II-6.18: The European Commission proposes a package to enhance consumer protection and strengthen consumer confidence in financial services, comprising deposit guarantee schemes, investor compensation schemes, and insurance guarantee schemes. The proposals were sent to the European Parliament and the Council of Ministers for consideration

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MAIN INFORMATION

The European Commission proposes a package to enhance consumer protection and strengthen consumer confidence in financial services, comprising deposit guarantee schemes, investor compensation schemes, and insurance guarantee schemes. The proposals were sent to the European Parliament and the Council of Ministers for consideration.

CONTEXT AND SUMMARY

In order to further improve protection of users of retail financial services, including retail investors, the European Commission has announced changes to existing European rules on July 12, 2010 (IP/10/918). The review is in line with the Commission Communication of 4 March 2009 "Driving European recovery" and the more recent Commission Communication of 2 June 2010 on "Regulating Financial Services for Sustainable Growth", striving to address loopholes in the regulatory and supervisory system and reinforce the protection of users of financial services. Most among suggested improvements related to deposit guarantee and investor compensation schemes could become effective by 2012 and 2013.

Recent financial crisis confirmed the risk of the run on banks and inability of banks to pay off all deponents at the same time. The Directive 94/19/EC obliged all Member States to establish the appropriate deposit guarantee system and reimburse the deponents up to a certain amount. As a quick response to the financial crisis that emerged in 2008, the coverage level was raised to € 100 000, and the co-insurance mechanism was suspended. However, due to the other shortcomings of the existing regime, the

Commission has proposed to fully amend the 1994 Directive (see also Commission's MEMO/10/318). In short, the following are the most important novelties:

- Increased Coverage and better financing of the scheme – The proposal confirms suggested € 100 000 cover, including small and medium sized deposits and deposits in non-EU currencies, but excluding certain types of deposits such are all deposits of financial institutions and public authorities, structured investment products and debt certificates. The proposal would establish more solid ex-ante financing of the reserve, which could be supplemented by additional ex-post contributions. Should it be considered insufficient, schemes would be authorised to borrow a limited amount from each other, while other funding arrangements will serve as the last resorts. Contributions will still be born by banks, however based on the risk that each individual bank poses to the system.

- Standard information template – The introduction of a standard template and specification of account statements would enable bank account holders to be better informed on the coverage and functioning of the scheme.

- Faster payouts and less bureaucracy in the payout process – Bank account holders shall be reimbursed within seven days. Such a short payout would assume an active role of the supervisory authority, who would be obliged to keep informed the managers of Deposit Guarantee Schemes. The Commission has proposed the opportunity for the deponent to contact home based deposit guarantee scheme as a single contact point in situations when he has an account at a failing bank whose headquarters are based in another EU member state.

The Investor Compensation Scheme Directive (97/9/EC) has established regime that is just three years younger than the one established by the Deposit Guarantee Directive. In essence, this Directive does not provide compensation to investors against risks of their own investment decisions, but by providing compensation in cases where an investment firm is unable to return assets belonging to an investor.

The Commission has proposed measures to make rules on investor protection more efficient and ensure a level playing field concerning the type of protected instruments and the appropriate funding arrangements (see further the Commission's MEMO/10/319). The key novelties are related to the coverage and financing of the scheme, faster payouts, better information for consumers and the wider scope of investor protection.

In terms of coverage, under the Commission's proposal the current minimum amounting to € 20 000 will be increased to € 50 000 per investor. The proposal also aims to remove the option under which investors could bear a proportion of up to 10% of the loss within the compensation limit. In order to ensure long-term financing to compensate lost assets, the Commission has proposed a minimum target fund which shall be fully pre-funded, with the possibility to borrow a limited amount from other schemes and other funding arrangements as a last resort. Wider coverage of investor protection schemes would include situations related to a failure of a depositary or a sub-custodian.

The Commission has recently launched a public consultation on options to improve protection for insurance policy holders, including the possibility of setting up Insurance Guarantee Schemes in all Member States protecting consumers against the risk that claims will not be met if an insurance company closes down (see MEMO/10/320).

In its White Paper on Insurance Guarantee Schemes that was adopted as a part of this package in July 2010 (COM(210) 370), the Commission presented different options to ensure an appropriate level of consumer protection in the EU, and proposed to introduce a directive on insurance guarantee schemes. This Paper is open for consultations until 30 November 2010.

Links with other documents in the same sector

BRIEF COMMENTARY

The recent financial chaos has made people more conscious of the existence and limits of consumer protection schemes in all financial sectors. It seems that shortcomings have been detected and lessons learned from the crisis.

The Directive on Deposit Guarantee Schemes has not been substantially challenged and changed during the sixteen years following its entry into force. This Directive introduced only minimal harmonization. There were many obstacles to efficient deposit guarantee schemes the European Commission is striving to address in its proposal. The Directive on Deposit Guarantee Schemes has not been changed substantially for about 16 years although financial markets have significantly changed since then. The € 100 000 ceiling will assure that 95% of all bank account holders in the EU will get all their savings back. Faster payouts and a single contact point will certainly eliminate administrative burdens. Risk-based premiums will contribute to financial stability and efficiency, as banks having a riskier business model than others will pay higher contributions to Deposit Guarantee Schemes (they may amount up to about 3 times more). Novelties in the funding process will make sure that taxpayers shall no longer be the first instance in crisis management. Although a single pan-EU deposit guarantee scheme is desirable (the Commission's impact assessment estimates that € 40 million administrative costs per year could be saved), due to complicated legal issues this remains as a long-term project.

It is worth mentioning that the Larosière Group in its Report recommended setting up harmonized investment guarantee schemes throughout the EU. Changes to the Investment Compensation Scheme Directive are meant to assure better protection against fraudulent misappropriations, such as in the well known US Madoff affair. The rise in the ceiling to € 50 000 better reflects the existing situations in holding of financial instruments. There are now 39 investor compensation schemes in place in the EU's 27 Member States and therefore it is important to establish common rules not only relating to the payoff of individual investors, but also a common regulatory framework related to the funding of the schemes . The review also needs to take into account the new framework established by the Market in Financial Instruments Directive (2004/39/EC) for the provision of investment services across Europe.

Unlike the banking and securities sectors, there is no European legislation on guarantee schemes in the insurance sector today. At the moment, only twelve Member States operate one or more general insurance schemes. According to the Commission, one-third of the entire EU-EEA insurance market lacks any kind of coverage by an insurance guarantee scheme in the event an insurance company has to close down. However, in the insurance sector the Commission has decided to propose a solution based on minimum harmonisation, and not on maximum harmonisation as compared to deposits and investment products. The full harmonisation, which is unlikely to be feasible at this stage, should be expected at a later stage.

Overall, measures foreseen in the package should boost consumer confidence on one side, and could also be considered as part of the measures being taken to create a stronger crisis prevention and crisis management, leaving taxpayers aside. However, the implementation of such measures would require a lot of effort, coordination within the system of networked governance in the European regulatory arena and will certainly be a test for the new pan-European financial supervisory authorities (European Banking Authority, European Securities and Markets Authority).