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PRESS RELEASE

The Belgian deposit guarantee scheme in a European perspective

(Article published in the Economic Review, December 2010)

A deposit guarantee scheme provides a degree of protection for account holders' savings at the moment when a financial institution is unable to effect repayment. Since the financial crisis, such schemes have attracted greater attention. This article takes a closer look at the aims and the advantages and disadvantages of guarantee schemes, and how they were reformed at national and international level in view of the crisis. Those reforms are still ongoing, witness the recent legislative proposals by the European Commission on the matter. This article examines the implications and challenges resulting from these reforms, both for depositor protection and for the maintenance of financial stability.

Deposit guarantee schemes have two aims: to protect the savings of depositors and to maintain financial stability. By insuring the deposits, the deposit guarantee scheme fosters a climate of confidence so that banks are less exposed to self-fulfilling panics, or bank runs.

Deposit guarantee schemes have some advantages and disadvantages. By protecting deposits in times of crisis they safeguard the bulk of the financial wealth of households, preventing the development of a negative spiral between the financial sector and the real economy. Deposit guarantee schemes also offer some key advantages in connection with the maintenance of financial stability, especially in comparison with implicit guarantees which often offer a 'blank cheque' to all creditors of financial institutions. Thus, deposit guarantee schemes still provide incentives for monitoring risks by the market since they exclude a number of players (e.g. institutional investors, public authorities) from protection. Furthermore, they create a level playing field between large and small banks. However, deposit guarantee schemes do entail a risk of moral hazard. If the guarantees are substantial they may become a licence for risk-seeking behaviour on the part of both depositors and financial institutions, achieving the exact opposite of what was intended.

The schemes must therefore be so designed as that - as far as possible – they overcome these disadvantages while simultaneously attaining their goals of consumer protection and financial stability.

In the autumn of 2008, in order to restore confidence during the recent financial crisis, the deposit guarantee in Belgium was increased substantially from €20,000 to €100,000. That guarantee applies per depositor for the total accounts held per bank. It covers all deposits denominated in a currency of the European Economic Area, plus investment accounts and debt certificates issued by credit institutions (e.g. savings notes). A guarantee scheme for certain life insurance policies was also devised, similarly covering up to €100,000. The guarantee covering financial instruments and securities held with a depository (e.g. shares, bonds, investment funds) remains at €20,000.

The increased coverage under the Belgian scheme led to a substantial increase in the contributions from financial institutions; although that places a burden on the financial sector, it does enhance the credibility of the scheme. Up to now, the reserves of the Belgian guarantee scheme have come to around 0.4% of the total deposits held by households. It should be noted that a number of EU Member States have no *ex ante* reserves, so that they are totally dependent on resources collected *ex post* for any payout.

In view of the crisis, many EU Member States had already revised their deposit guarantees in 2008. An EU Directive in force since 11 March 2009 stipulates that all Member States must increase their guarantee levels to a minimum of €50,000 by July 2009 and to a fixed sum of €100,000 by the end of 2010.

As a result of the increased guarantee level of €100,000, individuals in Belgium now have virtually complete coverage. At the beginning of 2010 they held an average of around €22,500 in bank deposits. Although the deposit balances are unevenly distributed, with a small percentage of the population holding very large amounts, that average nevertheless indicates a high level of coverage implying that roughly 95% of deposits are fully guaranteed.

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A recent European Commission proposal for a new EU Directive, dated 12 July 2010, aims primarily to harmonise the schemes, as regards both the guarantees offered and the way they are financed, in order to create a level playing field between the Member States, promoting financial integration in the EU. Harmonisation was needed in view of the significant differences between national schemes and the lack of clarity which that created for customers of cross-border institutions. Thus, the proposal stipulates that from 2013, regardless of the institution which depositors have chosen in the EU, their total deposits per institution will be covered by a guarantee of €100,000, and the money must be paid out within 7 days after the default. The Commission also wants to enhance the efficiency and credibility of the schemes by simplifying their administrative rules and providing for more substantial *ex ante* financing, which is to amount to roughly 1.5% of total deposits by 2020. Finally, the proposal also devotes special attention to limiting risk-seeking behaviour, that could result from the guarantees offered, by making the financial institutions pay a contribution to the guarantee fund based partly on their risk profile. Despite the introduction of risk-based financing, however, prudential supervision and regulation will still have an important task to perform in limiting the risks.

However, this proposal has yet to be approved by the European Parliament and the Council. Its impact ought to be assessed in the light of the broader package of measures aimed at making the financial system more resilient, such as the new prudential supervision structure, the Basel III proposal for stricter capital and liquidity requirements, and the possible new levies on the financial sector.

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