# REFORM OF THE UK DEPOSIT PROTECTION SCHEME – EUROPEAN LAW ISSUES

The government consultation on *Financial Stability and depositor protection: Strengthening the framework* (January 2008) examines the deposit protection scheme in Part 5. The reforms proposed in this part give rise to a number of issues under European Law, set out below.

## 1.1 Equal treatment of all EU depositors

The consultation (at 5.21) proposes a nine-day timeline for payments under the new deposit protection scheme. This seems a very ambitious timescale for the scheme, especially in light of the fact that the EC Treaty, Directives 94/19/EC and 2001/24/EC have the combined effect of creating an obligation for Member States to give equal treatment to all EU depositors, whatever Member State they reside in.

Article 4 of Directive 94/19/EC provides that a deposit protection scheme created in a Member State "shall cover the depositors at branches set up by credit institutions in other Member States". Directive 2001/24/EC, Article 7, sets out an obligation for creditors of a credit institution which is the object of reorganisation measures to be notified of such measures on an equal footing with creditors in the home Member State of the credit institution. The result of these provisions is to place a burden on the FSCS to individually inform EU depositors outside the UK in the same way as those within the UK – although this would take longer than allowed for in the proposed timescale.

Further, the proposed system includes opening a new bank-account through an accelerated process, and instant access to the funds received by the depositors under the protection scheme when they deposit the cheque for such funds in this new bank account. Again, the practicalities of this process for non-UK residents would not allow for equal treatment. Unless account opening can be effected remotely from another Member State (including the deposit of cheques and the receipt of debit cards), non-UK residents would be unable to benefit from the streamlined process. Thus the proposed system would create disparity between depositors based on their place of residence, which is incompatible with the principle of freedom of movement and establishment under Articles 39 and 43 of the EC Treaty.

It should be noted that the FSA or FSCS would have to inform any Member States in which the credit institution concerned has branches if the operation of the deposit protection scheme for a UK credit institution were triggered, "if possible before [the decision to adopt any reorganisation measures] is adopted or otherwise immediately thereafter" (Directive 2001/24/EC, Article 4 – see below for further information on this duty to inform other Member States).

## 1.2 Host/Home Member State distinction under EU law

Directive 2001/24/EC creates a distinction between the host and home Member States for any given credit institution – that is to say, the 'home' Member State is that which gave authorisation to the credit institution under Directive 2000/12/EC, and any Member States in which it has branches which do not function under separate authorisation are 'host' Member States. In effect and for most credit institutions, this means that the home Member State is the place of incorporation and that other Member States in which the institution have branches are hosts. If the credit institution is

incorporated in a country outside the EU, the home Member State will be that in which it obtained authorisation to do business as a credit institution.

Article 3, paragraph 1 of Directive 2001/24/EC gives exclusive right to the home Member State to apply reorganisation measures to a credit institution – this means that only the home Member State has the power to close a bank which is in difficulties and activate any deposit protection scheme which would apply. Therefore, the FSA would have not power to close a bank which was not incorporated in the UK, even if it was in severe difficulties. The UK authorities would only be able to inform the authorities in the home Member State of the situation and apply to them to take action as necessary – and they have the duty to do this under Article 5 of Directive 2001/24/EC. This could delay the implementation of the deposit protection scheme in respect of deposits to UK branches of the credit institution. In a situation akin to the failure of BCCI, where a bank is incorporated in one Member State (Luxembourg in that case) but operates for the most part in the UK, this could have wide-ranging consequences as the UK authorities would lack any real power to protect the depositors at UK branches (regardless of their depositors' place of residence).

One of the important issues in such a situation would be in respect of information – any information needed to implement the deposit protection scheme in the UK would be likely to be situated in the home Member State or, even if situated in the UK, it is doubtful that the FSA and FSCS could have access to it without the approval of the competent authorities in the credit institution's home Member State. This could compromise the UK proposal's timeline in that any pre-emptive information-gathering would be made difficulty and time-consuming, or practically impossible.

Further, the home Member State has a duty under Article 4 of Directive 2001/24/EC to inform all other Member States in which the credit institution has branches of the start of reorganisation measures. In the situation where the UK was a host Member State, the FSA would be informed of the reorganisation measures and would have no power to decide how reorganisation should be effected, beyond an ability to discuss the matter with the home Member State and influence decisions in this way. Again, in a scenario close to the BCCI failure, the UK regulator could find itself without a significant role in proceedings which would affect a very large number of UK depositors. Where, however, a credit institution which has its home regulator in another Member State was a member of the FSCS scheme, which it could be (see Article 4, paragraph 2 of Directive 94/19/EC), the UK would be obliged to operate the UK scheme as equivalently as possible as for a UK regulated institution, so as not to create discrimination with regard to rights of establishment for passported banks.

### 1.3 **Non-European Union banks**

Where the failing credit institution is incorporated outside the EU, Article 8 of Directive 2001/24/EC places on the Member States hosting branches of this institution the duty to inform one another of a decision to adopt any reorganisation measures, and to "endeavour to coordinate their actions" in respect of this institution. EU law therefore has a limited impact on the application of the deposit protection scheme in these circumstances, though it should be noted that coordination with other Member States could have the effect of slowing down procedures. Further, on a practical note, it may be very difficult, or impossible, to obtain any information regarding the depositors of a credit institution incorporated outside the EU within the timescale set by the proposal, even where the UK is the lead regulator.

### 1.4 **Level playing field throughout the EU**

The UK should consider whether it would be compatible with EU law to legislate to require UK branches of non-UK regulated banks participating in the UK scheme to give access to relevant

information wherever it is held so that the UK scheme may be applied to the extent the branch's depositors will benefit from it. This would afford depositors, including those residents in other EU States, with comparable benefits from the UK deposit scheme.

While the depositor protection scheme may not engage Articles 39 and 43 of the EC Treaty and is a consequence of EU legislation, the proposed reform certainly does not meet broad EU objectives of equal treatment since it potentially places depositors with banks using their passport rights to do business in the UK at a severe disadvantage to depositors with banks for which the home Member State is the UK. Such distinction between credit institutions depending on the regime of the country of primary regulation does not comply with EU law principles. In so far as the solution of this issue is unclear, the UK should press for EU level amendments to one or both of Directives 94/19/EC and 2001/24/EC to deal with this issue and with cooperation where two of more schemes apply, in order to level the playing field between EU Member States as far as practicable. It appears possible from recent EU Commission initiatives that both Directives might be revised, giving an opportunity for this to be done (Communication of 28 November 2006 in respect of Deposit Guarantee Schemes and Consultation process in respect of the Winding up of Credit Institutions: summary of responses to the consultation dated December 2007).

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