the European Parliament and the Council, publication in the Official Journal of the European Union, entry into force

Options for Influencing the Political Process

Leading Directorate General:	DG Internal Market
Committees of the European Parliament:	Economic and Monetary Affairs (in charge) rapporteur Peter Simon (DE, S&E Group); Internal Market; Legal Affairs
Committees of the German Bundestag:	Open
Decision mode in the Council:	Qualified majority (adoption by a majority of Member States and at least 255 out of 345 votes; Germany: 29 votes)

Formalities

Legal competence:	Art. 53 Abs. 1 in conjunction with Art. 54 TFEU (Freedom of Establishment)
Form of legislative competence:	Shared competence (Internal Market)
Legislative procedure:	Ordinary legislative procedure

ASSESSMENT

Economic Impact Assessment

Ordoliberal Assessment

DGS support the stability of the financial market. Their benefit lies in strengthening depositor confidence in the availability of their deposits. This is the only way to prevent a rush on a bank, where depositors withdraw their deposits collectively from a bank. Such a "bank run" represents a threat to any bank's existence, as the business model of banks is precisely that customer deposits are not hoarded but passed on profitably in the form of a loan or investment.
Also, statutory rules for the running of DGS are useful in principle, for they can stipulate clear and general criteria which improve the credibility of DGS and consequently the stability of the financial market. The insufficient level of transparency regarding the financial means of some schemes, together with the fact that during the recent crisis a total of six DGS were not able to finance a default of 0.81% of eligible deposits (source: Joint Research Center, Report on the efficiency of DGS, May 2008), proves the necessity of such rules.

Rules regarding the financing of DGS, in particular the obligation to hold at least 1.5% of the eligible deposits ex ante, i.e. before a crisis occurs, could strengthen the credibility of DGS. In addition, such rules **avoid** that insolvent banks do not even contribute to the costs of DGS to start with (**"moral hazard"**) **and that tax-payers are burdened**. Moreover, an ex post financing has procyclical effects: it costs liquidity in the middle of a credibility crisis.
For **the limitation of repayment to Euro 100,000** there are no convincing arguments. First, it **is counterproductive, as it reduces the deposit guarantee level in several Member States** – e.g. Germany. This will most definitely not increase the subjective level of trust with depositors.
Second, the capping of deposit guarantees cannot be justified with the stability of the financial markets. Although the Commission understandably wishes to avoid that in the event of a crisis depositors transfer large volumes of their monies to other Member States with higher deposit guarantee levels, the Commission confuses cause with consequence if it chooses to fight this fact with a levelling of DGS. Far preferable would be that such crises did not happen in the first place due to consistent banking supervision in all EU Member States.
Third, coverage levels which exceed Euro 100,000 do not necessarily distort competition between banks. In fact, capping is more likely to prevent competition, because banks are no longer able to offer in particular rich and risk-averse depositors the protection they desire.
The only question worth discussing is whether or not additional protection promises overstep the line to misleading advertising if they are not backed by sufficient financial means. The Commission's argument that such high guarantees are not viable in the event of a system crisis is not convincing. For the same applies to coverage levels of Euro 100,000: no deposit guarantee could deal with a comprehensive system crisis. Fourth, maximum coverage amounts cause an insolvable conflict with the institutional guarantee – in Germany, the savings and cooperative banks – which aims at avoiding ex ante imbalances in member banks.
The obligation to mutually borrow loans between DGS is to be rejected. It **facilitates domino effects and thus leads to higher risks.** Moreover, the financial responsibility for solvency crises should remain at national level, since it is mainly there that banking supervision is carried out – also after the establishment of the banking supervision authority.

Impact on Efficiency and Individual Freedom of Choice

The rule to repay deposits within a period of 7 days is unrealistic and merely attests to sheer activism. This can only be complied with – if at all – through huge costs and effort, such as for massive staff increase in DGS. **The period of 20 days should remain in effect.**

Legal Assessment

Legislative Competence

The Directive is correctly based on Art. 53 (1) in conjunction with Art. 54 (1) TFEU, whereby the EU may adopt rules for the uptake and operation of entrepreneurial activities.

Subsidiarity

A credible financing of DGS can also be achieved through national instead of European regulation. Although this is not true for EU wide coverage caps and the obligation to mutually borrow loans, both are counterproductive (see above).

Proportionality

Limiting the coverage level for contractual and institutional DGS is an inappropriate intervention into entrepreneurial freedom and eliminates the possibility of banks to use higher coverage amounts voluntarily as tools in the competition. The argument that in this way the distortion of competition is avoided is not enough to justify such an intervention. The definition of a minimum coverage would suffice for achieving the aim and would still enable competition, and is to be preferred as the softer means.

Compatibility with EU Law

Limiting the coverage amount is not in line with the guiding principle of a high consumer protection level, as is provided for by the articles 12, 114 (3) and 169 (1) TFEU. On the contrary, the current legal position with a minimum coverage serves consumer protection: where a Member State chooses to prescribe a higher minimum coverage, it is free to do so.

Compatibility with German Law

Pursuant to the German DGS and depositor repayment law, institutional DGS may – as stipulated by Directive 2009/14/EC – be acknowledged as an alternative to membership in a statutory repayment body. In future, such an acknowledgement is subject to a maximum coverage of Euro 100,000.

Conclusion

Limiting the maximum repayment amount to Euro 100,000 is counterproductive and cannot be justified by the stability of the financial market. The obligation to mutually grant loans between DGS has a destabilising effect. The repayment period of 7 days is not realistic and too short.

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