



Sveriges Riksbank's response to the EU consultation on the review of the Directive 94/19/EU on Deposit Guarantee Schemes

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Sveriges Riksbank welcomes the opportunity to comment on the European Commission's review of Directive 94/19/EC on Deposit-Guarantee Schemes (DGS). Below please find answers to a number of questions posed in the consultation.

Question 1: Do you agree in general that the current framework of DGS in the EU needs to be revised? Are the areas identified for review the right ones, or are there other priorities?

The proliferation of the EU financial integration has highlighted a need to revise the community legislation on Deposit Guarantee Schemes. The current financial crisis has further underlined this need. The minimum harmonisation of the DGS directive and the lack of rules on funding have resulted in great diversity among the deposit guarantee schemes in the EU, with distorting implications on the efficient functioning of the internal market for financial services, both in terms of level playing field and of financial stability (i.e. the ability to efficiently prevent and manage financial crisis).

The recent changes to the DGS directive have addressed some concerns. However, these changes mostly apply to the expenditure side of DGS', i.e. compensation amounts and payout delays. Crucial issues such as financing arrangements and the role of DGS in the overall crisis management framework etc. have not been reformed. Consequently, most weaknesses of the current regime remain unresolved and have, to certain extent, become even more pronounced. For instance, moral hazard problems and the risk for insufficient financial capacity of individual DGS' increases as the coverage of the guarantee increases at the same time as financing arrangements are left unchanged. The same reasoning applies to the level

- playing field issue as competitive distortions are amplified due to the asymmetric reform of the directive.

Also, the current crisis has clearly highlighted that the financial capacity of privately administered schemes to cover DGS liabilities cannot be taken for granted. In a major systemic crisis no private stakeholder can be expected, unless a huge fund has been built up, to have the financial strength to accumulate enough liquidity to make prompt reimbursement to depositors. The size of DGS liabilities are simply too large for a private insurer to manage on a stand alone basis. Thus, in order to avoid that any burdens for compensating depositors in the future will fall on tax-payers the role of governments as ultimately responsible for honouring the DGS-liabilities has to be recognised and funding arrangements has to be adjusted accordingly.

In addition, the pay box nature of most DGS' and the incompatibility of national crisis management and resolution arrangements (which defines the trigger points and usage of DGS funds) create problems. Since the EU, besides the DGS-directive, lacks common regulation on crisis management it remains a significant gap in the EU framework for preventing and managing financial crisis. This gap needs to be closed, either by reforming DGS legislation into a more comprehensive and workable crisis management tool for all types of institutions or by introducing a separate community legislation with the same purpose. This problem is most pronounced for the larger cross-border institutions, where the existing DGS-funds are clearly inadequate.

Appropriateness of the coverage levels

The following options could be considered:

- (a) **Revert to a coverage of € 50 000**
- (b) **Coverage of € 100 000 (current approach – from end 2010 onwards)**
- (c) **Coverage of a higher amount**
- (d) **Coverage depending on the actual size of deposits or economic indicators such as the Gross Domestic Product per capita (thus different in each Member State)**
- (e) **Unlimited coverage**

Question 2: Which of the above options would you prefer? Would you prefer another option? Please explain your choice.

On the one hand, experiences from the crisis have clearly illustrated the rationale for extensive DGS coverage, both in terms of scope and level, as well as a need for very short payout delays. On the other hand, there are also several convincing arguments for keeping DGS coverage fairly limited. First, increasing the size of the guarantee means that the implicit liability to tax-payers increases proportionally. Second, and more importantly,

■ guaranteeing certain types of saving products but not others is likely to distort the allocation of capital in the savings markets. Preferably, a distinction should therefore be made between short term deposits that should be covered and more savings type of products that in the views of the Riksbank should fall outside the scope of the DGS: It is not obvious that long term savings in a bank should benefit from a guarantee when savings in individual securities do not. (and to make it clear we would oppose including any securities in the scope of the DGS) Third, moral hazard will increase the more extensive the guarantee is. However, all these arguments speaking in favour of limited coverage can effectively be mitigated by well designed pricing mechanisms for the DGS. By collecting guarantee premiums in advance and in relation to the risk of each institution governments will be compensated for the risk taken. Also, such a pricing mechanism would limit the incentives for depositors to put unproportionately large amounts into deposit accounts vis-à-vis other saving products.

It will also limit the moral hazard problems as the possibility for banks to finance high risk activities with high yielding deposits decreases. Thus, implementing a pricing model based on risk sensitive premiums makes the coverage level less important in maintaining discipline among depositors and guaranteed institutions. Provided that such model will be introduced the Riksbank supports a harmonisation of coverage levels at a level sufficient to cover the direct bank deposits of the majority of retail depositors in the EU. The appropriate level is not evident but the arguments presented above indicates a need to limit the coverage and EUR 100,000 is clearly well above the amounts that the vast majority of retail depositors have as direct bank deposits.

In any case, differentiated coverage levels between member states do not seem advisable, neither from a level playing field perspective nor a financial stability perspective.

Question 3: Should the coverage level you prefer (Question 2) be a minimum or a fixed level? Or do you think a different solution would be more suitable, e.g. a range with a minimum and maximum level? If so, please describe. Please give reasons for your choice.

Minimum harmonisation obviously entails a risk of differentiation of coverage levels among different DGS'. As mentioned above this may have distorting implications on functioning of the internal market. Harmonisation is therefore desirable. However, once again, the pricing issue is the critical aspect in this respect. If funding arrangements based on risk sensitive ex ante premiums are introduced the need for a fixed level becomes of secondary importance.

Question 4: Do you have background information or evidence whether depositors have split up their deposits when the financial crisis aggravated in autumn 2008?

Should depositors be actively encouraged to split up their deposits between different banks or is this inappropriate? Please give reasons.

In Sweden there were some reallocation activities among depositors holding uncovered deposits. This was not only related to limitations in coverage level but also due to the limited coverage for time deposits in the Swedish scheme. These activities practically ceased when the government extended the coverage by doubling the coverage level and included all time deposits in the guarantee.

We do not see any obvious merits in encouraging depositors to split up deposits between different institutions.

Question 5: Do you think this problem could be solved with a mere information obligation towards depositors (see Questions 22-25)? Or do you think banks should have the option to ask for coverage per brand name to avoid aggregation of accounts in case of failure? If so, and how, should this be taken into account when the contributions of such banks to DGS are calculated?

For the purpose of avoiding regulatory arbitrage the coverage should apply for the aggregated deposits within the same bank, i.e. legal entity. As indicated in the question, the proper solution would be to require banks to inform the depositors of the terms of DGS coverage.

Question 6: If the coverage level is fixed, should there be exemptions that allow a higher coverage of certain products for social considerations? If so, for which products should there be exemptions and up to which amount? Should this be harmonised or should Member States have the discretion to decide on this? In the latter case, which elements should be within the discretion of Member States (e.g. amount and duration of coverage)?

Also in this case there may be scope for regulatory arbitrage, if making exceptions to the coverage level for certain products. The Riksbank therefore supports as few exceptions as possible. Few exceptions also facilitate the procedures for pay-outs – an important aspect in any DGS, as evidenced in this crisis.

Question 7: Should temporary high account balances be covered? If so, up to which amount and for how much time? In which situations should these balances be covered? Should this be harmonised or should Member States have the discretion to decide on this? In the latter case, which elements

■ should be within the discretion of Member States (e.g. situation, amount and duration of coverage). Should, in order to facilitate payout, such balances be transferred to special accounts that are ‘tagged’? Do you see other solutions to protect temporary high balances?

See the answer to question 6 above.

Question 8: Should mutual guarantee schemes and voluntary schemes be integrated into the Directive so that the same rules would apply for them as for 'classical' DGS? If so, how? Should there be restrictions on advertising for these schemes? Please provide reasons.

From a level playing field perspective it seems acceptable to keep the present arrangements, provided that funding arrangements are harmonised in accordance with an ex-ante risk based premium model. However, this issue also relates to the broader question of the appropriateness of privately administrated DGS'. As mentioned above the crisis has clearly illustrated that the financial capacity of privately administrated schemes to cover liabilities cannot be taken for granted. The Riksbank believes that it should be recognised in the DGS-directive that the governments bear the ultimate responsibility for the DGS' and that they should receive full compensation for assuming the risks that such responsibility entails. Privately administrated schemes could still be allowed but they should be required to reinsure their liabilities with the government.

Scope of deposits covered by DGS

The scope of eligible deposits could be in the discretion of Member States or harmonised. If it is harmonised, it could be considered to fully cover certain deposits, to cover them only up to a certain percentage of the normal coverage level, or not to cover them at all.

A. Structured deposits:

Question 9: Which solution(s) would you prefer as regards structured deposits? Please provide reasons. Would you prefer another option? Please describe.

B. Debt certificates issued by a credit institution:

Question 10: Which solution(s) would you prefer as regards debt certificates? Please provide reasons. Would you prefer another option? Please describe.

C. Accounts in non-EU currencies:

Question 11: Which solution would you prefer as regards accounts in non-EU currencies? Please provide reasons. Would you prefer another option? Please describe.

- For reasons stated in the answer to Question 2, the Riksbank would refer a rather limited scope. Securities and securities-like instruments should therefore not be covered.

In terms of accounts in non-EU currencies, it seems reasonable for financial stability concerns that they are covered to the same extent as corresponding type of account in EU-currencies – i.e. no differentiation should be made based on the currency chosen.

Question 12: Should the eligibility criteria as regards depositors (provided for in Annex 1 no. 1-11 of the Directive) be fully harmonised or should Member States retain some discretion to decide about eligibility of depositors?

For the purpose of creating a DGS, that is efficient, credible, easy to understand and has limited competitive distortions, the EU need to agree on a harmonized system, including eligibility criteria, levels and type of accounts covered. To create such a system the exceptions in Annex II of the Directive needs to be fully harmonized across the EU membership.

Eligibility of depositors

If the eligibility criteria in Annex 1 no. 1-11 are harmonised, it could be considered to fully cover all depositors, to cover them only up to a certain percentage of the normal coverage level, or not to cover them at all.

A. Enterprises in the financial sector (Annex 1 no. 1, 2, 5, 6):

Question 13: Do you have background information or evidence whether a covered amount of € 100 000 is relevant for these enterprises?

Which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe.

B. Authorities on central and local level (Annex 1 no. 3, 4)

Question 14: Do you have background information or evidence whether a covered amount of € 100 000 is relevant for authorities?

Which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe.

C. Depositors having a relationship with the failed bank (Annex 1 no. 7, 8, 9, 11)

Do you have background information or evidence on how many depositors are actually concerned by this?

Question 15: Which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe.

D. Depositors who opened their account anonymously (Annex 1 no. 10)

Do you have background information or evidence on how many depositors are actually concerned by this?

Question 16: Which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe.

In many cases, financial institutions have larger open positions and deposits with each other, than what is covered by EUR 100,000. However, the Riksbank feels that it is reasonable to exclude such institutions from the coverage in order to counter moral hazard problems. Retail depositors are not in a position to monitor the performance and risks of a bank.

Introducing a guarantee for such depositors, it is important to have a number of agents with sufficient incentives to assume the monitoring role. It is therefore reasonable to exclude deposits by at least other relevant financial institutions. An alternative would be to exclude all institutions that are part of the DGS, i.e. the deposits of the financial institutions that also receive deposits guaranteed under the DGS would be excluded.

It may be more complicated to adequately define a reasonable group of managers, directors and close relatives (Annex I no. 7 and 8).

Coverage of companies/enterprises

The following categories could be used: Companies that cannot draw up abridged balance sheets; micro-, small, medium-sized enterprises or all enterprises)

The following options could be considered:

- (a) No coverage for any company or enterprise (i.e. no coverage of accounts used for professional purposes)**
- (b) Include certain categories of companies or enterprises but exclude others in a harmonised way**
- (c) Include certain categories and leave exclusion of other categories to the discretion of Member States (similar to current approach)**
- (d) Coverage for all enterprises and companies regardless of their size**
- (e) Limited coverage according to the category**

Question 17: Do you have background information or evidence whether a covered amount of € 100 000 is relevant for companies or enterprises above a certain size?

Would you prefer to keep the current approach (companies that cannot draw up abridged balance sheets may be excluded by Member States)? If not, which solution would you prefer?

■ **Please specify, which category/-ies should be used to distinguish and if so, to which amount you would limit the coverage. Please provide reasons. Would you prefer another option? Please describe.**

To avoid competitive distortions the DGS should treat all companies and enterprises equal, regardless of their size. If that implies that also large (non-financial) companies or firms that cannot draw up an abridged balance sheets are covered up to the coverage level, that is a minor problem.

A possible solution would be the establishment of a pan-European DGS.

Question 18: Would you be generally in favour of a pan-EU DGS? (If you disagree, please skip questions 19-20.) If so, should there be a transition period until a pan-EU DGS should be operational? If so, how long? Please provide reasons.

The main rationale for establishing a pan-European DGS is to overcome the large differences between national schemes and to create larger resources to cope with major bank failures in the EU. The Riksbank does not oppose a pan-European scheme as a long run solution. However, the benefits of such a scheme should not be exaggerated. The desired objectives could to a large extent be achieved by means of harmonisation, which seems like a more pragmatic way forward at this stage. For instance, harmonising rules on funding according to a model with risk sensitive premium, based on expected costs and with formal reinsurance across border between DGS' for cross-border banks with significant foreign branches, will achieve most of the benefits of a pan-European scheme as pricing based on expected cost gives no diversification benefits. Furthermore, as indicated in the below questions the introduction of a pan-European scheme raises several difficult boundary issues on how to design the structure and scope of such a scheme. The most challenging issue is probably how to deal with the separation of responsibility for DGS and supervision.

Structure of a potential pan-EU DGS

There seem to be at least the following options concerning the possible structure of a potential pan-EU DGS:

- (a) Single entity replacing the existing DGS**
- (b) A DGS that is complementary to existing DGS that would support the existing DGS if needed ("28th regime")**
- (c) "European system of DGS" (i.e. a network of schemes in the Member States that provide each other mutual assistance if needed, e.g. by borrowing from each other)**

Question 19: Which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe. If you support option (c), please indicate how in your view, such mutual assistance should be provided. Should mutual guarantee schemes and voluntary schemes (see question 8) be integrated into a pan-EU DGS? If so, how?

In case a pan-European DGS would be established the Riksbank would advocate a parallel system to the national DGS.

Scope of a potential pan-EU DGS

With regard to the scope of a potential pan-EU DGS, there are at least the following options:

- (a) All banks should contribute to a potential pan-EU DGS
- (b) Only large cross-border banking groups (i.e. banks with a certain systemic relevance that have subsidiaries in other Member States)
- (c) All cross-border banks (i.e. those who operate directly or by means of branches in other Member States than in the one where they are licensed)

Question 20: Which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe.

See the previous answer.

Mandate of DGS

The following options could be considered:

- (a) Retain current approach (other DGS functions than paying out depositors within discretion of Member States)
- (b) DGS provide liquidity assistance to banks in need
- (c) DGS participate in the reorganisation of banks
- (d) DGS play an active role in the winding up of banks

Question 21: Which solution would you prefer? Should this solution be recommended or mandatory? Please provide reasons. Would you prefer another option? Please describe. Would a broader mandate for DGS require a different funding mechanism or a higher level of funding? If you prefer a pan-EU DGS (Question 18), please precise which options you would prefer in that case.

The EU needs a comprehensive legislation on crisis management and resolution, including harmonised rules on early intervention, reconstruction, winding up of banks – all supported by sustainable and risk-adjusted financing arrangements. If part of these reforms takes place within or outside the DGS-directive is not the main issue.

- Still a useful, efficient and possible way forward is likely to be to give the DGS a role to play in crisis management – i.e. providing the DGS with specific intervention powers (or the authority to request certain actions from the supervisor) with the aim to minimize the cost to the deposit insurance scheme. The intervention powers and the mandate should cover; early intervention, reorganisation and winding up of banks even before an institution becomes insolvent. Still the supervision should remain a responsibility for the supervisory authorities and the provision of liquidity assistance should remain a central bank issue.

Such a set up would required that the DGS to cooperate closely with the supervisory authority and that the latter would be entrusted with measures to turn troubled banks around before a banks capital deteriorate below the formal minimum capital requirements.

Harmonisation of the information for depositors

In order to ensure that all depositors throughout the EU get the same information, it could be considered to recommend or prescribe a template for standardised information. This template could be annexed to the Directive or be developed by stakeholders.

Question 22: Which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe.

Advice to split up deposits between banks (See also Question 4)

Currently, depositors do not have to be informed that it is safer to split up deposits if the coverage limit is exceeded.

Question 23: Should such information be required or recommended? Please provide reasons. Would you prefer another option? Please describe.

For consumer protection purposes providing relevant information is important. To ensure such consumer protection, the terms of the deposit insurance guarantee should be made clear to depositor when setting up the account. However, to prescribe in the directive that depositors must be informed that it may be safer to split up deposits between different banks seems excessive.

When and how should depositors be informed?

The following options could be considered:

- (a) Retain current approach (details left to the discretion of Member States)**
- (b) Mandatory reference to information on DGS in advertisements**

- (c) **Mandatory reference to information on DGS on account statements**
- (d) **Require depositors to countersign information on DGS before entering into a contractual relationship and to receive a copy.**

Question 24: Which solution(s) would you prefer? Please provide reasons. Would you prefer another option? Please describe.

For an explicit deposit insurance system to be effective, depositors need to understand the extent of and limits to existing deposit protection schemes. With cross-boarder banking activities such system must be coherent across jurisdictions – i.e. a harmonized approach is needed. The solution itself is of less importance, but a mandatory reference to information on the DGS on account statements seems like a cost-efficient way forward.

Information in case of a bank failure

With regard to the question, from which DGS depositors should receive information when their bank fails, the following options could be considered:

- (a) **Retain current approach (Home country scheme must inform)**
- (b) **Host country DGS must inform depositors at branches in another Member State**
- (c) **Individual agreement between DGS about who informs depositors**

Question 25: Which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe. Which approach would you prefer in case of a pan-EU scheme not being a single entity (see question 19)? Please explain.

Set-off arrangements

The following options could be considered (please note that the options below are not mutually exclusive):

- (a) **Retain current approach (unlimited set-off; within discretion of Member States)**
- (b) **Discontinue or limit set-off for the payout of depositors**
- (c) **Discontinue or limit set-off in the insolvency procedure (when the DGS has subrogated into the depositors' claims against the bank)**
- (d) **Limit set-off to claims that have fallen due or are delinquent**
- (e) **Limit set-off to a certain amount or percentage of covered deposits but leave it optional**
- (f) **Encourage depositors to split deposits and liabilities between different banks (rendering set-off obsolete if this encouragement is effective)**

■ **Question 26: Which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe.**

The Riksbank sees severe problems with set-off clauses and would prefer abolishing all set-off arrangements as they may increase the risk of bank runs, or unnecessarily induce customers to choose different banks for their deposits and loans respectively.

Payout delays

In order to reduce payout delays as such, the following options could be considered (Please note that the options below are not mutually exclusive):

- (a) Retain current approach (4-6 weeks from end 2010 onwards)**
- (b) Reduce payout delay to one week after a certain transition period**
- (c) Differentiate payout delay, i.e. a longer payout delay only for depositors where set-off has to be calculated or whose eligibility has to be thoroughly examined.**

Question 27: Which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe.

If payouts need to be made, delays should obviously be kept as short as possible. The DGS administrator therefore needs to be equipped with adequate tools to ensure swift payouts. They should for example be able to get access to the information they need from institutions and supervisors, even in going concern situations. They should also be able impose requirements on the institutions administrative infrastructure, e.g. IT-systems. Furthermore, the DGS administrator could be given the tools to swiftly transfer the entire stock of deposits of a failing bank into a viable bank. Limiting the possibility to set-off is also likely to reduce the complexity of most payouts.

Alternative solutions

As an alternative (or supplementary) to a mere reduction of the payout delay, it could be considered to transfer deposits to another bank or to have an emergency payout procedure in place (e.g. € 10 000 within 3 days).

Question 28: Would you prefer such solutions? If so, on a voluntary or mandatory basis? Please provide reasons. Would you prefer any other option? Please describe.

See the previous answer.

Payout modalities

■ In order to achieve clear and fair payout modalities, the following options could be considered (please note that the options below are not mutually exclusive):

(a) As regards the calculation of payout delay, it could be considered to calculate the payout delay and the delay to determine a payout situation in calendar days

(b) As regards the currency of payment, it could be considered to leave this within discretion of Member States (current approach) or in the same currency as the deposits were paid in.

(c) As regards interest payment, it could be considered to leave this within the discretion of Member States (current regime) or to pay interest that has not been credited at the time of failure.

Question 29: Which solution(s) would you prefer? Please provide reasons. Would you prefer any other option? Please describe.

It seems reasonable that payouts normally should be made in the same currency as the deposits.

Verification of claims

In order to facilitate the verification of claims, the following options could be considered (please note that the options below are not mutually exclusive):

(d) 'Tag' eligible depositors when account is opened and then regularly keep up to date this information on account statements.

(e) Payout under reserve of later reclamation – verification only after payout

(f) Simplify eligibility criteria (see Questions 13-16)

(g) Harmonise eligibility criteria (see Question 12)

(h) Introduce a de-minimis rule (i.e. deposits below a certain size, e.g. € 10 would not have to be paid out)

(i) Limit or abandon set-off (see above)

Question 30: Which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe.

Application for reimbursement

In order to facilitate the application for claims, the following options could be considered:

■ (a) Retain current approach (depositors may have to take initiative, to fill in application forms and send them – electronic processing and own initiative payment within discretion of Member States)

(b) Payments by DGS on their own initiative without need for applications – only electronic request to depositors asking them to indicate new account or payment to the same account whenever feasible

Question 31: Would you prefer one of these solutions? If so, on a voluntary or mandatory basis? Please provide reasons. Would you prefer another option? Please describe.

Involving DGS at an early stage

In order to involve DGS at an early stage, it could be considered to require competent authorities to inform DGS either if appropriate (current approach) or by default when triggering of DGS becomes likely.

Question 32: Which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe.

We would prefer keeping the current approach.

Information exchange between banks and schemes

In order to improve information exchange between banks and schemes it could be considered to recommend or require that DGS have access to relevant banks' records when DGS are informed by competent authorities and that DGS and their member banks have a common interface to quickly exchange information

Question 33: Which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe.

To ensure timely pay-outs the DGS need to have access to relevant bank's records and information on the relevant bank's systems. Such information would however have to be treated with the highest confidentiality.

Proven capability of DGS to handle payout situations effectively

In order to ensure that DGS are capable to deal with payout situations, the following options could be considered:

(a) Retain current approach (stress testing required in general)

(b) Require DGS to regularly disclose the amount of ex-ante funds, their workforce and the result of regular stress testing exercises

(c) Make such disclosure (as referred to under point b) a precondition for cross-border services or establishment of branches

■ **(d) Regular peer review among DGS**

Question 34: Which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe.

In line with our previous reasoning on funding arrangements (i.e. to set up a tangible fund, of which the government has the responsibility for providing the necessary funds in the event of payout) it will not be necessary for the fund to have full coverage at any given point in time. The idea is rather to assure that the premiums are set to match the expected cost of the DGS over time. In such arrangement the single most important factor for ensuring the payout capability is to require DGS' to be either administrated by or reinsured with the government.

Topping-up arrangements

The following options could be considered:

- (c) Retain current approach (topping up within discretion of Member States; host country topping up regulated in some detail by the Directive (Annex 2) but home country topping up permitted)**
- (d) Make topping up mandatory in whatever form**
- (e) Recommend home country topping up**
- (f) Making home country topping up mandatory**
- (g) Making host country topping up mandatory**
- (h) Discontinue topping up**

Question 35: Do you consider topping up a problem? If so, which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe.

Topping up arrangements were introduced to avoid differences in the protection levels across jurisdictions. However, the current topping-up arrangements has shown complicated and difficult to implement. Moreover they are inconsistent with the supervisory and regulatory framework as the host country scheme might be called upon to reimburse depositors of a financial institution that is not supervised nor legally wound up by the host country authorities. The best possible solution to avoid discrepancies between EU member states, and thus the application of complex topping-up arrangements, is to agree on a harmonized DGS, including eligibility criteria, levels and types of accounts covered.

Cross-border cooperation between DGS

It could be considered that a DGS in a host country acts as a single point of contact for depositors at a branch in the host country. This could

encompass features such as post box services, advice in the host country's language or being a paying agent for the home country DGS.

Question 36: Which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe.

Level of funding of DGS

On top of improving the financing mechanism (Question 39) and a possible introduction of a pan-EU DGS (Questions 17-19), it could be considered to recommend or require a target level (certain percentage of deposits) for ex-ante funds, ex-post contributions and alternative means of financing (e.g. borrowing). A maximum level for the contribution of banks could also be considered.

Question 37: Which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe.

The Riksbank advocates funding arrangements based on insurance principles and where the government explicitly assumes the ultimate responsibility for providing the necessary funds in the event of payouts. No private system will be able to assume the full cost of a failure of a major bank without government backing. Therefore some form of public involvement is needed to make the system credible. This should be made compulsory as part of the revised directive.

In a government run or government backed insurance based model no target for DGS funding will be necessary since premiums are set to match the expected costs of the DGS over time. As governments can be expected to have the financial capacity to accumulate sufficient funds on demand premiums need not necessarily be kept in tangible fund. However, to handle minor problems and to increase the trust in the system some limited level of tangible ex ante fund may prove useful.

On funding arrangements more generally the Riksbank would welcome a harmonisation including the following components:

Banks should be mandated to pay risk-related deposit insurance premiums to the DGS. The DGS should be either administrated by or reinsured with the government. The funding model should share the characteristics of an ordinary insurance scheme, where the insurer assumes the liability in return for premiums which are paid in ex ante. Consistent with the insurance principle, the premiums is the property of the insurer. Level-playing field considerations speak in favour of a harmonised pricing model, with the fees agreed at the EU level. In principle, the premiums should be set to match this expected cost of the deposit insurance, i.e. the expected aggregated cost that each individual institution impose on the scheme over a defined time period (e.g. annually). In practice, there is a lot of

- uncertainty about the size of such a premium, why a best effort estimate of the expected cost would have to be made.

The contributions from the banks could be funded or channelled into a separate account in the state, as chosen by the country. Full coverage in a tangible ex ante fund will therefore not be required at any given point in time. The idea is rather to assure that the premiums balances the costs on average and over time. This would however require that the guarantor has unconstrained access to credit to finance temporary deficits in a “synthetic” fund. Thus, the guarantor must have sufficient financial strength, by itself or through back-up facilities, to borrow funds on reasonable terms, even when the financial system is under stress.

In a cross-border context and in situations where the present home country responsibility for deposit insurance and supervision is not deemed to be appropriate by the countries concerned, the home country should be able to reinsure its liability at the host country. This could be the case if 1) the home country is small in relation to the branch or 2) the branch is of systemic importance to the host country. As a benchmark, such reinsurance agreements could be expected to be met when the branch deposits amount to a certain level, say more than 2%, of either the home country’s or the host countries’ total deposits and where there is a formal college of supervisors. In return for reinsuring the deposits and thus assuming the responsibility for any payouts, the host country would receive the premiums for the branch. The presumption should be for such agreements to be met, as this will be the most logical regulatory response to the vision of a single market within the EU. Failure to meet an agreement would give host country authorities a possibility to restrict the growth of such branches.

Consistent with this, the EU supervisory arrangements could also be supplemented with formal arrangements for increased host country information on and influence over supervision in situations where these will be expected to assume a responsibility for financial stability.

Risk-adjustment of contributions to DGS

It could be considered to introduce risk-based contributions on a voluntary or mandatory basis. Particular models could be recommended or required.

Question 38: Would you prefer introducing risk-based contributions? Which models would you envisage? Please provide reasons. Please describe.

We strongly prefer mandatory risk adjusted contributions to DGS according to the principles set out above. This is probably the single most important area for reform in order to establish a European DGS-regime fit for internal market purposes, while contributing to financial stability and eliminating competitive distortion.

■ **Funding mechanisms**

It could be considered to make ex-ante funding mandatory and to require alternative short-term (interim) financing or long term borrowing in case of need.

Question 39: Which solution would you prefer? Please provide reasons. Would you prefer another option? Please describe.

If you prefer interim financing, please describe how and by whom such financing should be provided.

The Riksbank strongly argues for an ex-ante and risk related funding arrangement. See the answer to question 37.

Question 40: Are there any other issues that have not been mentioned above but should be dealt with in the context of the review of the DGS Directive? If so, please describe the problem and its different impacts as precisely as possible.

Sveriges Riksbank

Martin W Johansson

Acting Head of Department