

# EU deposit Guarantee

25 years of history: from a  
recommendation to a unified EU system ?

Michel TISON



## Overview

- Evolution of the EU regulatory framework prior to the crisis
- The Proof of the Pudding: the financial crisis
- Beyond the Crisis: towards a unified EU Deposit Guarantee System ?



## Evolution of the Regulatory Framework

- **1986: Commission Recommendation**
  - MS are asked to introduce mandatory deposit guarantee systems (DGS)
  - DGS should provide for 'reasonable compensation' to those depositors who do not possess the means to properly assess the bank's financial situation
  - DGS should cover deposits of branches
  - Recommendation had only limited success
  - => Commission initiates formal draft directive



## Evolution of the Regulatory Framework

- Directive 94/19/EC on Deposit Guarantee
  - MS should introduce/recognize one or more deposit guarantee systems
  - Membership for a DGS = formal authorization requirement for each credit institution
  - **Minimum harmonization** of coverage provided by each DGS
    - At least 20,000 ecu/€ for each “retail” depositor
    - Possibility to introduce limited (up to 10%) co-insurance
    - Limitation of regulatory competition:
      - Export cap (temporary) / top up option
      - Prohibition to ‘exploit’ comparative advantage of better DGS

## Evolution of the Regulatory Framework

- Territorial coverage follows “European passport” system
- No provisions on financing of DGS
  - DGS should be funded by credit institutions
  - Preamble: no Member State liability if DGS systems have been introduced that ensure compensation of depositors
- Implementation in Member States: important disparities
  - Level of coverage (eg Germany: unlimited coverage for clients of largest banks)
  - Co-insurance: only used in a few Member states

## Deposit Guarantee in the financial crisis

- Financial crisis identified various shortcomings
  - Co-insurance -> likely to induce bank run
  - Ex ante and ex post financing of DGS
    - Ex post financing puts full burden of bank failure on competitors
  - Disparities in level of coverage
    - Risk of run to banks with better DGS
  - Impossibility to meet DGS coverage *versus* depositor expectations (cf. Icesave – Landesbanki)
    - Pressure on ‘host countries’ to provide coverage

## Deposit Guarantee in the financial crisis

- Obligation for (home) Member State to ‘fill the gap’ when DGS fails to compensate depositors ?
  - EFTA-Court, case E-16/11, EFTA Surveillance Authority vs Iceland (28 January 2013):
    - 1994 Directive is not a system of ‘absolute constraint’: MS enjoy considerable discretion in how they organise DGS
    - Obligation of MS is to establish an effective framework for DGS (-> less strict than to ‘ensure compensation’)
    - No obligation for MS to ensure compensation of depositors if DGS is unable to cope with its obligations due to a systemic crisis
    - Cf. Also 2010 Impact Assessment (Eur Commission): contemplates financing of DGS of approx. 2% of eligible deposits



## Deposit Guarantee in the financial crisis

- Directive 2009/14: Adaptations to Deposit Guarantee Directive
  - From minimum to maximum harmonization
  - Uniform level of coverage: 100.000 €
    - ‘topping up’ for branches is abolished
    - What about systems of ‘unlimited’ coverage ? (cf. Germany: ‘private club’-system on top of statutory DGS)
  - Obligation for DGS to co-operate
  - Stricter deadline for effective compensation
    - 20 working days after determination of unavailability of deposits



## Beyond the crisis: the Banking Union

- July 2010: Commission proposal on Deposit Guarantee Schemes
  - No fundamental modifications regarding compensation of depositors
    - Coverage level remains at 100,000 €
    - Further reduction of compensation deadlines
    - Mutual systems can co-exist with recognized DGS
    - Cross-border failures: host country DGS acts as point of contact for depositors at branches



## Beyond the crisis: the Banking Union

- Financing of DGS
  - Available means proportionate to potential liabilities
  - *Ex ante*-financing: 1,5% of eligible deposits (with transition period of 10 years)
    - Contribution includes risk-based elements
    - Core indicators for risk-based elements: capital adequacy, asset quality, profitability, liquidity
  - If insufficient to cover a bank failure -> cascade system:
    - Additional *ex post* contribution of 0,5% of eligible deposits
    - Mutual borrowing facility between DGS (up to 0,5%)
    - Alternative funding arrangements for DGS

## Beyond the crisis: the Banking Union

- The Banking Union ‘package’
  - Recovery and Resolution Directive
  - Single Supervisory Mechanism
  - Deposit Guarantee -> inclusion of 2010 proposal
- Position of depositors within bank resolution ?
  - Covered deposits -> immune for resolution measures
  - Eligible deposits above 100,000 € ?
    - Possibility for bail-in ?
    - Seniority of eligible deposits ?

## Conclusions

- Banking Union does not (at this time) lead to EU Deposit Guarantee Scheme
  - -> 'network' of national systems with mutual assistance
- Fate of depositors is highly dependent of bank resolution framework
  - Eligible deposits: bail-in risk above coverage ceiling
    - -> incentive for diversification
  - Non-eligible deposits (institutional investors, large companies etc.)