COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

concerning the review of Directive 94/19/EC on Deposit Guarantee Schemes

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1. INTRODUCTION

Deposit Guarantee Schemes (DGS) provide a safety net for depositors so that, if a credit institution fails, they will be able to recover at least a part of their bank deposits. Directive 94/19/EC obliges Member States to ensure the existence of one or more schemes on their territory and has been effective in ensuring a minimum level of protection for depositors throughout the European Union. The directive has been implemented into national legislation in all Member States[1]

The Directive allows considerable scope for Member States to develop systems which are best suited to the prevailing market conditions. At the same time level playing field concerns are addressed by the inclusion of provisions which allow foreign bank branches from within the EU the option of joining schemes in the host market in order to be able to offer the same level of guarantee as host country regulated banks[2]

Nevertheless, eleven years after implementation into national law, the Commission has been reviewing the Directive in order to assess whether the existing rules are still fit for purpose in light of the continuing trend towards financial integration and cross-border mergers between credit institutions. In particular, differences between the way schemes are financed have been cited in the Commission's consultations by some as posing an obstacle for cross-border consolidation and as unfair from a competition perspective. There are also substantial differences between the guarantee levels afforded to depositors across the Member States and a number of issues have been highlighted regarding differences between the scope of coverage and the cross-border functioning between schemes.

The objective of this Communication is to draw conclusions from the consultation process, to respond to the concerns expressed by stakeholders, to identify short-term and non-legislative ways of improving the functioning of the directive and to set out the Commission's policy towards deposit guarantee schemes in the coming years.

1.1. Arguments in favour and against changing the existing framework from the stakeholder consultation

The consultation process has revealed differing opinions about whether the existing deposit guarantee arrangements are in need of change.

Some stakeholders have argued that the existing framework should be changed because of:

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1 Transitional arrangements have been agreed to allow adaptation to the €20,000 minimum coverage level prescribed in the Directive.

2 Referred to as "topping up" arrangements.

- substantial differences between the guarantee level afforded to depositors (ranging from just € 14 481 in Latvia to € 103 291 in Italy).

- substantial differences in the manner by which schemes fund pay-outs to depositors. These are *ex post* funded schemes which rely on collection of funds from members of the scheme once a bank has failed, and *ex ante* funded schemes which collect funds from members of the scheme through the levying of contributions - there are also significant differences between the size of *ex ante* funded schemes. Such differences, it is claimed, raise doubts about the ability of schemes to function on a cross-border basis under crisis conditions, create competitive distortions because of the unfair advantage to banks operating under schemes with lower costs, and cited as an obstacle for a bank seeking to consolidate its operations using the European Company Statute.

Other stakeholders, on the other hand, have argued against changes at the present stage, primarily due to the high costs entailed (in particular for those Member States with *ex post* schemes faced with the prospect of changing to *ex ante* schemes). They argue that the system functions relatively smoothly in the current environment, it is adequate for supervisory purposes and they do not agree that the existing arrangements create competitive distortions between markets. They also argue that the cross-border consolidation problems faced by only a very limited number of institutions do not suffice to fundamentally change existing arrangements.

1.2. Response to the Stakeholder consultation

At the current stage, the weight of opinion expressed would appear to favour maintaining the status quo and avoiding expensive investments to change the existing framework in the absence of a firmly established business case.

However it is the Commission's view that failure to keep pace with the increased degree of cross-border financial integration in Europe could ultimately prove very costly in the longer run, should the lack of standardised rules contribute to the inability of the supervisory safety net to function adequately in a cross-border crisis situation. The costs to the economy and the undermining of confidence in the single financial market could ultimately prove far higher than the level of investment needed to ensure satisfactory functioning of the pan-EU safety net.

Furthermore, failure to address some of these issues may ultimately prove harmful to consumers: even though direct cross-border deposits may still be at a relatively low level, recent research indicates that a rising number of EU citizens are considering acquiring financial products abroad. This includes a rising demand for opening bank accounts in another Member State.[3]

The Commission therefore proposes to respond to results of the review process in two different ways. Firstly it will seek to develop pragmatic and achievable approaches to identified problems which do not require changes to the existing regulatory framework. As a second step, it will examine more fundamental changes which might require an overhaul of the current EU legislation on DGS.

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[3] SEC (2005) 927, p. 11.

2. PRAGMATIC NON-LEGISLATIVE SOLUTIONS

The Commission believes that a number of short term improvements to the existing arrangements in response to the stakeholder consultation can take place without the need to make changes to the existing Directive. Design and implementation of such solutions could be carried out in cooperation with the Commission Working Group of Member States' representatives, the European Forum of Deposit Insurers (EFDI), or representative banking associations at EU level. Some interpretative guidance and recommendations are already provided below.

2.1. Definition of deposits and scope of coverage

The current definition of "deposits" in Article 1(1) is broad, and no stakeholder has provided any evidence to suggest that amendment would be needed to cover products which might fall outside the scope of the Directive.

However, as Member States are allowed to exercise discretion with regard to the exclusions which are listed in Annex I of the Directive[4], some stakeholders have suggested streamlining the scope of coverage and making it more coherent across Member States by limiting those discretions.

The Commission proposes to carry out a survey of savings products which are currently covered and the impact of any exclusion. The survey, which could be carried out with the support of the Commission working group on DGS or EFDI, should also investigate whether there is an appropriate cross-sectoral (i.e., insurance[5], investments and deposits) coverage without gaps. This would be useful given the increasingly blurred distinction between different financial products.

2.2. "Co-insurance"

According to the "Co-insurance" provisions contained in the Directive, Member States may decide that depositors should bear a certain percentage of losses themselves in the event their deposits become unavailable. Accordingly, some Member States have introduced rules which limit the amount paid out to depositors in the event of a bank failure even before the guarantee threshold has been reached[6].

At this stage, there would appear to be insufficient support to introduce any short-term change to co-insurance rules. In general, there seems to be no agreement among stakeholders about whether the underlying principle of *moral hazard*, (i.e. the risk that, because their deposits are insured in any case, depositors choose a bank without first assessing its soundness) justifies its application. Some consider co-insurance an indispensable element in preventing moral hazard, while others, in particular consumer associations, argue that depositors should not be placed in a position whereby they are expected to judge the soundness of the credit institution.

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4 Member States may exclude e.g. deposits in non-EU currencies or certain depositors such as the bank's managers or companies of a certain size.

5 A study on the feasibility of Insurance Guarantee Schemes in the EU will be commissioned.

6 Article 7.4 allows Member States to limit the guarantee to 90% of the aggregate deposits until the amount to be paid under the guarantee reaches €20.000 (see footnote 7).

In the light of these dissenting views, the Commission is not convinced that at this stage a change to the co-insurance rules would be justified. The Commission will review this in the future when considering other possible changes (see chapter 3) to the Directive[7].

2.3. "De minimis" clause

The consultation process has also revealed that certain stakeholders would be in favour of introducing a "de minimis" clause into the Directive, whereby very small deposits would not be reimbursed because the administrative costs would exceed the amount of reimbursement. There would seem to be very little impact on cross-border activities because it is unlikely that the amounts in question (e.g. € 20 was the amount suggested by the Commission services in the consultation paper[8]) would be decisive for depositors. On the other hand, modern IT systems should help to minimise administrative costs.

The Commission does not consider it appropriate at this stage to consider introducing a de minimis clause since both co-insurance and de minimis rules are linked to the limitation of depositor protection and therefore should not be dealt with separately.

2.4. "Topping-up" arrangements

Under "topping-up" arrangements, a bank branch that sets up business in another EU Member State where the coverage level is higher or the scope broader than in its home country has the right to join the host country DGS. This enables it to offer the same depositor guarantee level as local banks.

There is broad agreement among stakeholders and Member States that topping-up arrangements are necessary as long as coverage levels have not been harmonised, even if most stakeholders claim that their practical relevance is low due to the limited number of agreements that have been concluded.

There appears to be no great need to change the Directive in this regard, although there may be scope for non-regulatory actions aimed at facilitating agreements between DGS and to iron out possible frictions which have arisen under existing arrangements. An optional so-called 'master agreement' on topping up arrangements, which could be developed by EFDI and adapted according to the individual DGS's needs[9], would be supported by the Commission under the condition that they will respect Community law.

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7 However, one aspect regarding co-insurance has arisen during the consultation process and merits clarification. It concerns whether or not the Directive allows co-insurance to be applied already at the minimum coverage level of € 20 000. The correct interpretation of Article 7(4) is that the minimum coverage level may be limited to a specified percentage of deposits, but that this percentage must be equal to at least 90 % of aggregate deposits until the amount to be paid reaches the minimum coverage level of € 20 000: the minimum coverage level can under no circumstances fall below this amount. The Directive's explanatory memorandum clarifies that the minimum coverage must be left intact after application of co-insurance. For a Member State applying 10% co-insurance, this means therefore that the minimum coverage level must be set at € 22 222. The Commission will ensure correct application of Article 7(4) by Member States.

8 http://ec.europa.eu/internal_market/bank/docs/guarantee/consultationpaper_en.pdf.

9 See Annex II of the Directive; further work could cover areas where difficulties have occurred in negotiating an arrangement, such as the mitigation of the impact of different set-off regimes and the different priority status that home and host DGS enjoy in a liquidation procedure in the home country of the bank.

The public consultation has indicated some support for "home country topping up", in light of the multiple obstacles for topping-up arrangements that result from the minimum harmonisation of DGS. Under home country topping up, the home and not the host country scheme would cover the difference between the coverage levels. The Commission considers it useful to clarify that, under the Directive, Member States are already free to allow such arrangements.[10]

Furthermore the existing provisions on "topping-up" only deal with the provision of services via branches. However, services are increasingly being provided in another Member State directly without the establishment of branches or subsidiaries. It could be useful in the longer term to consider whether to extend the current requirement to cover the direct provision of services from another Member State[11]. Given that the Directive does not actually *prevent* DGS from granting access to credit institutions operating in such a way, legislative change does not appear to be a priority at this stage.

2.5. Exchange of information requirements

Most stakeholders in the public consultation were not in favour of introducing further provisions governing the exchange of information between home and host DGS into the Directive in support of membership conditions for branches. However, a non regulatory approach aimed at improving the flow of information between DGS – in particular those linked through topping up arrangements - could be explored in order to avoid any unnecessary lack of clarity in this area. The Commission would be supportive of work carried out by EFDI aimed at developing a non-binding model agreement, but wishes to emphasise that such work should not interfere with the ongoing work in other fora on the wider topic of crisis management (which may also comprise information exchange and involve different authorities with different mandates and responsibilities).

2.6. "Risk-based" contributions to DGS

Some DGS already base contributions to their scheme according to the individual risk of credit institutions, in line with the recommendation of the G10 Financial Stability Forum[12]. The introduction of risk-based contributions to DGS could be a desirable enhancement to the existing framework and could facilitate the transferability of contributions between schemes (although not in an ex-post financing system). Most stakeholders who are in favour of ex-ante schemes favour risk-based contributions for the sake of fairness, and because they provide an incentive for sound management, since those credit institutions that bear less risk would have to pay lower contributions and vice versa. Some stress that risk-based schemes increase the effectiveness of DGS with regard to their ability to deal with potential failures. Whereas DGS are already free within the bounds of the Directive to introduce risk-based elements, *harmonisation* would clearly require an amendment of the Directive and, in view of its complex nature, would not be a short term project. Nevertheless, the Commission supports the introduction of risk based elements and recommends that the determination of 'risk' should be

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10 Although "Home country topping-up" might actually lead to an unequal treatment of domestic and foreign depositors, because the former would enjoy a lower coverage than the latter, such discrimination against domestic depositors would not infringe European law.

11 From a legal perspective, the current provisions cannot be interpreted as meaning that a host state DGS would be obliged to allow membership from a credit institution operating directly from another Member State.

12 http://www.fsforum.org/publications/Guidance_deposit01.pdf.

based on already available and harmonised tools (e.g. such as those within the Capital Requirements Directive framework[13]). The Commission would support preparatory work by EFDI and/or the working group on DGS which might subsequently be voluntarily applied. It may in the longer term serve as a basis for a harmonised approach.

2.7. Transferability or refundability of DGS contributions

In light of the difficulties experienced in practice by one banking group to consolidate funds paid into different schemes into a single DGS, stakeholders' views were split on whether to amend the Directive and introduce rules about the transferability or refundability of paid-in DGS contributions. Some saw a need for rules in order to reduce financial burdens on firms when entering another scheme, while others insisted that DGS contributions had to be seen as non-refundable 'insurance premiums' and argued that withdrawal of funds would weaken schemes. Should a bank decide to move its seat into another Member State or consolidate operations under the European Company Statute, the Directive neither prevents a refund or transfer of contributions, nor does it qualify them as 'insurance premiums'. In the absence of harmonisation, Member States are thus free to regulate this issue as they see fit. Nevertheless, the Commission recommends that any new rules permitting transfer or refund of DGS contributions should neither weaken the fund in a way which would endanger its functioning nor lead to an inappropriate accumulation of risks. Even if it is currently not required by Community law, it would appear useful if credit institutions were properly informed whether or not national law foresees a partial or complete refund.

2.8. Consumer information and advertising

Consumer associations have stressed that depositors are insufficiently informed about DGS and rarely know which deposits are covered and up to which amount. Some stakeholders have also proposed deleting the provision in the Directive[14] which restricts the use of information about DGS in advertising. Since other provisions[15] of the Directive already require "comprehensible information" about DGS' coverage and the impact on cross-border activities would not appear to be significant, an amendment to the Directive would not appear to be necessary. It would appear more appropriate at this stage to focus efforts on improving consumer information at national level. The Commission encourages Member States to make further efforts in this area and will monitor the correct application of these articles. The Commission proposes to carry out a survey of current practice with the support of a Commission Working Group.

2.9. Deadline for reimbursement/mitigation of impact on depositors

Under Articles 1(3) and 10 of the Directive, the competent authorities must determine the unavailability of deposits within 21 days after a failure followed by a further deadline of three months for the DGS to pay out to the affected depositors. This deadline can be extended twice (for three months each) under exceptional circumstances. In an era of IT that enables DGS to trace depositors and calculate payments more easily than when the Directive was adopted, it is important to consider whether a "normal" maximum waiting period of nearly 4 months is still appropriate.

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13 Directive 2006/48/EC, OJ L 177, 30 June 2006, p.1, and Directive 2006/49/EC, OJ L 177, 30 June 2006, p.201.

14 Article 9(3).

15 i.e. Articles 6(2) and 9(1).

This issue has not been raised in the consultations, and data about the length of payment periods is not available. The Commission intends to conduct a survey among DGS and encourage an exchange of best practices between schemes on how to mitigate the effects of a failure for depositors under national law, for instance by providing advance payments or guaranteeing interim credits (provided that the latter is in conformity with EU state aid rules[16]). The Commission will also investigate whether differences exist with regard to interpretations as to the precise moment at which deposits become unavailable.

2.10. Pan-European/regional DGS

The idea of developing a pan-European DGS was rejected by nearly all stakeholders; further work on this approach does not seem appropriate at present. Some stakeholders were open to the idea of regional DGS covering several Member States. This could be an option for Member States whose systems share similar features (such as the funding mechanism) and may even resolve some level playing field issues (e.g., coverage and co-insurance) and allow the transferability of funds. The Commission sees no legal obstacles for Member States to enter into such agreements under the existing Directive, and this could indeed represent a solution for banks that seek to move their headquarters to another Member State or adopt the European Company statute (SE).

Statistical obligations

Both JRC reports revealed that deposit data were extremely difficult to obtain, although considerable efforts have been made and close contacts with DGS established with the support of EFDI. Further work building on those efforts will be necessary to improve data availability, so that future policy debates are informed by better empirical evidence. In the longer term, consideration could be given to the introduction of common statistical obligations for DGS.

3. DOES CURRENT EU LEGISLATION ON DGS NEED CHANGING?

From a financial stability perspective, it is crucial that DGS contribute to smooth crisis management, in particular where significant cross-border banking groups are concerned. It may be the case that the existing differences between DGS as regards funding mechanisms, coverage levels, and rules for paying out to depositors hamper fast and efficient crisis and bankruptcy resolution in cross-border situations. Furthermore any perceived malfunctioning of DGS may undermine confidence in the EU financial system.

However before determining whether this is indeed the case and before any far-reaching decisions can be taken about whether and how to revise the current EU rules as regards Deposit Guarantee Schemes, clarity is first needed about the overall division of supervisory responsibilities and financial liabilities in such crisis situations. In other words the 'burden sharing' arrangements between Member States. Further clarity about burden sharing arrangements is important from the perspective of DGS, because in particular:

- Some DGS may play an important role in crisis management by providing additional liquidity to a credit institution - solely or in addition to central bank liquidity support (it is

[16] See COM 2004/C 244/02.

important to clarify that if these DGS are public institutions, they must follow the EU state aid rules[17]).

- Should it be decided to let the bank fail and to trigger payout to depositors by the DGS, clarity is needed about who takes the decision between these options, and in the latter case it may be necessary in cross border situations to manage the participation of various DGS; it is thus crucial to know to what extent they would be able to absorb the call on their funds.

Regulatory and supervisory authorities are aware of these issues and further work on burden-sharing among finance ministries, the ECB and central banks, and other supervisors and the Commission is currently underway in a number of different fora.

Only once burden sharing arrangements have been clarified, can the longer term issues be addressed:

(a) DGS objectives: clarification is needed about the role DGS are expected to play and on the balance that should be struck between pure consumer protection objectives and the extent to which DGS should be expected to contribute to the stability of the financial system;

(b) DGS funding mechanisms: DGS are usually funded by contributions from credit institutions themselves, on an ex-ante, ex-post or mixed basis. The consultation has shown that a clear majority does not wish to harmonise financing mechanisms now, as they believe that the costs entailed would be greater than the expected benefits. Consistent with the Commission's Better Regulation approach, the cost impact of a change of funding mechanisms has been assessed.

(c) The interim report produced by the JRC on this subject has been published[18] and Annex III provides a brief summary. The results show that further harmonisation of funding mechanisms would imply a financial burden of € 2.5 bln to € 4.3 bln[19] cumulatively over a period of 10 years for the banking sector in the six Member States that currently operate ex post DGS (see Annex III). The expected benefits of a more standardised ex ante funded system of DGS have not been assessed and indeed are more difficult to quantify – as from a financial stability perspective these would only become apparent if the EU banking system were confronted by a crisis with cross-border dimensions. The benefits from a business perspective would include fostering an efficient and level playing field. At this point the Commission would concede that the business case has not yet been established, although further ongoing work on burden sharing and crisis management may result in a stronger case for change being established in the longer term.

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17 ibid.

18 http://ec.europa.eu/internal_market/bank/guarantee/index_en.htm.

19 See Annex III and JRC report, (table 10) showing premiums payable based on covered deposits (which are partly based on estimates); premiums based on eligible deposits (see table 9) may be higher.

(d) Risk-based contributions: as stated above (2.1.6) the Commission is in favour of risk based methods. If progress were made on funding mechanisms, then harmonising the method for contributions could follow;

(e) Minimum coverage level: the impact work in this area shows that, given the disparities in average deposits in Member States, the pursuit of truly harmonised conditions for the protection of deposits may not be achieved by simply fixing a common guarantee level for all countries given the wide economic disparities. Possible changes to the minimum level should only be contemplated in the much longer term;

(f) Use of DGS funds: the possibility to use the funds in a DGS to provide liquidity assistance to banks is worth further consideration, but depends on progress in the broader work on crisis management;

(g) Cooperation between DGS, supervisors, central banks and governments: legislative requirements setting out the need for enhanced cooperation could follow from the broader work on financial stability and evolution of supervision;

(h) Reorganisation and winding up of credit institutions: Directive 2001/24/EC[20] will soon be reviewed by the Commission services. At least two issues are of importance for failures affecting DGS in more than one Member State and will be taken into account during the review process:

– DGS should – after the failure – enjoy the same access to information as supervisory authorities in order to be in a position to recover their claims; and.

– equal treatment of DGS should be ensured, in particular with regard to the priority of claims.

4. CONCLUSIONS

The review of the Directive has highlighted a number of areas where there are deficiencies in the way DGS are regulated at EU level.

The Commission takes the view that many improvements to DGS can best be achieved in the shorter term without the need to change the existing Directive and proposes to address those issues without delay. These issues have been set out in chapter 2 and a summary of the proposed actions is included in Annex II A.

A convincing case has still to be established as to whether a more fundamental change to the existing regulatory framework will be necessary in a longer term perspective and whether or not the expected benefits of such change outweigh the costs. The Commission recognises that there is insufficient evidence of tangible progress on the broader safety net issues at the present stage to be able to undertake those changes aimed addressing some of the more specific and fundamental shortcomings in the Directive. Addressing these shortcomings

[20] Directive 2001/24/EC, OJ L 125, 5.5.2001, p.15.

would require an important legislative effort to harmonise the funding of national schemes with significant financial consequences for a number of Member States' banking sectors but with few apparent immediate benefits. Any further legislative change will depend on ongoing work in other connected areas (see Annex II B) as well as on sufficient support from Member States and stakeholders and will be preceded by appropriate impact assessments. In particular a clearer picture is needed of the division of supervisory responsibilities and, if necessary, more consistency in "burden-sharing" approaches (i.e. who foots the bill) in the event of a cross-border EU banking crisis.

ANNEX I

Procedural issues and consultation of interested parties

This Communication is based on the following elements of the Commission's "better regulation" policy[21]:

Member States' finance ministries have been consulted in the European Banking Committee (EBC) and its predecessor, the Banking Advisory Committee (BAC). At its July 2006 meeting, the EBC endorsed a policy paper that contained most of the elements of this Communication. Member States' supervisory authorities in the Committee of European Banking Supervisors (CEBS) have provided technical advice on specific aspects of DGS and the European Central Bank (ECB) has also carried out important background work. Member States have additionally been consulted in writing and at two technical meetings of the working group on DGS in 2005 and 2006.

A public stakeholder consultation was launched in July 2005. A synthesis of the more than 40 contributions is available on the web page of the Directorate-General Internal Market and Services.[22]

The Commission has conducted two quantitative studies. Firstly, work on a possible change to the minimum coverage level was carried out with the Commission's Joint Research Centre (JRC)[23], and further JRC work has subsequently been undertaken on the cost implications of changes to the funding mechanisms of DGS (the JRC's interim report is attached in Annex III).

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21 COM(2002) 275 final.

22 http://ec.europa.eu/internal_market/bank/guarantee/index_en.htm

23 Ibid.

ANNEX II

A. List of short-term non-regulatory actions proposed in the Communication

Survey on savings products covered under national DGS,	Commission Working Group on DGS or EFDI
Development of a non-binding 'master agreement' on topping up arrangements	EFDI
Development of a non-binding model agreement on exchange of information between DGS	EFDI
Development of common voluntary approaches to inclusion of risk based elements for DGS.	Commission Working Group on DGS or EFDI
Improvement of comprehensible information about DGS' coverage to consumers; identification of deficiencies and agreement and promotion of best practices	Commission Working Group on DGS with consultation of the banking industry
Improvement of payment delays to depositors; survey among DGS on delays and best practices	Commission working with EFDI

B. Timetable of wider Commission initiatives with implications for Deposit Guarantee Schemes

Publication of Communication on DGS	Commission	Autumn 2006
Report to EBC on progress of ECB and Basel Committee liquidity projects and Commission services work	Commission services	November 2006
Impact assessment on costs of introduction of common ex ante financed schemes by MS (final report)	Commission services	End 2006
Report to EBC on crisis management cooperation with 3rd countries and bail out rules	Commission services	March/April 2007

Report to EBC on lender of last resort arrangements	Commission services	June/July 2007
Report to EBC on further work on evolution of supervision	Commission services	October/November 2007
Report to EBC on review of re-organisation and winding up Directive	Commission services	October/November 2007
Publication of study on Insurance Guarantee Schemes in the EU analysing problems and evaluating options and their feasibility	Commission services/ external consultants	End 2007
Report to EBC on completion of Commission services liquidity work	Commission services	End 2007
Decision about follow-up to study on Insurance Guarantee Schemes	Commission	2008
Commission report to Council and EP on supervisory arrangements (under 20006/48/EC Art. 156 para 3) on the effectiveness of supervisory arrangements put in place in the CRD and any proposals for change	Commission	2012

ANNEX III

Further work carried out by the JRC on the effects of changing the funding mechanisms of EU Deposit Guarantee Schemes[24]

DGS are usually funded by contributions from credit institutions themselves: either on a regular basis ('ex-ante'), on a case by case basis after a failure ('ex-post') or comprising both ex-ante and ex-post elements ('mixed'). Changing funding mechanisms would entail differing costs for participants. For instance, the cost for a full ex-post mechanism is close to zero (administration fees entail the only cost as long as no failure happens), while annual fees are paid in ex-ante schemes destined for the creation of a float ready to be used in the event of a crisis. At present, 19 Member States have ex-ante funded schemes while 6 Member States have ex-post schemes[25].

The public consultation has revealed that a clear majority does not wish to harmonise financing mechanisms now, on the grounds that this would create more costs than benefits. Those in favour of harmonisation (mainly Nordic stakeholders) believed that only harmonisation could solve the current distortion of competition where a branch competing with domestic credit institutions has to pay different DGS fees.

For this reason, the Commission has requested the JRC to conduct research into the cost impact of changing the funding mechanisms of EU DGS. The enclosed interim report provides a quantitative evaluation of the costs associated with harmonising the existing funding mechanisms of DGS. It looks at four scenarios ranging from ex-post funding to a "high" ex-ante funded coverage ratio of 0.84% of covered deposits[26].

The key finding of the report is that many Member States already require equal or higher contributions than those necessary to reach the coverage ratios defined in the scenarios. In order to reach the lowest ex-ante funded scenario (0.16% coverage ratio), only 9 Member States would need to increase contributions. To achieve the highest coverage ratio under the scenarios (0.84%), 14 Member States would need to increase contributions[27]. The costs for those Member States which currently operate ex post schemes (see table) of building up a low ex-ante funded scheme based on scenario 3 (0.16% coverage ratio) would range from € 2.5 bln to € 4.3 bln[28] depending on the level of risk associated with the members of the scheme cumulatively over a period of 10 years.

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24 http://ec.europa.eu/internal_market/bank/guarantee/index_en.htm

25 At this time Austria, Italy, Luxembourg, the Netherlands, Slovenia and the United Kingdom have ex-post funded DGS.

26 For the definition of 'covered deposits' see the report.

27 Note that, due to a lack of comprehensive data from one Member State, results can be compared only among 24 Member States.

28 See Annex II, p. 35 (table 10) showing premiums payable based on covered deposits (which are partly based on estimates); premiums based on eligible deposits (see table 9) may be higher.

	Low coverage, low risk adjusted fund	*Low coverage, medium risk adjusted fund*	*Low coverage, high risk adjusted fund*
IT	512 640 000	683 520 000	854 390 000
LU	1 670 000	22 300 000	27 880 000
NL	268 580 000	358 110 000	447 640 000
AT	90 820 000	268 580 000	121 100 000
SI	8 620 000	11 500 000	14 370 000
UK	170 3930 000	2 271 910 000	2 839 880 000
Total	2 586 260 000	3 615 920 000	4 305 260 000

The Commission recognises that this study does not paint a complete picture of the costs and benefits of changing the funding mechanisms. On the one hand, it does not consider the opportunity cost of the capital tied up in funds which cannot be used by banks for other purposes.

On the other hand, the study has not attempted to assess the cost impact of non-harmonisation of funding mechanisms, i.e. maintaining the *status quo*. These costs should not be neglected; the current distortion of competition whereby a branch competing with domestic banks has to pay different DGS fees would continue. The issue of compensation of contributions to DGS when credit institutions change their subsidiaries into branches would be more easily resolved if financing bases were similar across Member States.

Neither has the study given consideration to the potential benefits of changing the existing systems. The extent to which a more standardised ex ante funded system of DGS might be able to better withstand a banking crisis with cross-border implications have not been assessed and indeed are more difficult to quantify.

The results of this research show that harmonisation of funding is not impossible in financial terms, although the costs for industry would be significant in certain Member States. The key question is whether the advantages of ex-ante funded systems outweigh the costs incurred. At this point the Commission is not convinced that this is the case. Further analysis will be required on this issue.