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Latest developments towards deposits transferability within the EU: a further step towards depositors' trust?

Abstract: This presentation will pose some questions regarding EU policies / initiatives in the banking sector and their contradictory - sometimes- goals as regards market stability. Touching upon subjects such as the liberalization of capital movements, bank account switching, bank insolvency measures and consumers' ignorance of banking and financial products/operations, it will conclude that further and deeper consumers' financial education is needed for the establishment of safe and trustworthy financial markets.

Based on the title of this presentation, I should be speaking on the latest developments on deposits transfers within the EU with a view to examining whether EU legislative initiatives, if any, provide for a safer environment for consumers of banking services, and in particular depositors; in other words, whether depositors should feel safer or not when trusting their money to credit institutions.

However, while doing my research, I found that developments on deposits transfer *per se* have not been that many and, more importantly, are not of a legal nature, at least directly. All reflexively though, deposits regulation in European banks has been subject to some significant changes. The latter, I shall try to present in brief, in order to reach a conclusion as to their bearing on depositors' trust and offer some suggestions for the latter's enhancement.

But let us first briefly define the legal framework surrounding deposits transfer. In this respect, we need to touch upon the subject of free movement of capital, which for EU citizens came along with the Treaty

of Rome back in 1957. It is noted here that the Treaty of Rome provided for the free movement of capital only to the extent necessary to ensure the proper functioning of the common market. Hence, despite initial progress on capital movements during the 60's, capital freedom was not literally reached before the early 90s. This was due to 'exchange controls' introduced by many member states as a means to control the relationship between their domestic with international currency markets, to balance their current payments and, in general, to exercise their national monetary and economic policies.

Recognizing the damage that this situation was doing to the completion of the single market, the Council adopted Directive 1988/361, which, in essence, provided for the removal of all exchange controls. Later, with the entry into force of the Maastricht Treaty the freedom of capital movements gained the same status as the other internal market freedoms. So, from January 1994, not only were all restrictions on capital movements and payments between EU member states prohibited, but so were restrictions between EU member states and third countries.

According to the EU Court of Justice interpreting Directive 1988/361, restrictions on capital movement falling within the EU prohibition of restrictions would include:

- ✓ operations in current and deposits accounts with credit institutions,
- ✓ investments in real estate,
- ✓ operations in securities,
- ✓ financial loans and sureties,
- ✓ direct investments,
- ✓ transfers related to insurance products and
- ✓ personal capital movements such as gifts and personal loans.

Of course, the great boost to capital movements in the EU was given by the common currency. Following the introduction of the euro, EU

authorities and national governments focused their attention on integrating the euro payments market by means of implementing harmonized payment schemes for payments made in euro. In 2007 was introduced the Directive on Payment Services, the so called PSD, which officially provided the legal foundation for the creation of an EU-wide single market for payments. The PSD's purpose was to establish a modern and comprehensive set of rules applicable to all payment services in the European Union. Its specific target was to make cross-border payments as easy, efficient and secure as 'national' payments within a member state. To achieve that, the PSD would introduce the necessary legal platform for the single Euro Payments Area, which in turn would serve the single market by improving competition between payment services providers across the EU. More practically, from the consumer's perspective, the PSD has contributed to substantially shortening the time required to execute transactions and increased the consistency of the information provided to consumers in relation to their payment services. The PSD was of course complemented by other pieces of EU legislation, all working towards the creation of an integrated market for electronic payments in euro, with no distinction between national and cross-border payments, as a means to further strengthen the functioning of the internal market.

All these developments in the field of banking regulation have not only improved the ability of payment service providers to operate across the EU, but more importantly have brought substantial benefits to Europe residing consumers themselves, in particular through cheaper transactions, faster payments and more transparent conditions and prices.

So, for international payments in euros within the EU, banks today should be charging no more than what they would for a national transaction of the same value in euros (Regulation 260/2012). The previous rule applies to all electronically processed payments in euros, including:

- transfers between bank accounts in different EU countries

- withdrawals from cash machines/ATMs in EU countries
- payments by debit or credit card across the EU
- direct debit transactions
- money remittances.

Banks in EU countries which do not use the euro must also charge the same fees for transactions in the EU, as they would for a domestic transfer, if the payment or transfer is made in euros.

Nonetheless, opening of accounts and moving deposits on a cross-border basis from a bank in an x member-state to a bank in another member state is proven in reality to be not that small of a deal. A survey on retail financial services, conducted by Eurobarometer in 2012, showed that only 3% of the respondents declared having opened a cross-border account. Consumers were dissuaded from purchasing retail financial products cross-border by unclear information (21%), lack of clarity of the rights available to them (18%) and due to the alleged complicated process such a transaction entailed (15%). It is true that, not long ago, a client of ours applied to open an account in Malta, and in the end refrained from doing so as three months passed and the list of docs requested by the bank kept growing instead of decreasing, even though being a natural person.

Seeing things from the banks' perspective, it may indeed be that legal restrictions have gone away, however, a bank, being a private institution, is free to choose whether or not to accept a customer's deposit with it. Before opening a bank account, banks try to get to know their potential clients. This obviously requires more due diligence in assessing bank account requests from non-residents. Many banks have often a policy not to accept non-locals for customers. Their refusal though is only acceptable on the basis of sound commercial justification, as nationality discriminations are excluded. In case of refusal from a bank, any potential bank customer has the right to request a written statement explaining the reasons for their refusal. And if a case of discrimination on grounds of nationality arises, that customer could take

his/her complaint to a consumer protection agency, such as the European Financial Dispute Resolution Network (FINNET). At this point, taking from personal experience during the last couple of years, I must stress that Greek depositors found little resistance, or even none, to open accounts with many zeros abroad, while smaller amounts of deposits were often denied access to foreign credit institutions.

In light of still existing obstacles, and with a view to further deepening the integration of the EU payment account market, a recent proposal of the EU Parliament and of the Council is aimed at improving transparency and comparability of fee information as regards payment accounts, facilitating switching between bank accounts and eliminating discrimination based on the residency of bank customers. By making all the above steps, the proposal is supposed in turn, to bring improved prices and services for consumers. It is also supposed to guarantee access to basic payment services to all EU consumers and prohibit discrimination based on residency against consumers who intend to open a payment account abroad, to the benefit of both payment service providers and consumers.

Still a question arises: Do all the above developments both facilitate and ensure cross border banking activities from the consumers' point of view? To change slightly the question, have these developments helped towards enhancing bank customers' trust towards the banking system? The answer is undeniably multifaceted. On the one hand, focusing only on the technical side of the above changes, it is certain that one can claim that the EU banking system is unquestionably moving towards deeper integration, which in turn, is expected to bring about a more solid and unified single market of banking services. This will allegedly strengthen bank customers' sense of security when dealing with credit institutions either within their member state of residence or in another EU member state.

But is such deeper integration enough to appease depositors' nervousness and uncertainty during an era of economic unrest and financial insecurity? I am afraid, it isn't.

The ongoing financial crisis is still testing the system's resistibility and the above legal developments and initiatives are not, in my opinion, suitable for addressing the real problems of EU's currently fragmented banking market. It should have been expected that the credit institutions' problems would affect depositors' trust in a very adverse manner that cannot be easily forgotten, let alone, undone. The issue of course lies mainly with the banking industry of the EU periphery, as due to lack of trust to the system, deposits started fleeing banks of the periphery towards the core EU countries, with different pace, since the outburst of the crisis. But, it would not be imprecise to say that the whole European banking industry has, a few years now, entered a state of hypnosis that holds it back from serving its core purpose, to finance the real economy. Only yesterday the ECB cut its benchmark main refinancing rate at 0.25 per cent.

In this respect, the recent proposal for a directive on the recovery and resolution of credit institutions will not improve the picture. On the contrary, the proposal is expected by many market participants and experts to operate in a pro-cyclical manner and affect respectively the EU banking sector in the form of an exit of deposits towards non EU countries. The debate over the famous bail-in tool provided for in the proposal, applied firstly to bank account holders in Cyprus, is continuing to simmer in Europe. The fact is that the bailout of Cyprus back in April caused a mini-run on banks in many of the union's members, exacerbating a decline in lending to the real economy. This data comes from the European Central Bank.

The country most affected was of course Cyprus itself, where private deposits fell by €3.2 billion, or 7.3%, as savers and businesses tried to get their hands on as much cash as possible under the capital controls imposed after the country's bail-out was agreed. The impact was also felt strongly in Greece, where private deposits fell by €2.8 billion, or 1.6% after the solution reserved to Cyprus. In absolute terms, the biggest drop was in Spain, where deposits fell by more than €23 billion, or 1.5%, namely to their lowest level since October 2012. Like lenders in

Cyprus, Greek and Spanish banks are recipients of big bailout funds, and the aid still hasn't entirely restored confidence in the sector.

Approaching the issue critically, it is true, in my view, that the bail-in tool cannot but scare depositors and drive them away from European banks; in the beginning perhaps only the ones making their deposits with the banks of the weaker countries of the periphery. But in the long run also the depositors in north too. It is not a secret that credit institutions all over Europe are still struggling to adapt to the deleveraging demands of the new capital adequacy ratios introduced by Basel III. EU citizens may as a result feel compelled to move their deposits outside Europe. The movement of capital freedom allows them to do so. We need to bear in mind that banks operate largely based on trust and can quickly become unviable if their customers lose confidence in their ability to keep their deposits safe.

So, what is all this fuss about a more integrated European market for banking services? Is it realistic to focus our attention on the technical aspects of a common market while at the same closing our eyes to the reality that the future bank failure regime of the proposed directive will bring? How could we best address the issue of lack of trust for the EU banking sector? The Single Supervisory Mechanism will certainly constitute a first step. So will a pan-European deposit guarantee scheme, if such a measure is finally introduced, as it should...

A truly prudential answer to the problem would be, in my opinion, to financially educate banking services consumers, to train depositors on the workings of the banking industry. A small search through the internet shows that we are very far from such a reality. As a lawyer, I have come across dozens of clients who lost all, or part of their money, when investing in bank issued debt that was sold to them as an alternative to their bank deposit. They were persuaded to do so due the "advantage" of a greater interest rate. This personal experience, which I am sure I can share with many of you in this room, shows that, without financial literacy, full and informed participation of individuals in economic life cannot be achieved. More than that, it is a chimera. It is a

true fact, that the market has in practice rejected any legislative efforts, be it through the MiFID, consumer protection laws etc, to educate consumers, since I can hardly recall having come up against any cases where the client actually reads or even receives the material which includes info on the product he/she is to acquire.

If as depositors we are not aware that the money we deposit with a bank becomes that bank's money from the moment we make such deposit, and the only thing we are being left with against that same bank is a claim of the size of the deposit, then it is not at all evident that we will pay attention to the financial standing and credibility of such a credit institution. This situation creates a vicious circle whereby financially illiterate depositors opt for institutions more keen to offer great interest rates or short freezing period for their savings deposits, whereas prudent banks do not seem as much appealing to depositors.

How long such a state of affairs may continue without the regulator noticing, it may be asked? I am afraid too long, as reality and, in particular, the ongoing financial crisis has shown... So, what do you think? Is the situation mentioned just previously destroying bank consumers' trust and destabilizing the banking system? Of course it is. Aren't banks and sovereign states interconnected? No need to answer that, of course.

So, why not turn banking services consumers into real participants in the industry? Why not enlighten them on the financial risks they bear each time they deal with a bank or, for that purpose, any other financial entity?

In my view, it is high time we put financial literacy at the epicenter of the measures towards better-performing, sound and safe financial markets. At last regulators should be clearly assigned the mandate to financially educate consumers. But not only regulators. Financial institutions, as an industry, should be asked to take the lead in consumer literacy and establish industry funded agencies with the same purpose. As for banks seen as sole institutions, they should, in my opinion, be rated not only

for their credit standing but also for their attitude to consumers' enlightenment and openness to scrutiny.

Above all, financial literacy must finally constitute a serious issue for EU member states, and why not be even taught at schools. Today, the task of administering and allocating personal financial resources appropriately is considerably more elaborate and extensive, in terms of both the skills and the knowledge needed, than was the case for previous generations. Financial developments pose considerable threats for the financial wellbeing of individuals and households alike. They also pose a variety of risks to society, which, as we have been very violently shown in the recent years, bears the costs arising from market inefficiencies.