

# Consultation response

**Ref: 4109**

## European Commission consultation: *Review of Directive 94/19/EC on Deposit- Guarantee Schemes*

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Since 1994, European Union Directive 94/19/EC on Deposit Guarantee Schemes (DGS) has ensured that all Member States have in place a safety net for depositors if banks fail to pay. The DGS established under the Directive protect depositors and help to maintain the stability of the banking system. The schemes are designed to compensate depositors for deposits at banks up to a specified limit (€ 50 000 by end of June 2009 and €100 000 by the end of 2010) when a bank is not in a position to pay out deposits.

Events in 2007 and in 2008 exposed deficiencies in DGS and their consequences in terms of depositors' confidence. As a result, amendments to the DGS Directive were adopted (final text published on 13 March 2009). This in particular raised the minimum coverage of DGS in the EU, reduced the deadline to decide if a bank has failed, reduced the payout delay, and abandoned the concept of coinsurance. These changes were an important step in response to the immediate challenges of the crisis situation. But a series of other issues were also identified that appeared appropriate for further review in the slightly more medium term. The DGS Directive therefore provides for a review clause and includes a list of issues to be reviewed. These issues are dealt with in this consultation paper.

## Key points and recommendations

1. The maximum coverage available under deposit guarantee schemes (DGS) should not be less than € 100,000, and we believe that a case could be made for a higher limit. However, the limit would be less critical if there were: a) extended coverage for higher balances in certain circumstances b) coverage per brand not per registered entity and c) regular reviews of the amount.
2. We strongly recommend that European law should allow member states discretion to give extended coverage for balances above the limit in order to promote socially desirable outcomes, such as preventing hardship among people who have large amounts on deposit to pay for social care. Such sums should be protected without time limit, and the monetary limit should be no lower than £500,000, and unlimited for compensation awards, settlements and back-payments of all kinds.
3. In addition, higher coverage should be permitted for temporary high balances for a period of up to 18 months.
4. It is not realistic to rely on encouraging consumers to reduce their risk. While some will do so, their actions may contribute to instability, and those who are not aware of the need to act (such as isolated older people) will be disadvantaged.
5. A pan-European DGS would have many advantages but is likely to take some time to set up and in the meantime pan-European action is needed

so that consumers can claim through their local DGS rather than having to claim direct to the foreign scheme. We recommend that some kind of network is set up as soon as possible, perhaps along the lines of the 'FIN-NET' system for complaint schemes, in order to facilitate and formalise existing ad hoc arrangements between schemes.

6. The appropriate information for depositors will depend on policy decisions, but we recommend that the EU sets out the minimum key information that should be disclosed, and when, with host states retaining a large measure of discretion in how the information is presented.
7. We support proposals to reduce payout delay to one week, but even this time-scale may cause hardship for the most vulnerable in society. We recommend that member states are required to set up back-up systems to get cash quickly to those in hardship. The banking authorities should also consider transferring compensation automatically to a special 'holding' account, such as a Post Office Card Account in the UK. The individual would then have access to banking facilities until they are in a position to make an informed choice on an appropriate replacement account.

## 1. Introduction

Age Concern England and Help the Aged joined together in April 2009 to form a single charity dedicated to improving the lives of older people. As the biggest charity in this sector in the UK, it will create a single voice for older people and help them to protect their rights and fulfil their aspirations. It is also a major provider of services to older people both directly and through local partners in England.

Deposit Guarantee Schemes (DGS) are important for all retail customers, but particularly so for older people:

- People's savings tend to reach a peak at the time of retirement. For example, research by the International Longevity Centre UK<sup>1</sup> found that people who are currently aged 65-74 have higher mean household liquid assets than any other age group, at just over £40,000.
- Older people have limited, or no, opportunity to build up further assets. They may rely on relatively small amounts of savings to top up their pension income.
- As people age, they are often advised to reduce their exposure to equities and place more of their savings in cash to remove exposure to investment risk.

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<sup>1</sup> International Longevity Centre, *Asset accumulation across the lifecycle*, September 2007

- Most older people receive significant parts of their income in the form of state pensions and benefits, and it has been UK Government policy to move to paying state benefits through the banking system.

The level of consumer concern around this topic emerged during research we carried out in 2008 with members of Age Concern forums<sup>2</sup>, for example:

*'Integrity – I am disgusted with the way that banks have changed ...I don't trust them at all. I don't think the banks are prudent at all. I have money in banks – interest rates can be high – but you only get protected on the first £30,000 – so you're torn between security and interest'*

We are not in a position to comment on every question in this consultation. Responses to questions on which we have a view are given below.

## 2. Scope and level of coverage of DGS

### **Question 2: level of coverage**

We accept that a €100,000 limit will cover 90% of deposits, but older people may well have significantly more on deposit at certain times – e.g. when trading down from one property to another, or after moving into a residential care home. So we would not support a limit of less than € 100,000, and believe that a case could be made for a higher limit in order to bolster confidence in the banking system.

However, the limit would be less critical if:

- There is extended coverage for higher balances in certain circumstances, and particular where the depositor is not in a position to minimise their risk (for example because they do not have full mental capacity)
- Coverage is 'per brand' not per registered entity (see below)
- The figure is regularly reviewed and increased to reflect the general value of deposits. However, the frequency of reviews would need to be balanced with the desirability of having a simple figure that could be easily described to consumers.

### **Question 3: a minimum or fixed level of coverage**

We acknowledge the problems caused by 'topping up', but it is essential that member states are able to allow cover for balances above the limit in certain circumstances that should depend on socially desirable outcomes, such as preventing hardship among people who have large amounts on deposit to pay for social care. However, the higher the level of coverage, and the better the

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<sup>2</sup> *An inclusive approach to financial products*, Age Concern England, 2008

coverage for higher balances in exceptional circumstances, the more acceptable a fixed level of coverage will become.

***Question 4: should depositors be encouraged to split up their assets?***

***Question 5: could this problem be solved with a mere information obligation towards depositors?***

No. It is not realistic to rely on encouraging consumers to reduce their risk. While some will do so, this may actually contribute to instability if it leads them to move their money around in search of the 'safest' account. In addition, a reliance on information alone will disadvantage consumers who are not aware of the need to act (such as older people with limited access to sources of information) .

In addition, the UK system of providing protection per registered entity rather than per brand, means that those depositors who do try to split up their assets are faced with great confusion and complexity. For example, in a specialist personal finance radio programme aired during the crisis, an interviewee from the Financial Services Compensation Scheme could not give a definitive answer to a question about whether two well-know banks which belonged to the same banking group would count as a single bank. Banking products may also be sold under the brand of an intermediary.

We believe that coverage should be per brand, not per registered entity. Many of the problems with this approach in funding terms – for example the incentive for banks to set up multiple brands – would be reduced if this were combined with a move to pre-funding of compensation. Banks would have no incentive to set up multiple brands purely to increase compensation for individuals (at surviving banks' expense) if there was an element of pre-funding that took the number of brands into accounts. If two brands merge, the compensation 'rights' of each brand could be preserved as has been the case (on a temporary basis) for merging organisations in the UK.

***Question 6: If the coverage level is fixed, should there be exemptions that allow a higher coverage of certain products for social considerations?***

***Question 7: Should temporary high account balances be covered?***

Yes. We strongly recommend that European law should allow member states discretion to give higher coverage either for social considerations or for temporary high balances. Our preference is that special treatment should be allowed for particular sources of wealth where social considerations apply, such as:

- pension lump sums;
- deposits held for the purpose of paying for residential care;
- divorce settlements;

- redundancy payments;
- proceeds of pure protection contracts; or
- compensation awards and settlements of all kinds, not just personal injury – for example, someone may receive compensation for loss arising from breach of financial services regulation
- back-payments of benefit entitlements
- accounts run by receivers and attorneys on behalf of people without capacity
- sale of a primary residence and property bought for dependent relatives, for use as their primary residence.

These sums should be protected without time limit. The limit should be no lower than £500,000, and should be unlimited for compensation awards, settlements and back-payments of all kinds.

In addition we would support the protection of temporary high balances, at member states' discretion, for a period of up to 18 months.

We do not see the necessity for transferring such accounts to special 'tagged' accounts which may be administratively costly – the extended coverage could be claimed in arrears.

### ***Questions 9, 10, 11: scope of deposits covered***

We would favour giving member states a certain level of discretion in the types of deposit. For example, in the UK, structured deposits are often marketed in such a way as to be indistinguishable from structured investments, and they should both be protected to the same extent.

## **3. Structure and mandate of DGS**

### ***Question 18: would you generally be in favour of a pan-EU DGS?***

A pan-European DGS would have many advantages but is likely to take some time to set up. We are not in a position to give a view on the structure and scope of a potential pan-European scheme, but whether or not such a scheme is achieved, pan-European action is needed. Consumers should be able to claim through their local DGS rather than having to claim direct to the foreign scheme. We recommend that some kind of network is set up as soon as possible, perhaps along the lines of the 'FIN-NET' system for complaint schemes, in order to facilitate and formalise existing ad hoc arrangements between schemes. Working on a voluntary basis in this way would also make it easier for non-member states to participate.

## 4. Information for depositors

### ***Question 22: harmonisation of information for depositors***

The desirable level of harmonisation will depend on the method of distribution. Harmonisation is less likely to be necessary, in our view, if consumers are able to make a claim through their local DGS. In addition, it is vitally important that information is presented in a way that will be comprehensible to the EU 'citizen on the street' in each member state. We do not believe a prescribed template will be helpful. We recommend that the EC sets out key information that should be disclosed, as a minimum, with host states retaining a large measure of discretion.

### ***Question 23: should advice to split up deposits be required or recommended?***

This will depend on policy decisions (for example, whether cover is 'per brand' or per registered entity) and on the exact form of disclosure (see below). In detailed information, this advice could be given but including it as a matter of course could lengthen disclosure statements to such an extent that they remain unread. We would not support making it a requirement in every case.

### ***Question 24: when and how to inform depositors***

This will depend on the minimum level of information required, and this in turn will depend on policy decisions taken on, for example, extended coverage for social purposes. Information on any deposit guarantee regime should also be tested for 'consumer comprehensibility' before it is enacted, which suggests that member states should have some discretion on presentation. Experience in the UK has shown that information statements can be lengthy and not necessarily easy to understand.

Although depositors should understand any limitations on protection before they make a deposit, and this suggests that there should be mandatory information on advertisements, there is a risk that consumers might become blasé about standard wording that they see regularly. In addition, information which cannot cover every aspect might give false reassurance.

In order to balance these competing priorities, we recommend that there should be a layered approach to disclosure as follows:

- mandatory disclosure of high-level information on advertisements along the lines of 'A deposit guarantee scheme applies – check with [the host state DGS] for restrictions on cover'
- mandatory disclosure of more detailed information on statements
- host state discretion for the exact presentation and wording.

We do *not* support the proposal that depositors should have to countersign information in most cases. This will be administratively complex, some people may not understand the information, and it should not be necessary in the vast majority of cases where the account is fully protected. However, we do recommend that a special disclosure should be made, personalised to the depositor, where:

- a bank knows that the account will not be fully protected (because it is above the maximum payout, for example), or
- a claim, if necessary, would have to be made directly to a DGS in another member state.

### ***Question 25: information when a bank fails***

We recommend that the host state DGS should be responsible for informing depositors, as they will be able to place the information within the local context and it will be easier for consumers to approach them. Giving them responsibility will also give them an incentive to work closely with the home state DGS, during a transition to a pan-EU DGS.

## **5. Set-off arrangements**

Allowing set-off of debts against liabilities is complex and difficult to explain to consumers, particularly where loans and savings are sold under different brands but compensation is provided per registered entity. Allowing set-off could also create hardship if the customer's ability to borrow has declined since the loan was first granted (because they have retired, for example).

We therefore recommend that set-off is not permitted, either by the DGS and in any insolvency procedure. We do *not* think the option of encouraging depositors to split deposits and liabilities is workable. Quite apart from the practical difficulties (particularly in the UK where different brands are often used), this could hamper the workings of a competitive marketplace as the same institution may offer the best rates for borrowing and saving.

## **6. Procedures for payout**

### ***Question 27: payout delays***

We support option b), reducing payout delay to one week. If amounts above the normal maximum are covered for social purposes, then at least the normal maximum amount should be paid out within one week.

**Question 28: alternative solutions (transfers to another bank or emergency payout procedures)**

**Question 31: application for reimbursement**

As well as a reduction in payout times, we believe that member states should be required to establish back-up systems, to provide emergency access to funds for those in hardship. These systems would act as a safety-net in case the payout deadline is missed. Even if a one-week payout time is achieved, emergency access to funds may be needed for people on the lowest incomes, who usually budget on a weekly basis. Our research<sup>3</sup> has found that although many low-income pensioners have bank accounts, they often withdraw all their money at once and then work in cash (for example because they find it easier to budget that way or because they have limited mobility and need cash to pay for help in the home). If their account is credited the day before a bank fails, they could be without funds for the rest of the week and they may not have access to credit.

We are particularly concerned about people who would find it difficult to open replacement bank accounts, for example because of limited mobility or poor health. We do not think it would be feasible to expect them to make a choice of account and open it within the time needed to avoid hardship. The banking authorities should consider transferring their compensation automatically to a special 'holding' account, such as a Post Office Card Account in the UK. The individual would then have access to banking facilities until they are in a position to make an informed choice on an appropriate replacement account.

**Question 36: Cross-border cooperation between DGS**

We recommend that the host state DGS should act as a paying agent for the home country DGS.

## 7. Financing of DGS

We are not in a position to comment in detail on the funding of DGS. However, we strongly support proposals for pre-funding, which will greatly improve consumer confidence in the banking system and reduce the unfairness of solvent firms having to bail out failed competitors. We also support a risk-based levy which would increase the incentives for banks to manage their risk effectively.

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<sup>3</sup> *Financial exclusion among older people*, Help the Aged, September 2007