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**REPORT FROM THE COMMISSION  
TO THE EUROPEAN PARLIAMENT AND TO THE COUNCIL**

**Review of Directive 94/19/EC on Deposit Guarantee Schemes**

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**1. INTRODUCTION**

This report covers those issues raised by the review clauses of Articles 7(1a) and 12(1) of the Directive which are not, or not entirely, dealt with by the proposal to amend Directive 94/19/EC:

- Appropriateness of a fixed coverage level of €100 000 (Article 7(1)(a));
- Appropriateness and arrangements for providing full coverage for certain temporarily increased account balances (Article 12(1)(b));
- Benefits and costs of introducing a pan-European Deposit Guarantee Scheme (Article 12(1)(d));
- Harmonisation of the scope of products and depositors covered, including the specific needs of small and medium-sized enterprises and local authorities (Article 12(1)(f));
- The link between deposit guarantee schemes and alternative means of reimbursing depositors, such as emergency payout mechanisms (Article 12(1)(g)).

This Report should thus be read in connection with the legislative proposal it accompanies. Finally, the report also briefly discusses the link between Deposit Guarantee Schemes and the Commission's work on bank resolution.

**2. LEVEL AND SCOPE OF COVERAGE**

This section deals with the appropriate level of coverage, temporarily high deposit balances and the special needs of authorities and small and medium-sized enterprises (SME).

**2.1. Appropriateness of the fixed coverage level of €100 000**

Directive 2009/14/EC requires Member States to ensure that by 31 December 2010 their level of coverage is fixed at €100 000. This Directive was adopted in autumn 2008 when the financial crisis aggravated. Due to the urgency of the matter, no impact assessment was carried out at the time. The Commission has retroactively assessed the appropriateness of a fixed coverage level of €100 000.

The 'minimum harmonisation' approach taken by Directive 94/19/EC resulted in significant differences between the coverage levels in Member States. When the financial crisis aggravated in autumn 2008, some EU depositors moved their deposits from banks in Member States with a lower coverage level to those with higher deposit protection. Such differences may cause serious distortions. Deposit movements based solely on one factor (the coverage

level) may be costly for depositors, as switching from one bank to another may, for example, affect the rate of interest they earn. For credit institutions, such a sudden and significant outflow of deposits may create heavy liquidity strains. This may in turn affect the 'real economy' (as banks may limit their lending activity in times of financial instability) and eventually lead to government intervention and the use of public funds. Moreover, if depositors choose their bank according to the deposit protection offered (which banks do not control), rather than the quality and cost or benefits of the product, they are not taking full advantage of the Internal Market. To avoid such distortions in the future and ensure a level playing field across the Internal Market, the level of coverage should in principle be the same everywhere.

The coverage levels in Member States still vary greatly, from the minimum of €50 000 to €103 291 in Italy<sup>1</sup> and even unlimited guarantees in some Member States. Currently, 16 of out 27 Member States either already apply the coverage level of €100 000 or have legislation in place to introduce it this year. Therefore, reverting to any level of coverage lower than €100 000 would be confusing for depositors and, by unnecessarily aggravating the risk of runs on banks, could undermine confidence again. It would also be misinterpreted as the EU lacking a clear vision and consistent overall strategy for reforming Deposit Guarantee Schemes, which are a key element of the financial safety net.

A fixed coverage level of €100 000 is the optimal solution in terms of effectiveness and cost-efficiency. It would substantially improve deposit protection without disproportionately increasing the costs for banks and depositors. In comparison with the coverage levels applicable in Member States before the financial crisis, it would increase the *amount* of covered deposits from 61% to 72% of eligible deposits; it would also increase the *number* of fully covered deposits from 89% to 95% of eligible deposits. The benefits of adopting a coverage level higher than €100 000 would be very limited (for example, the level of €200 000 would increase the number of fully covered deposits by less than 2% only) and higher coverage would thus not seem to justify the additional costs.

Consequently, the current mechanism of increasing coverage to a fixed level of €100 000 is appropriate.

## **2.2. Small and medium-sized enterprises (SME) and local authorities**

In order both to simplify and harmonise the system and to ensure faster payout by making it easier to verify claims, the Commission is in favour of including or excluding entire categories of depositors such as enterprises and authorities in all Member States rather than differentiating within a given category (i.e. by size of enterprise or the nature of the authority) since such distinctions would be time-consuming and costly.

SME are currently covered to the extent that they are permitted to draw up abridged balance sheets. This is roughly equivalent to the EU definition of small enterprises. Since this subcategory of SME already amounts to 98.7% of all EU enterprises (99.8% if all SME were covered), the costs of identifying around 1% of depositors during payout and potentially delaying the process of reimbursing depositors are estimated to be higher than the expected benefits of saving payouts to such a low number of depositors. Therefore, the Commission proposes to cover all enterprises regardless of size.

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<sup>1</sup> In Norway, the (converted) coverage level amounts to more than €240 000.

Since deposits by local authorities are currently excluded in 20 Member States, their exclusion would thus only be relevant in seven Member States and have a more limited impact than their inclusion. The coverage level of €100 000 would be insignificant for most of them since around 83% of local authorities in the EU are estimated to have deposits of more than €50 000 and about 72% of more than €100 000. However, in some EU-12 Member States (e.g. the Czech Republic and Lithuania), the average deposits of municipalities are the lowest in the EU so the impact there might be higher.

There are far fewer local authorities than depositors in the EU (about 121 000 local authorities while 450 million other depositors). The limited number of local authorities compared to all other depositors minimises the impact on financial stability in the event of a bank failure. Even if municipalities are technically insolvent, there are means under national law to ensure that they can continue to carry out their basic duties to the public and, if needed, they have much easier access to credit than ordinary citizens.

While all enterprises should be covered by Deposit Guarantee Schemes, local authorities should be excluded.

### **3. A PAN-EU DEPOSIT GUARANTEE SCHEME**

In order to improve cross-border cooperation among Deposit Guarantee Schemes and overcome the current fragmentation of the system (there are almost 40 schemes in the EU), the Commission services analysed the benefits and costs of introducing a pan-EU Deposit Guarantee Scheme. The following structural options were taken into account:

- a single entity acting as a pan-EU scheme, replacing the existing schemes;
- an additional scheme at EU level (a so-called ‘28th regime’) supplementing and supporting the existing schemes in 27 Member States;
- a network of existing schemes (‘an EU system of Deposit Guarantee Schemes’), including a mutual borrowing facility; this would mean that if the financial capacity of one DGS was depleted, it could borrow money from the other schemes (a similar system is applied in Austria).

As regards membership, the following options were taken into account: (i) all banks as members; (ii) only cross-border banks as members (i.e. banks with branches in another Member State); (iii) only large, systemically important banks as members.

A single pan-EU Deposit Guarantee Scheme would be cost-efficient, since it saves administrative costs of about €40 million per year. It would thus be an economically effective solution to overcome the fragmentation problem, but there are some legal issues to be further investigated. Therefore, the idea of a single pan-EU scheme should be seen as a longer-term project and be subject to further review by 2014. It should also be in line with the developments and progress as regards the new supervisory architecture in the EU and developments in bank resolution (see next section).

A ‘28th regime’ would seem rather ineffective since it would add complexity without resolving the problem of inconsistencies stemming from the existence of almost 40 schemes in the EU. A network of existing schemes (‘an EU system of Deposit Guarantee Schemes’)

would be relatively easy to set up since it would not require changes in the legal set-up of national schemes. Moreover, depositor confidence would be strengthened if there was a mutual borrowing facility between schemes, making the risk of government intervention less likely.

In this situation, a network of Deposit Guarantee Schemes with a mutual borrowing facility (see Annex) should be considered as the first step to establishing a single pan-EU scheme in the future. It should be noted that the introduction of a pan-EU scheme presupposes full harmonisation of Deposit Guarantee Schemes and could therefore only enter into force after the target level for their funds of 1.5% of eligible deposits has been reached.

A pan-EU Deposit Guarantee Scheme of whatever structure should comprise all banks. Any other option would be potentially distortive and would seem inconsistent with the Internal Market.

#### **4. EMERGENCY PAYOUT**

The Commission proposes to reduce the payout period to seven days. However, emergency payout has not been identified as a preferable option.

Fast payment of a certain amount in advance (e.g. €10000 in three days) while retaining the current payout period (i.e. four to six weeks) for amounts above €10000 would require Deposit Guarantee Schemes to pay out twice and the costs (stemming from human and technical resources) would likely almost double as well. Fast payout without proper verification of claims (due to time pressure) could result in a higher than normal rate of erroneous payments. It would result in further costs for Deposit Guarantee Schemes because of the resources required to recover erroneously paid money. It could be very difficult in practice and time consuming, as it would likely force schemes to challenge claims before the courts. An ‘emergency payout’ could also be detrimental to depositor confidence, as it would send a very negative market signal to depositors. Depositors who only receive part of their deposits on short notice may believe that the Deposit Guarantee Scheme does not have sufficient funds to pay the whole amount and may thereby cause a run on banks by trying to withdraw all their deposits.

Therefore, an ‘emergency payout’ would be cost-inefficient and could undermine depositor confidence. If a Deposit Guarantee Scheme can pay out €10000 after three days, it should also be able to pay out €100000 within a short deadline if it is soundly financed. It is much more efficient to ensure the necessary conditions to achieve a much faster standard payout as set out in the Commission’s legislative proposal.

#### **5. DEPOSIT GUARANTEE AND BANK RESOLUTION (ALTERNATIVES TO PAYOUT)**

The alternative to triggering Deposit Guarantee Schemes and liquidating the bank would be bank resolution (i.e. organising an orderly failure) that entails continuity of banking services, so that depositors have continuous access to their funds. In particular, deposits may be transferred to another bank.

However, the Directive on Deposit Guarantee Schemes should not be too prescriptive on such alternatives to payout since bank resolution is the subject of separate communications<sup>2</sup> paving the way for a forthcoming legislative proposal. The proposal on Deposit Guarantee Schemes should not anticipate the ongoing work on bank resolution, nor on the other hand should progress on Deposit Guarantee Schemes be delayed by further developments in this field. A good solution would be to ensure that the Directive on Deposit Guarantee Schemes remains adaptable to changes arising from further work on bank resolution. Consequently, the Commission proposes that the cost to Deposit Guarantee Schemes of transferring deposits as a resolution measure should not exceed the cost of reimbursing depositors.

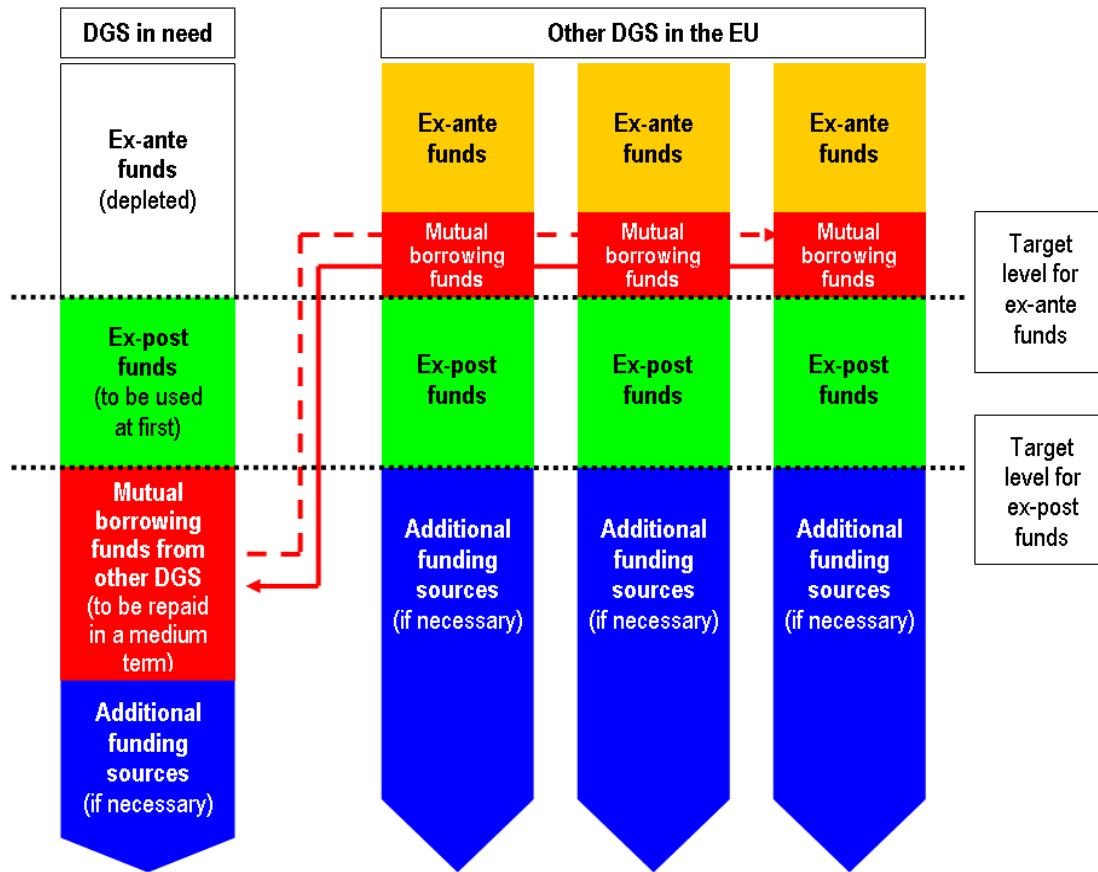
If Deposit Guarantee Schemes had a broader mandate, i.e. including early intervention measures (e.g. recapitalization, liquidity assistance, guarantees), they would need to be adequately funded. Additional funds would need to be collected beyond the target level. This is because bank resolution is an alternative to payout while early intervention does not always prevent a payout later on. For this reason, Deposit Guarantee Schemes should only to a limited extent be allowed to use their financial means in order to avoid a bank failure without being restricted to financing the transfer of deposits.

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**Annex: An outline of financing elements in an ‘EU network of Deposit Guarantee Schemes’ subject to mutual borrowing**

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<sup>2</sup> See COM(2009) 561 and COM(2010) 254.



Source: Commission services.