Review of Directive 94/19/EC on Deposit Guarantee Schemes
The ABI’s Response to the EU Commission’s Consultation

Introduction

1. The ABI is the voice of the insurance and investment industry. Its members constitute over 90 per cent of the insurance market in the UK and 20 per cent across the EU. They control assets equivalent to a quarter of the UK’s capital. They are the risk managers of the UK’s economy and society. Through the ABI their voice is heard in Government and in public debate on insurance, savings, and investment matters.

2. The ABI welcomes the opportunity to respond to the Commission services’ consultation ‘Review of Directive 94/19/EC on Deposit Guarantee Schemes’.

3. The ABI is on the Register of Interest Representatives. Our registration number is 730137075-36. The ABI’s address is 51 Gresham Street, London EC2V 7HQ.

Overall Comments

4. The ABI has an interest in the Commission’s proposals relating to deposit guarantee schemes because of the potential read-across to the forthcoming proposals on insurance guarantee schemes. It is also the case that the structure of the UK Financial Services Compensation Scheme (FSCS) means that changes to the deposit protection element of the scheme can have a significant impact on insurers.

5. The UK has operated compensation schemes covering deposits, insurance and investments for over 30 years. The UK insurance industry supports the existence of compensation arrangements as an important factor in providing consumer protection and maintaining the industry’s reputation.

6. The separate compensation arrangements have now all been brought together under the FSCS. Although there remain separate sub-schemes for deposits, life insurance, general insurance, pensions and mortgage business recent changes have introduced a provision for cross-subsidy between the sectoral sub-schemes (a development to which the ABI remains strongly opposed).

7. We accept that the current financial crisis has shown that there is a need to strengthen compensation arrangements. However, we believe that the differences between the products available and the market structures in each Member State mean that it would be inappropriate to introduce highly harmonised compensation regimes. In particular we oppose any suggestion that there should be an EU-wide scheme or mutual bail-out arrangements between schemes – these would mean that the some of the cost of paying compensation would fall on firms (and indirectly
on customers) in other states most of whom will have no business in or connection with the Member State in which the insolvency has taken place. We would be concerned that such a system would not be understood by consumers and would lack legitimacy in the eyes of the industry thereby undermining confidence in compensation arrangements.

8. In our view, therefore, a lower harmonisation approach should be adopted which will enable compensation arrangements, subject to robust minimum criteria, to be tailored to meet the needs of each market. We accept that a unified level of compensation across the EU will help give depositors certainty about the level of compensation but Member States should have flexibility over issues such as scope, eligibility and funding arrangements for their national schemes.

9. Our detailed comments on some of the questions raised in the consultation paper are in the attached annex.
Questions for Consultation

Q2 Coverage level

We believe that the current minimum of €50,000 provides a high-level of coverage to depositors. However, we have no strong objections to an increase to €100,000.

What is important, however, is that compensation is not unlimited (or set at such a high level as to be effectively unlimited) as this creates moral hazard – neither banks nor depositors will have an incentive to behave cautiously if it is clear that full compensation will be paid in the event of failure. Unlimited (or very high) compensation can also distort competition as it might encourage some banks to offer (and many depositors to accept) unsustainably high returns in the knowledge that depositors would be fully compensated.

Q13 – Q.16: Eligibility of depositors

The main function of compensation schemes should be to protect individual customers and small businesses. Therefore, while we believe that Member States should have some discretion over eligibility we believe that compensation should not normally be available to larger businesses, public bodies or larger charities/voluntary sector bodies. It should be assumed that these bodies have access to professional advice not available to individual customers and so are better placed to assess the risks of placing deposits with a particular institution.

It should also be recognised that while providing compensation to such entities at €50,000 or €100,000 will substantially increase the burden of paying compensation on the industry it will do little to mitigate the potential losses suffered by these bodies.

Q17 Coverage of companies

We believe that coverage should be limited to small enterprises and below.

Q18 Pan-European DGS

We disagree that there should be any form of pan-European DGS (or IGS if and when these become a directive requirement) or any requirement for mutual bail out provisions between national schemes. Such arrangements would mean that some of the cost of paying compensation would fall on firms (and indirectly on customers) in other states most of whom will have no business in or connection with the Member State in which the insolvency has taken place. We would be concerned that such a system would not be understood by consumers and would lack legitimacy in the eyes of the industry thereby undermining confidence in compensation arrangements. It should be a matter for individual national
governments to put in place arrangements to provide support to compensation schemes where necessary.

**Q21 Mandate of DGS**

The fundamental job of a compensation scheme is to act as the last resort provider of compensation to the customers of a failed financial institution. It may well be appropriate for a compensation scheme to have wider responsibilities (in the UK this has long been the case for life insurance and has recently been introduced in respect of the deposit scheme) but it should be a matter for individual Member States to decide whether to provide national schemes with these powers.

**Q27 – Q33 Procedures for payouts**

We do not have detailed comments on these proposals. However, we wish to point out that this is an area where banking and insurance are significantly different. There is a need for fast payouts in respect of deposits, as customers will need access to their money in order to avoid disruption to many day-to-day activities. However, in the case of insurance this will not usually be the case – claims will only need to be paid out when they fall due which in many cases could be some years after the insurer becomes insolvent. In the UK the FSCS is still paying claims arising from the failure of firms (Independent and Chester Street) that became insolvent at the beginning of this decade – and in the case of Chester Street it is expected that some claims will continue for the next 20 years or more.

Therefore, the Commission should be aware that when it considers the introduction of IGS payout procedures should be adopted which are appropriate for the industry and there should be no read-across from the banking provisions.

**Q37-Q39 Funding mechanisms**

We believe that this should remain a decision for Member States with respect to their national schemes.

In the UK all the sub-schemes of the FSCS operate on an ex-post basis (with liquidity provided by loans from the Government when needed). However, the UK Government is currently considering whether to move the deposit scheme to a pre-funded basis.

Pre-funding may be appropriate in the case of deposits where there is a need to have money available for fast payouts. However, we do not believe that this would be appropriate for insurance where payment of claims may be spread across many years.