Protection of Small Depositors against Banks in Distress[1]

1. Introduction

The Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions, to be implemented by EU Member State prior to 5 May 2004, states in recital (5): 'The adoption of Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes, which introduced the principle of compulsory membership by credit institutions of a guarantee scheme in their home Member State, brings out even more clearly the need for mutual recognition of reorganisation measures and winding-up proceedings'. In this article I will describe the contents of the Directive on deposit-guarantee schemes ('Directive 94/19'), which was adopted ten years ago.[2] It should be noted in advance, that within the European Community the Directive on deposit-guarantee schemes is to be regarded as an early demonstration of a measure to harmoniously align the activities of credit institutions throughout the Community area.[3] Directive 94/19 and the Winding-up Directive with regard to credit institutions (Directive 2001/24) mainly are a product of the same banking crisis, the collapse of Bank of Credit and Commerce International (BCCI) in 1991. In the beginning of the 90s the drafting work on the proposal for a Winding-up Directive came to a standstill, but the demise of BCCI in 1991 led to a new impulse in June 1993. The part in the proposal containing the draft-norms on deposit insurance was taken out and became the object of a separate Directive.[4] The Directive 94/19 has a double aim, namely to promote this harmonised alignment through the elimination of all restrictions on the right of establishment and the freedom to provide services, while increasing the stability of the banking system and protection for savers. See the Directive's first recital.[5] Therefore 'savers' are protected in that they to a certain limit will not loose their money when this is deposited at a bank and the bank is unable to pay its debt to this depositor. In the context of the Directive 94/19 a 'deposit' shall mean 'any credit balance which results from funds left in an account or from temporary situations deriving from normal banking transactions and which a credit institution must repay under the legal and contractual conditions applicable, and any debt evidenced by a certificate issued by a credit institution', see art. 1 Directive 94/19. Hereunder we will take a closer look at this definition.

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[1] Author: Bob Wessels. Source: Journal of International Banking Law and Regulation 2004/9, 331ff.

[2] I will not deal here with the alleged causal relation between the Directive 94/19 and the Winding-up directive with regard to credit institutions, Directive 2001/24.

[3] It should be noted that the Directive is applicable to deposit-protection schemes for branches established in other EEA Member countries (Norway, Iceland, Liechtenstein).

[4] See Galanti, The New EC Law on Banking Crisis, in: International Insolvency Review 2002, p. 49 et seq. The author points out that the enactment of Directive 94/19 stressed even more the lack of a European framework on mutual recognition of bank crisis measures; on the other hand the priority to speedily finalise the Winding-up proposal decreased because in 1994 a European coordination of national compulsory protection schemes was now in place.

[5] The recitals have not been numbered. In total there are 24 'Whereasses'.

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2. Background

The Directive's goal is to arrange for a legal framework for the situation, which might arise if deposits in a credit institution that has branches in other Member States become 'unavailable'.[6] In the recitals it is described as '….. indispensable to ensure a harmonised minimum level of deposit protection wherever deposits are located in the Community; whereas such deposit protection is as essential as the prudential rules for the completion of the single banking market.' Recital 24 says that '….. deposit protection is an essential element in the completion of the internal market and an indispensable supplement to the system of supervision of credit institutions on account of the solidarity it creates amongst all the institutions in a given financial market in the event of the failure of any of them'. These wordings underline that deposit protection is regarded as of utmost importance. Depositors should be protected in the event of the closure of an insolvent credit institution, but the depositors at any branches situated in a Member State other than that in which the credit institution has its head office must be protected too by the same guarantee scheme as the institution's other depositors. Protection pays off, is the underlying idea of the directive.[7]
The Directive 94/19 must be seen in a development over time. The EC Commission issued a recommendation in 1986[8] with regard to the introduction of deposit-guarantee schemes in the Community, but the Parliament and the Council did determine nearly eight years later that the recommendation had not fully achieved the desired results. Various schemes were in place in Austria, Belgium, France, Germany, The Netherlands, Spain and the UK; the recommendation was adopted by Denmark, Ireland, Italy and Luxembourg, but Portugal and Greece did not install schemes. It was concluded that this situation might prove prejudicial to the proper functioning of the internal market, which provided for a system for the single authorisation of each credit institution and its supervision by the authorities of its home Member State, which entered into force on 1 January 1993.[9] Whereas the single authorisation is valid throughout the Community ('European passport'), a branch in a host Member State does not longer require authorisation in that latter State. Its taking up and carrying forward of the banking business and its solvency will be monitored by the competent authorities of its home Member State ('Home country control'). It is

[6] See on the theme in general Jackson, Deposit Insurance and bank Failures in the United Kingdom, in: Financial Stability Review 1996, p. 38ff; Devos, La Protection des Systèmes de Paiement en Cas de Défaillance d'un Participant, in: 59 Revue de Droit Bancaire 1997, p. 11ff; Garcia, Deposit Insurance – A Survey of the Actual and Best Practices, IMF Monetary and Exchange Affairs Department Working Paper, WP/99/54 (1999); Hüpkes, The Legal Aspects of Bank Insolvency. A Comparative Analysis of Western Europe, the United States and Canada, Studies in Comparative Corporate and Financial law, Volume 10, The Hague/London/Boston: Kluwer Law International (2000), p. 27 et seq. and p. 149 et seq.; Dale, Deposit Insurance in Theory and Practice, Journal of Financial Regulation and Compliance, Vol. 8, no. 1, 2000, p. 36 et seq.; Garcia and Prast, Depositor and Investor protection in the EU and the Netherlands: A Brief History (2003), available via <<www.dnb.nl>>.

[7] According its fourth recital the cost to credit institutions of participating in a guarantee scheme bears no relation to the cost that would result from a massive withdrawal of bank deposits '….. not only from a credit institution in difficulties but also from healthy institutions following a loss of depositor confidence in the soundness of the banking system'.

[8] O.J. L 33 of 4 February 1987.

[9] Second Council Directive 89/646/EEC of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC, O.J. L 386 of 30 December 1989, as amended by Directive 92/30/EEC (O.J. L 110 of 28 April 1992).

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this situation that justifies covering all the branches of the same credit institution set up in the Community by means of a single guarantee scheme, see recital seven, which continues: '….. whereas that scheme can only be that which exists for that category of institution in the State in which that institution's head office is situated, in particular because of the link which exists between the supervision of a branch's solvency and its membership of a deposit-guarantee scheme.' Therefore, with the Directive 94/19, an approach of harmonisation is adopted that confines itself '….. to the main elements of deposit-guarantee schemes and, within a very short period, ensure payments under a guarantee calculated on the basis of a harmonised minimum level'.[10] Given this context of the regulation of the business of credit institutions it is therefore logical that Directive 94/19 uses definitions, which mirror these of other EU measures. A 'credit institution' shall mean an undertaking the business of which is to receive deposits or other repayable funds from the public and to grant credits for its own account'. This definition laid down in art. 1(4) Directive 94/19 has been taken from (the predecessor of) the 2000 Banking Directive. The description of 'credit institution' does not apply, though, to the Central banks of the Member States or a grouping of other financial institution such as credit unions, municipality banks, friendly societies and post office giro institutions.[11] According to art. 1(5) Directive 94/19 a 'branch' shall mean a place of business which forms a legally dependent part of a credit institution and which conducts directly all or some of the operations inherent in the business of credit institutions; any number of branches set up in the same Member State by a credit institution which has its head office in another Member State shall be regarded as a single branch. This definition nearly literary has found its way into the Winding Up Directive on Credit Institutions (Directive 2001/24).[12] The implementation date of the Directive 94/19 was 1 July 1995.[13]

3. Deposit and depositor

A 'deposit' shall mean any credit balance which results (i) from funds left in an account or (ii) from temporary situations deriving from normal banking transactions and (both (i) and (ii)) which a credit institution must repay under the legal and contractual conditions applicable, and any debt evidenced by a certificate issued by a credit institution. Art. 1, fourth sentence, describes the method to understand 'credit balance', by providing that for the purpose of calculating a credit balance, Member States shall apply the rules and regulations relating to set-off and counterclaims according to the legal and contractual conditions applicable to a deposit. Certain types of legal

[10] Recital 8.

[11] See for the whole list of excluded institutions art. 2(3) 2000 Banking Directive. The definition however applies e.g. to savings banks and mortgage banks, see Garcia and Prast (note 4 above), p. 7.

[12] The word 'conducts' became 'carries out' and 'operations' evolved in 'transactions'.

[13] See art. 14, which provides furthermore, that Member States shall forthwith inform the Commission of the implementation. The Member States shall communicate to the Commission the texts of the main provisions of national law, which they adopt in the field governed by this Directive, see art. 14(2). In principle the Directive also applies to the 10 EU-accession countries, which will bring the EU to a 25 Member States community in May 2004, see O.J. L 236 of 23 September 2003.

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instruments will be treated as deposits, where certain others shall not.[14] It has been found appropriate to exclude from cover, in particular, the deposits made by credit institutions on their own behalf and for own account (art. 2 first dash).[15] Art. 2 excludes also from any repayment by guarantee schemes 'own fund instruments' of a credit institution and deposits arising out of money laundering transactions.[16]

The Directive's basis is 'the principle of a harmonised minimum limit per depositor rather than per deposit'. The limit applies '…. to each identifiable depositor.'[17] A deposit-guarantee scheme shall stipulate that the aggregate deposits of each depositor must be covered up to €20 000 in the event of deposits' being unavailable (art. 7(1)).[18] It was recognised that '….. in the interest both of consumer protection and of the stability of the financial system' a minimum guarantee level should not leave too great a proportion of deposits without protection. It would, however, not be appropriate to impose throughout the Community a level of protection which might in certain cases have the effect of '….. encouraging the unsound management of credit institutions'. In 1994 it appeared reasonable that within a balance between these protective principles and the moral hazard to which they may lead[19] – taking too into account the cost of funding schemes – the harmonised minimum guarantee level should be set at ECU 20 000.[20]

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[14] Shares in UK and Irish building societies apart from those of a capital nature covered in art. 2 Directive shall be treated as deposits. Bonds, on the other hand, which satisfy the conditions prescribed in Art. 22(4) Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (O.J. C 163 of 30 June 1992 and O.J. C 178 of 30 June 1993) shall not be considered deposits, see art. 1, second and third sentence.

[15] Although this should not prejudice the right of a guarantee scheme to take any measures necessary for the rescue of a credit institution that finds itself in difficulties, according to the tenth recital.

[16] All instruments which would fall within the definition of 'own funds' in art. 2 Directive 89/299/EEC of 17 April 1989 on the own funds of credit institutions, O.J. L 124 of 5 May 1989, and deposits arising out of transactions in connection with which there has been a criminal conviction for money laundering as defined in art. 1 Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering, O.J. L 166 of 28 June 1991.

[17] Recital 19.

[18] In certain Member States it is encouraged that depositors look carefully at the quality of credit institutions, with the sanction that an 'unavailable' deposit is not fully reimbursed. The Directive wishes to limit such a practice in respect of deposits falling below the minimum harmonised level, see recital 18, second sentence. The Directive contains a transitional provision saying that until 31 December 1999 Member States in which deposits are not covered up to (at that time) ECU 20 000 may retain the maximum amount laid down in their guarantee schemes, provided that this amount is not less than ECU 15 000.

[19] See e.g. Garcia, Deposit Insurance: Obtaining the Benefits and Avoiding the Pitfall, IMF Working Paper 96/83 (August 1996). In contrast to previous empirical literature, recent research findings show that the establishment of explicit deposit insurance schemes significantly reduces the risk taking of banks, see: Gropp and Vesala, Deposit Insurance and Moral Hazard: Does the Counterfactual Matter?, European Central Bank Working Paper No. 47, March 2001.

[20] For the quotations see Recital 16.

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The central principle of a €20 000[21] guarantee cover for every deposit however does not include all depositors or deposits. Member States may provide that certain depositors or deposits shall be excluded from guarantee or shall be granted a lower level of guarantee (art. 7(2)). Those exclusions are listed in Annex I.[22] The choice for a Member State to exclude a depositor or a deposit seems to be related to that State's own considerations with regard to the need of special protection.[23] On the other hand, the Directive does not preclude the retention or adoption of provisions, which offer a higher or more comprehensive cover for deposits. In particular, deposit-guarantee schemes may, on social considerations, cover certain kinds of deposits in full (art. 7(3)). This provision is of a different legal nature in that it shall not be implemented. It seems to mirror a policy statement in cases where one State may defend that a scheme in another State competes with the scheme in the former State. Such a defence does not carry any weight. In addition to specifications with regard to (the nature of) depositors or deposits, the financial limit is open for further specification by a Member State. A Member State may limit the guarantee as provided for in art. 7(1) or the limit referred to in art. 7(3) to a specified percentage of deposits, although that limit again has its limitations.[24]

Art. 8(1) provides that the limits referred to in art. 7(1), (3) and (4) shall apply to the aggregate deposits placed with the same credit institution irrespective of the number of deposits, the currency and the location within the Community. Directive 94/19 provides a rule 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.'[25] An example here is the use of a joint account. A joint account is an account opened in the names of two or more persons or an account over which two or more persons have rights that may operate against the signature of one or more of those persons (see art. 1(2) Directive 94/19). When calculating the aforementioned limits, the share of each depositor in a joint account shall be taken into account (art. 8(2)), but in the absence of special provisions, a joint

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[21] The amount is open for review by the EU Commission at least once every five years. The Commission can propose to the European Parliament and to the Council an adjustment '…. taking account in particular of developments in the banking sector and the economic and monetary situation in the Community' (art. 7(5)). The first review shall not take place until five years after the end of the period referred to in art.7(1), second subparagraph, therefore as of 31 December 2005 the undertaking of a review may be expected. In Austria, Belgium, Greece, Germany, the Netherlands and Spain the level of protection is €20.000 per account. Other EU Members States protect deposits up to €40.045 (Denmark), €60.000 (France) to even €103.291 (Italy), see Gropp and Vesala (see note 17 above), Appendix I.

[22] Annex I lists (among others) deposits by certain financial institutions, by government and central administrative authorities, by provincial, regional, local and municipal authorities and by pension and retirement funds. An exclusion can be applied too with regard to deposits by a credit institution's own directors, managers, members personally liable, holders of at least 5 % of the credit institution's capital, persons responsible for carrying out the statutory audits of the credit institution's accounting documents and depositors of similar status in other companies in the same group, by 'close relatives and third parties' acting on behalf of the latter depositors or by 'other companies in the same group'.

[23] See recital 18, first sentence.

[24] The percentage guaranteed must be equal to or exceed 90 % of aggregate deposits until the amount to be paid under the guarantee reaches the amount referred to in art. 7(1), see art. 7(4).

[25] Recital 19.

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account shall be divided equally amongst the depositors.[26] Art. 8(3) Directive 94/19 contains a further provision for the case that a depositor is not absolutely entitled to the sums held in an account. In that situation the person who is absolutely entitled shall be covered by the guarantee, provided that this person has been identified or is identifiable before the date on which the competent authorities make the determination described in art. 1(3)(i) or the date on which the judicial authority makes the ruling described in art. 1(3)(ii). These descriptions refer to the unavailability of a deposit. If there are several persons who are absolutely entitled, the share of each under the arrangements subject to which the sums are managed shall be taken into account when the limits provided for in art. 7 (1), (3) and (4) are calculated, see art. 8(3), second sentence.[27] Art. 7(6) ensures that Member States will implement a rule containing that the depositor's rights to compensation may be the subject of an action by the depositor against the deposit-guarantee scheme.

4. Deposit-guarantee scheme

The Directive introduced in 1994 a level of harmonisation of deposit-guarantee schemes within the Community, which did not of itself call into question the existence of systems that already were in operation. Since the mid 60s most of the Member States established deposit-insurance schemes; in some countries the establishment date lies after 1994, e.g. in Finland, Greece, Portugal and Sweden.[28] These systems do protect credit institutions as a whole or contain an alternative and are managed under the responsibility of professional organisations and / or are (partly) regulated by statute. The Directive leaves in principle, under certain conditions, these systems intact. The variety of status, however, only should be noticeable with regard to compulsory membership of a scheme and the exclusion from a scheme. The Directive 94/19 provides that each Member State shall ensure that within its territory one or more deposit-guarantee schemes are introduced and officially recognised.[29] The recognition aims to formally confirm existing schemes. No credit institution authorised in a Member State may take deposits, unless it is a member of such a scheme, see art. 3(1) second sentence, or is (i) an exempted credit institution, or (ii) a credit institution with alternative guarantee arrangements.
With regard to (i) a Member State may exempt a credit institution from the obligation to belong to a deposit-guarantee scheme in the case that this credit institution belongs to a system, which protects the credit institution itself and in particular ensures its liquidity and solvency. Such a system implies the guaranteed protection for depositors '….. at least equivalent to that provided by a deposit-guarantee scheme', see art. 3(1) second subparagraph, that too provides the criteria,

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[26] Member States may provide that deposits in an account to which two or more persons are entitled as members of a business partnership, association or grouping of a similar nature, without legal personality, may be aggregated and treated as if made by a single depositor for the purpose of calculating the limits of art. 7 (1), (3) and (4), see art. 8(2).

[27] This provision shall not apply to collective investment undertakings, see art. 8(3), third sentence, which seems superfluous given the definition of 'deposit' in art. 1(1).

[28] See Gropp and Vesala (note 17 above), Appendix I.

[29] In principle Directive 94/19 requires every credit institution to join a deposit-guarantee scheme, see recital 15.

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which have to be fulfilled according to the decision of the competent authorities. These conditions are the following:

a. the system must be in existence and must have been officially recognised when the Directive 94/19 is adopted (therefore in 1994),

b. the system must be designed to prevent deposits with credit institutions belonging to the system from becoming unavailable and it should have the resources necessary for that purpose at its disposal,

c. the system must not consist of a guarantee granted to a credit institution by a Member State itself or granted by any of its local or regional authorities, and

d. the system must ensure that depositors are informed in accordance with the terms and conditions laid down in art. 9 Directive 94/19.[30]

With regard to (ii), it is possible that a Member State's national law (with the express consent of the competent authority) permits a credit institution to be excluded from a deposit-guarantee scheme. Such a credit institution may continue to take deposits if, before its exclusion, it has made alternative guarantee arrangements. These arrangements must ensure that depositors will enjoy a level and scope of protection at least equivalent to that offered by the officially recognised scheme (art. 3(4) Directive 94/19). Alternative schemes are provided e.g. by savings and cooperative banks in Germany.[31]

The costs of schemes are in principle borne by the credit institutions themselves.[32] The sanctions on non-compliance[33] seem quite strict. If a credit institution, member of a scheme, does not comply with the obligations incumbent on it, the competent authorities, which issued its authorisation shall be notified and, in collaboration with the guarantee scheme, shall take all appropriate measures. These may include the imposition of sanctions to ensure that the credit institution complies with its obligations (art. 3(2)). If these measures fail to secure compliance on the part of the credit institution, the scheme may, where national law permits the exclusion of a member, with the express consent of the competent authorities, give not less than 12 months' notice of its intention of excluding the credit institution from membership of the scheme, see art. 3(3). The second sentence of the last provision contains a rule with regard to the coverage of

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[30] Art. 3(1), third subparagraph, contains a notification procedure for those Member States, which make use of this option.

[31] See Garcia and Prast (note 4 above), p. 8.

[32] Recital (22) provides that it is not indispensable, in Directive 94/19, to harmonise the methods of financing schemes guaranteeing deposits or credit institutions themselves, given, on the one hand, that the cost of financing such schemes must be borne, in principle, by credit institutions themselves and, on the other hand, that the financing capacity of such schemes must be in proportion to their liabilities. The general principle, however, is that this must not jeopardise the stability of the banking system of the Member State concerned. The administration of a scheme in Member States is managed (i) by a private organisation, (ii) by a joint form of administration or (iii) by a governmental body. Member States have either funded or non-funded schemes, with a mixed form in the UK (initial contribution and ex post funding when needed), see Gropp and Vesala (note 17 above), Appendix I.

[33] Art. 12 provides that notwithstanding art. 3 Directive 94/19, those institutions authorised in Spain or in Greece and listed in Annex III shall be exempt from the requirement to belong to a deposit-guarantee scheme until 31 December 1999. Such credit institutions shall expressly alert their actual and intending depositors to the fact that they are not members of any deposit-guarantee scheme. During that time, should any such credit institution establish or have established a branch in another Member State, that Member State may require that branch to belong to a deposit-guarantee scheme set up within its territory under conditions consonant with those prescribed in art. 4 (2), (3) and (4).

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deposits made during the notification period: deposits made before the expiry of the notice period shall continue to be fully covered by the scheme. If, on the expiry of the notice period, the credit institution still has not complied with its obligations, the guarantee scheme may, again having obtained the express consent of the competent authorities, proceed to exclusion. If an exempted credit institution is unable to make alternative arrangements, which comply with the conditions prescribed in art. 3(4), the competent authorities shall revoke the institutions' authorisation forthwith, see art. 3(5) Directive 94/19.[34] Deposits, which are held when the authorisation of a credit institution is withdrawn shall continue to be covered by the guarantee scheme, see art. 5.
Following the Directive's adoption in 1994, in 1995 and 1996 most Member States and EEA-countries amended their systems of deposit protection, with Germany (1998) and Luxembourg (1999) being in a last wave. The degree of changes differed quite substantially. The Netherlands and the UK made moderate changes. Germany and Italy on the other hand applied significant amendments.[35]

5. Branches of EU credit institutions

The Directive 94/19 realises that the retention in the Community of schemes providing cover for deposits which is higher than the harmonised minimum may, within the same geographical territory, lead to disparities in compensation and unequal conditions of competition between national institutions and branches of credit institutions from other Member States. In an effort to counteract those disadvantages, branches should be authorised to join their host countries' deposit-guarantee schemes. In that way they can offer their depositors the same guarantees as are offered by the schemes of the countries in which they are located.[36] Art. 4(1) Directive 94/19 therefore provides that deposit-guarantee schemes introduced and officially recognised in a Member State in accordance with art. 3(1) shall cover the depositors at branches that have been set up by credit institutions in other Member States. From the rationale of non-competition follows that neither the level nor the scope, including the percentage, of cover provided shall exceed the maximum level or scope of cover offered by the corresponding guarantee scheme within the territory of the host

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[34] Directive 94/19 recognises that in certain specific cases in certain Member States, in which there are no deposit-guarantee schemes for certain classes of credit institutions and which take only an extremely small proportion of deposits, the introduction of such a system may take longer than the time laid down for the transposition of the Directive (compliance by 1 July 1995, see art. 14). In such cases a transitional derogation from the requirement to belong to a deposit-guarantee scheme may be justified, although such a credit institutions would operate outside its home Member State, the home Member State is entitled to require their participation in a deposit-guarantee scheme, which it had set up. See recital 21.

[35] See for a more detailed account of the changes in Belgium, Germany, Italy, Sweden, the UK and The Netherlands: Garcia and Prast (see note 4 above), p. 12 ff.

[36] Recital 14 intents to prevent that the level of scope of cover offered by guarantee schemes should become an instrument of competition. It has been regarded as necessary, at least during an initial period, to stipulate that the level and scope of cover offered by a home Member State scheme to depositors at branches located in another Member State should not exceed the maximum level and scope offered by the corresponding scheme in the host Member State. However, possible market disturbances should be reviewed after a number of years, on the basis of the experience acquired and in the light of developments in the banking sector.

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Member State. This stand-still, also known as the 'export-prohibition', was in place till 31 December 1999.[37]
Where the level and/or scope, including the percentage, of cover offered by the host Member State guarantee scheme exceeds the level and/or scope of cover provided in the home Member State, the host Member State shall ensure that there is an officially recognised deposit-guarantee scheme within its territory which a branch may join voluntarily in order to supplement the guarantee which its depositors already enjoy by virtue of its membership of its home Member State scheme (art. 4(2)).[38] Art. 4(2) results in a voluntary membership of the branch. If however the branch does not comply with the obligations incumbent on it as a member of a deposit-guarantee scheme, the competent authorities, which issued the authorisation shall be notified and, in collaboration with the guarantee scheme, shall take all appropriate measures to ensure that the aforementioned obligations are complied with, see art. 4(4) Directive 94/19. The sanction is the equivalent of art. 3(2) Directive 94/19.[39] Member States shall ensure that objective and generally applied conditions are established for branches' membership of a host Member State's scheme. Admission shall be conditional on fulfilment of the relevant obligations of membership, including in particular payment of any contributions and other charges. Member States in implementing these conditions shall follow the Guiding principles set out in Annex II. These 'Guiding principles' provide that where a branch takes the initiative and applies to join a host Member State scheme for supplementary cover, the host Member State scheme will bilaterally establish with the home Member State scheme appropriate rules and procedures for paying compensation to depositors at that branch. A set of four principles, laid down in Annex II, apply to the drawing up of those procedures and in the framing of the membership conditions applicable to such a branch. To facilitate charging, the host Member State scheme will be entitled to assume that its liability will in all circumstances be limited to the excess of the guarantee it has offered over the guarantee offered by the home Member State regardless of whether the home Member State actually pays any compensation in respect of deposits held within the host Member State's territory.
In a multi-national bank insolvency the general principle is that the depositor protection scheme in a home Member State carries responsibility for the deposit guarantee scheme for the depositors of the bank in distress and its foreign branches. This scheme furthermore determines the compensation, including the question whether depositors are treated equally in receiving compensation, see art. 4(1). Branches however may, as stated before, when the level or scope of

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[37] Before that date, the Commission was under the duty to draw up a report on the basis of the experience acquired in applying this rule of stand-still and to consider the need to continue it. The Commission concluded that a prolongation would not be justified, see Commission's Report of 22 December 1999.

[38] Recital 13, third and fourth sentence, does regard it as appropriate that after a number of years the Commission should report on the extent to which branches have made use of this option and on the difficulties which they or the guarantee schemes may have encountered in implementing these provisions; it is not ruled out that home Member State schemes should themselves offer such complementary cover, subject to the conditions such schemes may lay down.

[39] If those measures fail to secure the branch's compliance with the aforementioned obligations, after an appropriate period of notice of not less than 12 months the guarantee scheme may, with the consent of the competent authorities which issued the authorisation, exclude the branch. Deposits made before the date of exclusion shall continue to be covered by the voluntary scheme until the dates on which they fall due. Depositors shall be informed of the withdrawal of the supplementary cover, see art. 4(4), second subparagraph.

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the host Member State's scheme exceeds the level of the home Member State scheme, voluntarily join '….. to supplement the guarantee which its depositors already enjoy by virtue of its membership of its home Member State scheme', art 4(2). The quoted wording seem to suggest that in case the compensation to depositors is paid out of the host Member State scheme, the payment shall be reduced by the amount already paid out in the home Member State.[40] This treatment would carry two weaknesses. The first is that the Directive itself does not contain a provision that expressly states that the compensation obtained in one scheme shall be seen as 'compensation' in another scheme when the entitled depositors in the latter scheme have obtained an equivalent dividend.[41] The second is that in the case a foreign depositor may already have been compensated according to the scheme of the host Member State that has been joined voluntarily by the foreign branch, he must return what he has obtained to the liquidator.[42]

6. Branches of non-EU credit institutions

The Directive 94/19 contains a small portion with regard to branches of non-EU banks. Art. 6(1) obliges Member States to check that branches established by a credit institution, which has its head office outside the Community have an equivalent cover. In case this would not be so Member States may stipulate[43] that these branches must join deposit-guarantee schemes in operation within their territories. The non-EU bank shall provide all relevant information concerning the guarantee arrangements which cover their deposits to actual and intending depositors at their branch(es). This information shall be made available in the official language or languages of the Member State in which a branch is established in the manner prescribed by national law and shall be drafted in a clear and comprehensible form, according to art. 6(3).

7. Information

The Directive is based on the idea that information is an essential element in depositor protection. For this reason information towards (prospective) depositors must be the subject of a minimum number of binding provisions. Unregulated use in advertising of references to the amount and scope of a deposit-guarantee scheme could affect the stability of the banking system or depositor confidence. It is however left to Member States to lay down rules to limit such references.[44] Art. 9 Directive 94/19 describes the principles around providing information that have to be fulfilled by Member States. They shall ensure that credit institutions make available to actual and intending depositors the information (i) which is necessary for the identification of the deposit-guarantee scheme of which the institution and its branches are members within the Community or any alternative arrangement provided for in art.3(1), second subparagraph, or art. 3(4), and the

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[40] See Hüpkes (note 4 above), p. 150.

[41] A rule like this would mirror the imputation-provision of art. 20(2) EU InsReg.

[42] A rule like that would mirror art. 20(1) EU InsReg.

[43] Subject to art. 9(1) Directive 77/780/EEC

[44] Recital 20.

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information (ii) with regard to the provisions of the deposit-guarantee scheme or any alternative arrangement applicable, including the amount and scope of the cover offered by the guarantee scheme. That information shall be made available in a readily comprehensible manner and shall also be given on request on the conditions for compensation and the formalities, which must be completed to obtain compensation.[45]

8. Payment of an unavailable deposit

'Whereas deposit-guarantee schemes must intervene as soon as deposits become unavailable' (see recital 9) it is important to provide a clear definition of 'unavailability'. The amount of words used in art. 1(3) does not create an optimistic mood. Art. 1(3) Directive 94/12 describes an 'unavailable deposit' as a deposit that is due and payable but has not been paid by a credit institution under the legal and contractual conditions applicable thereto, where either:
(i) the relevant competent authorities have determined that in their view the credit institution concerned appears to be unable for the time being, for reasons which are directly related to its financial circumstances, to repay the deposit and to have no current prospect of being able to do so. The competent authorities shall make that determination as soon as possible and at the latest 21 days after first becoming satisfied that a credit institution has failed to repay deposits which are due and payable; or
(ii) a judicial authority has made a ruling for reasons which are directly related to the credit institution's financial circumstances which has the effect of suspending depositors' ability to make claims against it, should that occur before the aforementioned determination has been made.
The 'unavailability' therefore starts on the day of the competent authority's determination (CAD) or the day of the judicial authority's ruling (JAR). Art. 10 creates the basis for a claim of a depositor. The application of the claimant is to be filed by the competent authorities. A deposit-guarantee scheme shall be in a position to pay duly verified claims by depositors in respect of unavailable deposits within three months of the date of CAD or JAR. The eligibility for a payment under the guarantee is based on documents relating to the conditions to be fulfilled and the formalities to be completed, which shall be drawn up in detail in the manner prescribed by national law in the official language or languages of the Member State in which the guaranteed deposit is located, see art. 10(4). A payment can be made in cash, but the rationale of the Directive 94/19 (among others: 'stability of the banking system') seems strong enough to allow payment by making available the a depositor a transferred deposit in another bank.
Most notable is the 3-moths period for paying out the compensation. With good reason this period has been characterised as 'unambitious'.[46] Art. 10(2) even provides for an extension of the time

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[45] The information shall be made available in the manner prescribed by national law in the official language or languages of the Member State in which the branch is established. Member States furthermore shall establish rules limiting the use in advertising of the said information '…… in order to prevent such use from affecting the stability of the banking system or depositor confidence.' In particular, Member States may restrict such advertising to a factual reference to the scheme to which a credit institution belongs. See art. 9(2) and (3) Directive 94/19.

[46] Garcia and Prast (note 4 above), p. 8, refering to the 3 day period for compensation provided in the Federal deposit insurance coverage by the Federal Deposite Insurance Corporation (FDIC) in the US. Here, since 1980 accounts in some 9200 banks and

limit '….. (i)n wholly exceptional circumstances and in special cases'. Examples, which might fall under these words have not been given. An extension shall not exceed three months, although the competent authorities may, at the request of the guarantee scheme, grant no more than two further extensions, neither of which shall exceed three months.[47] Art. 10(3) seems to function as an abuse of right provision: the time limits laid down in art. 10(1) and (2) may not be invoked by a guarantee scheme in order to deny the benefit of guarantee to any depositor who has been unable to assert his claim to payment under a guarantee in time.

9. Subrogation

Garcia and Prast point out that the obligation for a Member State to establish and officially recognise a system of deposit protection, but the exemption from any obligation to support it financially sets 'a somewhat contradictory obligation'.[48] The deposit-guarantee scheme (or: deposit protection agency) is responsible for the administration of the scheme. In case of actual funding, the agency collects contributions and – ultimately – in case of 'unavailability' pays out. Art. 11 Directive 94/19 provides that without prejudice to any other rights which they may have under national law, schemes which make payments under guarantee shall have the right of subrogation to the rights of depositors in the liquidation proceedings of the concerned bank for an amount equal to their payments. Hüpkes notes that deposit agencies will have a natural interest to avoid liquidation proceedings, which will in almost all cases will be winding-up proceedings as now regulated according to the Winding-up Directive 2001/24. To back its preventive activities, in several countries schemes will have rights to obtain information from the member-credit institutions, specific audit functions or certain intervention powers, mostly in active cooperation with the supervisory authority.[49] Where the depositors will have a large total amount of a banks' outstanding debts, the scheme will by way of subrogation be one of the largest creditors during the winding-up proceeding of the bank.[50] In case depositors are accorded a priority the scheme will become a preferred creditor, like in the US and Switzerland.[51]

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saving associations are protected up to US$ 100.000,--, see Bradley, A Historical Perspective on Depostie Insurance Coverage, in FDIC Banking Review 2002, p. 1 et seq.

[47] Notwithstanding the time limit as mentioned in art. 10(1) and (2), where a depositor or any person entitled to or interested in sums held in an account has been charged with an offence arising out of or in relation to money laundering as defined in art. 1 Directive 91/308/EEC, the guarantee scheme may suspend any payment pending the judgment of the court, art. 10(5) Directive 94/19.

[48] Garcia and Prast (see note 4 above), p. 9.

[49] See further Hüpkes (note 4 above), who also refers to '…. the right of a guarantee scheme to take any measures necessary for the rescue of a credit institution that finds itself in difficulties' as provided for in recital 10.

[50] In the Netherlands a claim can be transferred to a third party by way of subrogation based on several conditions. The one that would give support to the transfer to the scheme would be art. 6:150(d) Civil Code: based on a contract between the third party, which has paid the claim and the debtor (i.e the bank), provided that the creditor (the depositor) at the moment of receiving payment (i.e the compensation) did know about this contract or was notified of its existence. I am not aware of the existenc of such a contract between 'scheme' and member-banks in the Netherlands.

[51] Hüpkes (see note 4 above), p. 93.

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Compensation in the setting of a multi-national bank distress may lead to complications where depositors are entitled to a compensation according to the home Member State scheme, but are entitled too to a 'supplement' guarantee, when a branch of the bank may have voluntarily joined a scheme in the host Member State. Art. 11 provides enough basis to assume that both home scheme and host scheme will be subordinated in proportion to the respective payments made.[52] This may however lead to different positions for home or host scheme, when e.g. in the host country the scheme will also be subrogated in a preference, where in the home country this may not be the case. Where the scheme is located abroad and would be subrogated it will however receive equal treatment in the winding-up proceedings initiated in the home Member State. Art. 16(2) Winding-up Directive 2001/24 provides after all that the claims of all creditors whose domiciles, normal places of residence or head offices are in Member States other than the home Member State '….. shall be treated in the same way and accorded the same ranking as claims of an equivalent nature which may be lodged by creditors having their domiciles, normal places of residence, or head offices in the home Member State'.
One can put question marks on the dual role of a scheme in that it acts as a creditor (in case of the collection of contributions of members-credit institutions), a semi-supervisor, an insurance-company (by paying compensation to depositors), and finally as a (preferred) creditor in winding-up proceedings. These positions may give rise to conflict of interests.[53]

10. Set-off

Annex II, Guiding principle (b) lays down the application method. The host Member State scheme will meet claims for supplementary compensation upon a declaration from the home Member State's competent authorities that deposits are unavailable. The host Member State scheme then will retain full rights to verify a depositor's entitlement according to its own standards and procedures before paying supplementary compensation. In intertwined financial relationships like these, the question of the possibility of set-off always pops up. The influence of set-off on the payments of compensation under a scheme are not clear. The following example may demonstrate this. A bank in home Member State D1 owns a branch in host Member State D2. The 'home scheme' compensates €20.000 to depositor X. Where the branch has joined the 'host scheme', depositor X receives the applicable supplementary cover the host scheme is offering, say €7.500. In the jurisdiction of D2 the possibility of an insolvency set-off is very limited and does not cover the possibility of setting off the compensation of €7.500 against a proven €6.000 claim the bank has against X. Subrogated in X's right (the scheme paid the full €7.500), the host scheme files his claim in the winding-up proceedings, to which according to art. 10(1) Winding-up Directive 2001/24 are applicable '….. the laws, regulations and procedures' applicable in the home Member State D1. If according to the laws of D1 a set-off of the obligation to pay compensation and the claim of the bank would have been allowed, the question arises whether the liquidator can limit the verification of the host scheme's claim to €1.500.

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[52] Hüpkes (see note 4 above), p. 150.
[53] In this way too Hüpkes (see note 4 above), p. 29.

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Hüpkes has noted that the Directive 94/19 is insufficient in that it does not provide any rules on set-off and on its effect on the payment of deposit protection. Annex II of Directive 94/19, which provides for the host Member State scheme to bilaterally establish with the home Member State scheme appropriate rules and procedures for paying compensation to depositors at that branch. According to condition (c) a home Member State and the host Member State schemes will cooperate fully with each other to ensure that depositors receive compensation promptly and in the correct amounts. In particular, the involved States '…… will agree on how the existence of a counterclaim which may give rise to set-off under either scheme will affect the compensation paid to the depositor by each scheme'. I read this possible agreement as one that is not dealing with mutual rights and obligations between two or more schemes, but as providing the two schemes with an authority to come to an agreement, which may influence depositors' claims. Under the regime of the Winding-up Directive with regard to credit institutions art. 23 Winding-up Directive 2001/24 provides that the adoption of reorganisation measures or the opening of winding-up proceedings shall not affect the right of creditors to demand the set-off of their claims against the claims of the credit institution, where such a set-off is permitted by the law applicable to the credit institution's claim. Art. 23 however does not seem to apply as it protects (the right to set-off) a claim of a creditor, not – as in the given case – (the right to set-off) a claim of the bank against a creditor (the depositor), who in another relationship is a debtor (according to the laws of D1) too. Moreover, it is to be seen whether depositor X possesses a claim at the moment the liquidation proceeding against the bank is opened. It seems to me that the moment that a right to set-off will exist will depend on the moment that the 'unavailability' of a deposit is determined an will therefore start on the day of the competent authority's determination (CAD) or the day of the judicial authority's ruling (JAR). This day could be a day after the opening of winding-up proceedings. Once concluded that the given case falls outside the scope of the Winding-up Directive 2001/24, it seems at least odd that involved States would be able (ultimately) to decide the extent of a financial claim, which clearly would be against art. 1 European Convention of Human Rights.

11. Liability

Not in the Directive 94/19 itself, but in recital 23, one finds a consideration, which intrigues. It is provided that the Directive '….. may not result in the Member States' or their competent authorities' being made liable in respect of depositors if they have ensured that one or more schemes guaranteeing deposits or credit institutions themselves and ensuring the compensation or protection of depositors under the conditions prescribed in this Directive have been introduced and officially recognised.' At first sight it is confusing that a recital would be used to create the legal effect the quotation seems to aim for. Furthermore, one wonders whether the European Parliament and the Council (official organs of the EC introducing the Directive) would have any legal capacity to influence rules with regard to liability issues, which will be decided by a Member States's domestic law, including its conflict-of-law rules. Although the topic of liability of a State or its supervisory authority should be dealt within a much broader context, I would like to point out a recent case, in which the possible liability of a supervisor is at stake.

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Peter Paul and other claimants are accountholders with the BVH Bank in Düsseldorf, Germany. The bank obtained its license of the authority ('Bundesaufsichtsamt für das Kreditwesen') in 1987 to engage in the banking business subject to the condition that it engaged in the business of holding deposits if it was a member of a guarantee scheme. As long as that would not be the case, the bank should inform potential customers that no guarantee scheme existed. For five years the bank tried to become a member of the deposit guarantee scheme. In 1992 the bank withdrew its application for membership, being not able to fulfil the conditions for admission. November 14, 1997, for reasons that do not relate to this case, BVH bank's authorisation to pursue the business of banking was withdrawn and insolvency proceedings were opened. December 1, 1997, Paul and other claimants, who each held accounts at the bank for over (now) €30.000 were rewarded €20.000. For the losses exceeding this amount the claimants sought compensation from the Federal Republic of Germany. Ultimately the German Supreme Court refers to the European Court of Justice with several questions that in November 2003 have led to the opinion of Advocate General Stix-Hackl.[54] She expressed the following opinions:

- art. 3(2) – art. 3(5) Directive 94/19 do not confer on a depositor a right to require the competent authorities to avail themselves of the measures referred to in the Directive's supervisory measures;
- as the necessary preconditions of State liability are not met, no entitlement is granted to redress for losses exceeding the scope of art. 7 Directive 94/19 caused to individual depositors by the failure of the competent authority;
- in the context of other Directives relating to banking law, their objectives not their wordings result in a right for individual depositor to have implemented certain supervisory measures;
- several of these Directives relating to banking law mention in their recitals (the interest of) investor protection. Recitals may act as an aid in interpreting a Directive; the effect of recitals is not so far-reaching as to enable an individual to derive rights from them;
- Directive 94/19 constitutes an exhaustive set of special rules for all cases of unavailability of deposits.

The judgment of the European Court of Justice has not been published yet.

12. Conclusion

Several surveys have shown that deposit-guarantee all over the world vary substantially in maturity, its (public or private) legal structure, its funding (ex ante or ex post) and its level of coverage. In terms of Gross Domestic Product the European coverage as far, as €20.000 is the limit, offer lower coverage then the schemes in most other parts of the world.[55] Against this background in a future review the Commission may consider adjustment of this amount, see art.

[54] Conclusion of Advocate General Stix-Hackl, November 25, 2003, Case C-222/02, published in ZIP 50/2003, p. 2288 ff.

[55] See Garcia and Prast (see note 4 above) referring to surveys and reports. For the EU from these assessments in general it is concluded that all countries are compliant with the spirit of the Directive and most are compliant with its provisions, although national definitions of 'joint account' and 'unavailable deposit' sometimes seems to deviate. For a recent summary of data, resulting from an internet-based International Deposit Insurance Survey (IDIS) and covering 47 country schemes, see <<www.iada.org>>.

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7(5) Directive 94/19. Consideration may be given too to the length of the period for paying out the compensation. The present period of 3 months has been chosen in a time where IT-support was much less advanced then now, some ten year later. The general principle of depositor protection, introduced ten years ago, is to be welcomed. In a few aspects the Directive – and possibly the ways in which it has been implemented in Member States – needs clarification, e.g. the uncertainty, which may exist with regard to the soundness of subrogation of a scheme into the rights of the banks' depositors and the vagueness of the rules of set-off. Given the prime importance of the stability of the stability of the banking system it seems undesirable to me that these incertitudes remain to exist even in the situation that distress of banks leading to compensations by schemes seem highly unlikely.

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