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AK Position Paper

Recast of directive 94/19/EC of the European Parliament and the Council on Deposit Guarantee Schemes (COM(2010)368)

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About us

The Federal Chamber of Labour is by law representing the interests of about 3.2 million employees and consumers in Austria. It acts for the interests of its members in fields of social-, educational-, economical-, and consumer issues both on the national and on the EU-level in Brussels. Furthermore the Austrian Federal Chamber of Labour is a part of the Austrian social partnership.

The AK EUROPA office in Brussels was established in 1991 to bring forward the interests of all its members directly vis-à-vis the European Institutions.

Organisation and Tasks of the Austrian Federal Chamber of Labour

The Austrian Federal Chamber of Labour is the umbrella organisation of the nine regional Chambers of Labour in Austria, which have together the statutory mandate to represent the interests of their members.

The Chambers of Labour provide their members a broad range of services, including for instance advice on matters of labour law, consumer rights, social insurance and educational matters.

More than three quarters of the 2 million member-consultations carried out each year concern labour-, social insurance- and insolvency law. Furthermore the Austrian Federal Chamber of Labour makes use of its vested right to state its opinion in the legislation process of the European Union and in Austria in order to shape the interests of the employees and consumers towards the legislator.

All Austrian employees are subject to compulsory membership. The member fee is determined by law and is amounting to 0.5% of the members' gross wages or salaries (up to the social security payroll tax cap maximum). 560.000 - amongst others unemployed, persons on maternity (paternity) leave, community- and military service - of the 3.2 million members are exempt from subscription payment, but are entitled to all services provided by the Austrian Federal Chambers of Labour.

Herbert Tumpel
President

Werner Muhm
Director

Executive Summary

The AK wonders whether a predominantly ex-ante financed fund represents the adequate solution for preventing a bank run.

- In view of the experiences with the dramatic developments of the 4th quarter 2008, the AK wonders whether a **predominantly ex-ante financed fund** represents the adequate solution for preventing a bank run, as **in systemic crises** the funds would be subject to the same capital market risks as other investors. In addition, the liquidity requirement of the deposit guarantee scheme funds would in the event put massive pressure on government bonds and trigger a sovereign-debt crisis.

- The question what would happen in case the target value has not yet been reached, also remains open - in this case, the Deposit Guarantee Schemes, none of which have reached the target level, **would not provide the necessary security to prevent a bank run**, so that once again only liability assumed by the states might provide the necessary confidence, as happened in the 4th quarter 2008.

- We welcome the plan to create the opportunity to **liquidate a bank through the deposit guarantee scheme**. This would limit the moral hazard of holders and managers. However, we are against the option to use the deposit guarantee to prevent bank insolvencies, which could turn Deposit Guarantee Schemes into bank insolvency funds.

- We also welcome the **provision of risk measures** at determining the contribution level; however, because of the "too big to fail" problem, it should be replaced by graduated contributions.

- The confirmation of the current **coverage level of EUR 100 000** is to be welcomed. Capping the coverage level is necessary to limit the moral hazard and to prevent any distortions of competition.

- Providing **savers** and intending savers with improved and mandatory **information** on the deposit guarantee, the Directive proposal fulfils a long-term request of the AK.

- The AK proposes to amend the Directive proposal with regard to making it **mandatory** to **refer** to the deposit guarantee in **all** forms of **advertising for savings products**. This could be achieved by introducing a uniform EU logo.

- Apart from that, the Directive should also provide for mandatory **information,** if an investment product (e.g.

bank bond) is **not** covered by the deposit guarantee.

- The proposal is ambiguous with regard to the **definition "deposit"**. Providing clarification on savings clubs and escrow accounts/custody accounts, which are used for buying and administering residential property, the text of the Directive would be desirable.

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- The AK supports the request of BEUC (The European Consumer´s Organisation), which considers a **separate** deposit guarantee level **for each bankmark used by a bank** to be necessary and not only - as intended - for each bank license. This would give greater protection to investors.

The AK position in detail

The AK considers it indispensible that savings certificates continue to be expressly included in the definition of deposit.

Article 1, a) Definition deposit/savings certificates

The proposed provision gives rise to concern that in future savings certificates will no longer be covered by the deposit guarantee because the formulation Art 1.1 "and any debt evidenced by a certificate issued by a credit institution" has been cancelled. The AK considers it indispensible that savings certificates continue to be expressly included in the definition of deposit.

The explanation in the Directive (page 7, Article 7.1.) comments on the definition: *"Deposits are now defined more clearly. Only entirely repayable instruments can be deemed deposits, not structured products, certificates or bonds. This prevents DGSs from taking unpredictable risks with investment products."* Recital 17 is also rather vague and says *"certain financial products with an investment character should be, excluded from the scope of coverage, in particular those that are not repayable in par."*

In our view, the definitions including exceptions are overall vague and not formulated precisely enough. In particular the three cases where instruments are defined, which are not considered to be a deposit, are open to scrutiny. The terms "instrument", "statement of account" and "par" are not clearly defined legally. The first exception should be supplemented by the savings certificate. The repayability at par is by itself not suitable as a limitation criterion. Delimitation in accordance with the type of deposit/security would be more appropriate.

One problem could lie in the exception of so-called "structured investment products" (to be found in the explanation of the Directive - see above). Over the past years, combination products, which would inextricably link a savings book with fund or security savings, have been forced through in Austria. Although it is indisputable that money in a savings account is covered by the deposit guarantee, linking it with funds assessment certainly makes processing more complicated. Legal clarification including a full explanation, which deposits are protected, is necessary in view of the increased complexity of investment products (e.g. linking the saving deposit rate to index, inflation etc).

Article 1, d) Joint account

The Recitals of Directive RL 94/19 EC on Deposit Guarantee Schemes state that the deposit guarantee *"per de-*

positor rather than per deposit has been retained; whereas it is therefore appropriate to take into consideration the deposits made by depositors who either are not mentioned as holders of an account or are not the sole holders; whereas the limit must therefore be applied to each identifiable depositor."

The AK supports the notion that this clarification will be incorporated in the new Directive text and - also in this clarify - in the definitions. This exact definition is especially necessary as the scope of joint accounts plays a major part in practice (from saving clubs to escrow accounts/custody accounts).

It is main task of the financial markets regulation to limit the systemic risk as much as possible.

Article 1, h) Target level

In view of the experiences with the dramatic developments of the 4th quarter 2008, the AK wonders whether a predominantly ex-ante financed fund represents the adequate solution for preventing a bank run, as in systemic crises the funds would be subject to the same capital market risks as other investors. The liquidity requirement in the event could even aggravate such crises because the Deposit Guarantee Schemes would in turn be forced to sell, which would withdraw liquidity from the market in a systemic crisis and put massive pressure on government bonds and trigger a *sovereign-debt* crisis, which, as the current situation has demonstrated, can quickly spread to other states. Above all, in the event that the target value could not been reached, no Deposit Guarantee Scheme could provide the necessary security to prevent a bank run, so that in the end once again only liability assumed by the states might provide the necessary confidence, as was the case in the 4th quarter 2008.

In view of the concerns in respect of having too much confidence in an ex-ante solution (systemic crises, *moral hazard*), the AK therefore supports one aspect of ex-ante financing, but proposes a lower target level of 1 %. A target level double as high would probably not be sufficient for a systemic crisis and it should be made clear that the part of the deposit guarantee, which was financed ex-ante should and could be used to prevent a bank run and possible chain reactions if an institution is in trouble, but not in case of a system crisis.

However, it is main task of the financial markets regulation to limit the systemic risk as much as possible. Once systemic risk occurs it is difficult to keep und control, which makes it easy for it to spread to other sectors. In particular the tolerated even promoted creation of a shadow financial system, undercapitalization through over optimistic model assumptions and procyclic evaluation rules as well as a naive belief in the market before the crisis have all contributed to this systemic risk. If this risk is not

limited through regulation, it will not be possible to repair it by guarantee schemes. The AK therefore urges the decision makers to give high priority to considerations on financial market stability when it comes to regulating the financial markets and to address issues such as capital buffers for credit institutions.

Article 5 (1) Fixed coverage levels EUR 100 000

The AK welcomes that the coverage level has been fixed at a high standard. One of the advantages of a fixed coverage level is that it prevents misleading advertising with the level of coverage level. The fixed coverage level also prevents distortion of competition between the states and can limit the *moral hazard*.

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Article 5 (2) Option Member States: coverage above the limit of EUR 100 000

The explanation of the Directive proposal (Article 7.2., page 7) includes an option by the Member States, which is not repeated in this form in the Recitals and in the text of Directive: *"However, Member States may decide to cover deposits, arising from real estate transactions and deposits relating to particular life events above the limit of EUR 100 000, provided that the coverage is limited to 12 months."*

The Directive itself stipulates in Art 5 Paragraph 2 that the coverage for private residential properties resp. certain social purposes should only be covered *"provided that the costs for such repayments are not subject to Article 9, 10 and 11 … "* This means that the repayment of these deposits is not financed by the Deposit Guarantee Scheme and that it is state aid (Recital 15). Whether this regulation belongs into the Deposit Guarantee Directive is doubtful. Apart from that, it is not clear which deposits it actually refers to (*"deposits arising from real estate transactions"*). Shall the vendor of a property be protected who receives the sales proceeds in his account or does it concern the escrow account, which is (almost) inevitably used for property purchases, until the change of holdership has been entered in the land registry.

The proposed period of 12 months after the amount has been credited is too short in case of real estate transactions as in respect of newly constructed buildings the purchase price often has to be deposited in an escrow account for a longer period, for example 20 months before handover. This justifies extending this period to 24 months.

In our opinion, the other "social purposes" in lit b are also inadequately defined.

It would be welcome if in all cases, where the depositor "involuntarily" or due to legal/ official procedures (for example deposits resulting from real estate transactions for private residential purposes, inheritance) deposits an amount above the deposit guarantee limit of EUR 100 000 at a bank, a higher threshold would be considered for a certain period.

The AK proposes that amounts above EUR 100 000, resulting from real estate transactions for private residential purposes should also be covered by Deposit Guarantee Schemes.

The AK proposes that amounts above EUR 100 000, resulting from real estate transactions for private residential purposes should also be covered by Deposit Guarantee Schemes. These transactions frequently concern higher amounts; however, they are generally deposited for a shorter period than saving deposits, because the amounts have only been deposited in an escrow account until the legal transaction is complete. From our point of view, this circumstance would justify these deposits being included in the Deposit Guarantee Scheme, even if their amount exceeds EUR 100 000.

Article 9 Financing of Deposit Guarantee Schemes

We welcome the proposal of Paragraph 5, 2nd sentence that Deposit Guarantee Schemes may be used in order to finance the transfer of deposits to another credit institution, provided that the costs borne by the Deposit Guarantee Scheme do not exceed the amount of covered deposits at the credit institution concerned. This would limit the *moral hazard* of holders and managers, because this would enable rescuing the banking functions without rescuing those who previously benefited from taking an excessive risk or whose wrong decisions were responsible for the bank getting into difficulties.

The AK is very sceptical of the proposal of Paragraph 5., 3rd sentence concerning the prevention of bank failures. This option again reduces the limitation of the moral hazard, where the focus is on rescuing the bank function and not the holder. Apart from that there is a danger that the deposit guarantee develops into an insolvency fund for credit institutions.

According to Paragraph 6, the Member States have to ensure, *"that Deposit Guarantee Schemes have in place adequate alternative funding arrangements to enable them to obtain short-term funding where necessary to meet claims against those Deposit Guarantee Schemes."* In case of a major crisis, a financing option as such would implicitly assume state aid, as was demonstrated at the end of 2008. The depositors were only reassured when the Republic assumed liability, which finally resulted in the fact that no guarantee case occurred because of the liability commitment.

The AK welcomes a harmonisation of the contributions, because institutions willing to take risks contribute more to the guarantee scheme.

Article 11 Calculating risk-based contributions to Deposit Guarantee Schemes as well as Annex I and Annex II

The AK welcomes a harmonisation of the contributions, because institutions willing to take risks contribute more to the guarantee scheme. However, we miss the fact that the "too big to fail" problem has not been taken into account and therefore propose that the total assets of a member as a share in the total assets of the credit institutions should be included as an additional indicator. The *"too big to fail"* problem and the *moral hazard* (susceptibility of the states to be blackmailed, because the insolvency of a systemic important state would plunge the entire economy into difficulties) associated with it are a factor in almost all the literature and economic policy discussion concerned with the financial and economic crisis. That is why this factor should be taken adequately into account.

Article 12 Cross-border cooperation

We welcome the improvement in cross-border cooperation. However, depositors, who have their residence in another country than the host Member State of the bank, should have the opportunity to benefit from cross-border cooperation in the deposit guarantee case and easier communication. This would mean that it would no longer matter where the bank has its headquarters (current legal situation) or where the bank has a branch (Directive proposal), but that each EU citizen has access to the Deposit Guarantee Scheme in his home country as point of contact and processing and pay office.

Article 14 Depositor information

In general, greater information duties towards the depositor are desirable, because in practice - there is no other way of explaining the many enquiries to the AK Consumer Advice Bureau - there is obviously a significant lack of information concerning the functioning of the deposit guarantee and the affiliation of the bank to a (certain) deposit guarantee.

The improvement of information on the deposit guarantee is therefore very welcome. In particular that in case of existing contracts information is provided on the statement of account. We assume the provision of an obligation whereby in case of existing savings books such information is already printed on the savings certificate or sent to the identified holder by post. Apart from that depositors should receive regular information on the deposit guarantee - once a year on the statement of account or the savings certificate to prevent any information deficits and ambiguities and to strengthen consumer confidence.

Why Art 14 Paragraph 1 states that *"Member States shall ensure that credit institutions make available to actual*

Enquiries during the financial crisis have shown that many consumers have little knowledge of the deposit guarantee and that information, which is as clear as possible, is required.

and intending depositors the information necessary for the identification of the Deposit Guarantee Scheme", is difficult to understand. This basic information should form part of the depositor information. To expect depositor to identify the relevant deposit guarantee themselves is both unreasonable and unacceptable.

The information sheet for intending depositors in accordance with Annex III makes sense. However, that the depositor - before concluding a deposit agreement - has to "countersign" this information sheet (page 4 point 3.1. and page 10 point 7.7. of the Directive explanation) is unusual and difficult to understand. Normally, the institution is obliged to inform the consumer of other pre-contractual information duties or make these available to him.

The AK is also in favour of the proposal that the depositor should not only be informed - as provided in Art 14 Paragraph 1 - if deposits pursuant to Art 4 are not repayable, but that the depositor/investor should also be informed if a deposit/investment - even if it is not a deposit pursuant to Art 2. In particular, if a consumer invests money in a bank's own products, which are issued by the same institution, information should be provided prior to concluding a contract that this investment is not covered by the deposit guarantee. Enquiries to the AK Consumer Advice Bureau during the financial crisis have shown that many consumers (depositors and investors) have little knowledge of the deposit guarantee and that information, which is as clear as possible, is required.

The European Consumer´s Organisation BEUC also sees a problem in the fact that the total amount of deposits - if a bank uses different names - should be combined and is in favour of the deposit guarantee to apply to each bankmark separately. The AK supports this request as this method provides more protection for the depositor. Consumers perceive banks more on the basis of their brand names and not according to the license granted.

However, should the regulation be adopted as proposed, it should become mandatory to inform existing depositors of any change in the company structure (e.g. change of a bank's name). It should be mandatory that the list of brands used by a credit institution should be made available to all customers of this institution.

We are therefore in favour of providing information in the investor information sheet in a comprehensible and non-technical language. The currently used definition "due and payable" deposits is perhaps not all that clear to consumers.

Article 14 (5) Mandatory reference in advertisements

The Directive explanation (page 4 point 3.1.) states a *"mandatory reference to DGSs in account statements*

and advertisements". In our opinion, the text of the Directive itself does not provide for any mandatory reference in advertisements. Art 14 only states: *"Member States shall limiting the use in advertising of the information referred to in paragraph 1 to a factual reference to the scheme guaranteeing the product to which the advertisement refers."*

The AK is in favour of committing a bank that advertises investment products, which are issued by the same bank, to insert a mandatory reference in its advertisements that these products are not covered by the deposit guarantee.

This only means from our point of view that for example the amount of the coverage level may not be advertised. However, the wording provides for a mandatory reference for any type of advertising. However, this would be desirable as the market often advertises top interest rates and intending depositors often complain about a lack of information. The AK requests that all advertisements for deposits have to include a mandatory reference to the Deposit Guarantee Scheme. This could be achieved by introducing an EU-wide uniform logo/certification mark. This mark would make it far easier for savers to place bank and investment offers. In addition, such a certification mark would increase the level of awareness of consumers across the EU and the knowledge of the scheme and the advantages of the deposit guarantee. A deposit guarantee mark could also be attached on savings certificates or statements of account.

We are in favour of committing a bank that advertises investment products, which are issued by the same bank (e.g. bank bonds, housing bonds), to insert a mandatory reference in its advertisements that these products are not covered by the deposit guarantee.

Guarantee associations/institution related guarantee schemes

The information restriction in Art 14 Paragraph 5 concerning institution related guarantee schemes, which are not recognised as a Deposit Guarantee Scheme and do not protect any deposits, is to be welcomed as hitherto the Austrian member institutions of the guarantee associations have informed savers of the unlimited deposit guarantee of the relevant guarantee association. What seems to be unclear is whether institute related guarantee schemes are possible, which are not recognized pursuant to Art 1 Paragraph 3, but which nevertheless guarantee deposits. This question arises from the reverse conclusion in Art 1 Paragraph 4.

Should you have any further questions please do not hesitate to contact

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