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Deposit Guarantee Schemes – Frequently Asked Questions

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EUROPEAN COMMISSION

MEMO

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Deposit Guarantee Schemes – Frequently Asked Questions

Why was the revision of the Directive on Deposit Guarantee Schemes necessary?

The original Directive on Deposit Guarantee Schemes (DGS) – adopted in 1994 – was not changed substantially for about 15 years although financial markets had significantly changed during that period of time.

The minimum harmonisation approach introduced in 1994 has resulted in significant differences between DGS as to the level of coverage, the scope of covered depositors and products and the payout delay. The financing of schemes was left entirely to Member States. This turned out to be disruptive for financial stability and the proper functioning of the Internal Market, notably when the financial crisis hit in autumn 2008.

Therefore the Council decided that the level of deposit protection should be gradually but quickly increased in the EU. The Directive of March 2009 required Member States to increase coverage of their DGS - first, to at least € 50 000, and then, to a uniform level of € 100 000 by the end of 2010.

Therefore, after first ensuring a targeted increase of the coverage level of DGS to reassure depositors, the Commission proposed in July 2010 a comprehensive review of the DGS Directive aimed at harmonising and simplifying the Directive in order to improve protection of deposits, maintain depositor confidence, and strengthen the safety net. The new funding requirements for schemes will ensure that DGS will be able to fulfil their obligations towards depositors, and faster access to deposits after a bank failure will stabilise the confidence of depositors and ensure financial stability.

What is the current level of deposit protection in the EU?

Deposits are covered up to €100.000.

In case of so-called temporary high deposit balance – stemming from real estate transactions (e.g. sale of a house) as well as from some specific life events (such as marriage, divorce, retirement, etc) – depositors will enjoy higher coverage, i.e. beyond the standard coverage level of € 100 000. However, such coverage will be limited in time (up to maximum 12 months).

Which deposits and depositors will be protected?

The new Directive confirms that € 100 000 is an appropriate level of protection and should be maintained. Deposits are covered per depositor per bank. This means that the limit of € 100 000 applies to all aggregated accounts at the same bank. If a bank operates under different brand names, the coverage level applies to the aggregated amount of all deposits of the same depositor held at this bank. Depositors must be informed that deposits held under different brand names of the same bank are not covered separately. However, deposits by the same depositor in different banks all benefit from separate protection.

Deposit Guarantee Schemes will protect all deposits held by individuals and enterprises whatever their size. However, deposits of financial institutions and authorities will not be covered (except for small local authorities that may be covered). Financial institutions do not need protection since they are professional market actors and authorities would have easy access to other sources of financing. Deposits in non-EU currencies will also be covered, which is important also for small and medium-size enterprises acting globally.

This above simplification and harmonisation will contribute to more transparency for depositors, faster verification of claims by the DGS, and in turn quicker reimbursement in the event of a bank failure.

How quickly will depositors get their money back after a bank failure?

Currently, depositors must be able to access their funds within 20 working days after a bank failure (or, more precisely, after the determination by the competent authority or a judge that deposits are unavailable).

Repayment deadlines will be gradually reduced from 20 working days to 7 working days. This reduction will be made in three phases:

- 15 working days as from 1 January 2019,
- 10 working days as from 1 January 2021, and eventually
- 7 working days as from 1 January 2024.

While the DGS will remain responsible for all banks authorised in their jurisdictions, they will also act as a "single point of contact" and manage, on behalf of the home DGS, the claims of depositors of local branches of banks opened in other EU Member States.

The measures stipulated in the Directive ensure that this faster pay-out will be achieved in practice. DGS will be informed at an early stage by supervisory authorities if a bank failure becomes likely. The DGS will have prompt access to information on deposits at any time. Banks will be required to tag eligible deposits, provide single customer views, and maintain their records up to date. The verification of claims is to be simplified by abandoning time-consuming set-off procedures. If a bank fails, no application from depositors will be needed: the scheme will pay on its own initiative.

As confirmed by the best practices in the world, rapid payout is feasible. In the United States, depositors are – even if under very different preconditions – usually paid out within a few days. A few years before the adoption of this Directive, the UK authorities also took measures to ensure a payout delay of one week.

What are the other benefits for depositors?

Depositors will have quite a number of further advantages: interest will now be taken into account when reimbursing deposits, loans cannot be deducted any more from the amount to be reimbursed, and depositors at branches of banks in other Member States will not be referred to a scheme in a country whose language they do not speak.

Moreover, the new Directive improves depositor information to ensure that depositors are aware of the key aspects of protection of their deposits by the DGS. For example, while depositing money at a bank, depositors will countersign a standardised information sheet containing all relevant information about the coverage of the deposit by the responsible DGS. The updated standardised information sheet will be sent by banks to their customers at least once a year. Banks will be obliged to inform their depositors about the DGS protection of their deposits on the statements of account. There will also be some restrictions on advertising on deposit products, by limiting it to factual information, without referring to unlimited protection, etc.

Will Deposit Guarantee Schemes have enough funds in place to ensure the safety of depositors' money?

There were shortcomings in certain countries the past. Even though it would economically not be feasible to provide DGS with an amount of money equivalent to all deposits, a new improvement ensure that banks will have to pay in to the schemes on a regular basis (ex ante), and not only after a bank failure (ex post).

In principle, the target level for ex ante funds of DGS is 0.8% of their covered deposits (i.e. about € 55 billion) to be reached within 10 years. In exceptional circumstances,(i.e. if the DGS has made cumulative disbursements in excess of 0.8% of covered deposits), Member States may extend the initial period of time for a maximum of 4 years.

In addition to ex ante contributions, if necessary, banks will have to pay additional (ex post) contributions to a certain extent, which will be limited in order to avoid pro-cyclicality and worsening financial situation of healthy banks. If this is still insufficient, DGS could borrow from each other up to a certain limit (on a voluntary basis) or – as a last resort – use additional funding sources, such as loans from public or private third parties (alternative funding arrangements).

The new financing requirements ensure that schemes have enough funds in place to deal with small and medium-size bank failures. Large banks will be subject to resolution according the Bank Recovery and Resolution Directive (BRRD).

Is it possible to set a higher or lower target funding level for DGS?

Yes. First, it should be noted that the above target funding level of 0.8% of covered deposits is a minimum level required by EU law. Member States can set a higher target levels for their DGS. Currently, schemes in about half of Member States have already reached the above target level or are relatively close to it. In one third of Member States, DGS funds are above 1% of covered deposits, and in a few of them, they are even beyond 2% or 3%.

On the other hand, the Directive stipulates that Member States, upon approval of the Commission, may set a target level lower than the above one, but not lower than 0.5% of covered deposits. This is possible where given the characteristics of the banking sector (e.g. concentration of most assets in a few banks) it is unlikely that banks will be liquidated,(they would be rather resolved), which makes triggering the DGS less likely.

Finally, it should be mentioned that the new Directive stipulates that 5 years after its entry into force, the Commission, supported by the European Banking Authority (EBA) will submit to the European Parliament and to the Council a report on, inter alia, the target level on the basis of covered deposits, with an assessment of the appropriateness of the percentage set, taking into account the failure of EU banks in the past.

How should the DGS funds be composed and invested?

In principle, the available financial means of DGS should include cash, deposits, and low-risk assets, which can be liquidated within a short period of time.

However, DGS funds may also consist of so-called "payment commitments". This means payment commitments of a bank towards a DGS which are fully collateralised providing that the collateral consists of low risk assets, and the collateral is unencumbered by third party rights. The total share of payment commitments shall not exceed 30% of the total amount of available financial means of the DGS. In order to ensure consistent application of the Directive in Member States, the European Banking Authority will issue guidelines on the irrevocable payment commitments.

Finally, in order to fulfil their obligations to reach the required target funding level, Member State may regard bank levies as equivalent to ex ante funds. The term "bank levies" refers to e.g. the mandatory contributions paid by banks to the State budget for the purpose of covering the costs related to systemic risk, failure, and resolution of institutions. However, "double counting" should be avoided, i.e. levies used for one purpose (BRRD) should not be counted for other purposes (e.g. to reach the target funding level required by the DGS Directive).

The available financial means of DGS must be invested in a low-risk and sufficiently diversified manner.

Will riskier banks pay more to DGS?

Yes. The Directive stipulates that the contributions to DGS will be based on the amount of covered deposits and the degree of risk incurred by the respective member. Without such risk-adjusting banks with the same amount of covered deposits would pay the same amount of contributions to DGS. If risk-adjusting is applied, those banks may pay different contributions (potentially, to a large extent), depending on whether their activity – measured by a set of specific indicators – is deemed more prudent or more risky. Riskier banks imply a higher likelihood of failure and, in turn, the need to trigger DGS. Therefore, such banks should pay more contributions to DGS.

On the other hand, Member States may provide for lower contributions for low-risk sectors which are governed by national law..

In order to ensure consistent application of this Directive in Member States, the European Banking Authority (EBA) will issue guidelines to specify methods for calculating the contributions to DGS. In particular, it will include a calculation formula, specific indicators, risk classes for members, thresholds for risk weights assigned to specific risk classes, and other necessary elements.

At the same time, DGS may use their own risk-based methods for determining and calculating the risk-based contributions by their members. However, each method shall be approved by the competent authority in a given Member states, and the EBA must be informed about the methods approved.

As stipulated by the new Directive, 3 years after its entry into force and at least every 5 years afterwards, the EBA shall conduct a review of the guidelines on risk-based or alternative own-risk based methods applied by DGS.

Should the use of DGS funds for bank resolution be allowed?

Yes, because it is often cheaper than paying out depositors. To a large extent deposit guarantee schemes and resolution frameworks share the same function: protecting depositors against the unavailability of their deposits, which may happen as a result of a single bank's failure or a systemic crisis.

DGS and resolution frameworks are mutually beneficial. On the one hand, resolution maintains the systemic functions of banks, avoids contagion and therefore additional payouts. On the other hand, DGS dissuades bank runs and therefore avoid vicious circles which lead to banks crises. As a result, the combined introduction of deposit guarantee schemes and resolution frameworks produces synergies.

In essence, maintaining the availability of deposits through resolution is equivalent to a payout. Indeed, it is even better – it is more beneficial for depositors to have continuous and unlimited access to their bank accounts and the full amount of their deposits than to have the right to a maximum of € 100 000 paid after several days (or weeks). Also, it is a cheaper solution when faced with a systemic crisis. Indeed, while a disorderly failure obliges the DGS to repay the total amount of covered deposits with an improbable and cumbersome claim over the liquidation estate, resolution "only" costs the amount necessary to bridge the gap and maintain the continuity of the systemic functions of the bank. Given that the means available for resolution are necessarily limited, it seems economically advantageous to allow the use of DGS funds for resolution purposes.

However, it appears necessary to limit such support to the potential cost which the DGS could have born in case the relevant institution would have failed.

What is the treatment of covered depositors under bail-in?

Covered deposits are explicitly excluded from the bail-in regime. This means that covered depositors will never suffer any losses and their deposits will always be protected up to the coverage level of € 100 000.

Is there depositor preference in insolvency and resolution? What does this mean for DGS?

Yes, there is depositor preference in both normal insolvency and resolution. More precisely, there is depositor preference for deposits held by natural persons and small and medium enterprises (SME) above the coverage level of € 100 000, whilst deposits under €100.000 are always protected. In both insolvency and resolution proceedings, claims of natural persons and SME have a higher ranking than claims of other creditors.

Can DGS and resolution funds be merged?

DGS and Resolution Funds must be separate (in terms of funding), but they can have a common administrative structure.

Should the use of DGS funds for early intervention be allowed?

Early intervention (recapitalization, liquidity assistance, guarantees, etc.) may be useful to rescue an ailing bank, but there is no guarantee that a bank failure will be avoided thanks such an intervention. As a result, payout of depositors may be eventually needed. Therefore, some DGS funds must be reserved for payout (or bank resolution measures, such as the transfer of deposits to another bank, which is an alternative to payout).

According to the Directive, DGS funds could be used for early intervention, provided that some conditions are met, e.g. the resolution authority has not taken any resolution action, the DGS has appropriate systems and procedures for selecting and implementing alternative measures and monitoring affiliated risks, the costs of the measures do not exceed the costs necessary to fulfil the statutory or contractual mandate of the DGS, etc. There is also a safeguard stipulating that the member banks of the DGS would have to provide the DGS with the means used for early intervention in the following situations: if there is a need to reimburse depositors and the available financial means fall below 2/3 of the target level, or if the available financial means of the DGS fall below 1/4 of the target level.

How does the proposal cater for the needs of Institutional Protection Schemes (IPS)?

IPS are loose groupings of banks of similar business profile in one Member State (e.g. Germany or Aistria) which have arrangements amongst each other to transfer funds and provide support to avoid the bankruptcy of a member-bank.

The new Directive gives them the following choice: an IPS may be officially recognised as a DGS (and be subject to all provisions of the Directive) or it may continue its activity as a pure IPS. In the latter case, an IPS would not be subject to the Directive (except for some information requirements), but its member banks would have to be members of an officially DGS in that Member State. This is to ensure that no bank may take deposits unless it is a member of such an officially recognised DGS.

The Directive acknowledges the stabilising function of IPS, which are aimed at mutual support of their members, and offers a lot of flexibility to them. The lower risk of banks adhering to IPS can be taken into account when risk-based contributions to DGS are determined. IPS can also continue to do their own risk assessment of their member banks.

Should we have a pan-European Deposit Guarantee Scheme in the EU?

A pan-EU DGS is not currently under discussion. The text opens the way to a voluntary mechanism of mutual borrowing between the Deposit Guarantee Schemes from different EU countries. This is the only form of mutualisation foreseen at this stage.

The pan-European Deposit Guarantee Scheme could be a potential option in the future once the current banking reforms (e.g. BRRD Bank Resolution and Recovery Directive) have been implemented and the other elements of the banking union such as the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) are in place.(.

That said, the new Directive stipulates that 5 years after its entry into force, the Commission will submit a report, and, if appropriate, could put forward a new legislative proposal.