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A SINGLE EUROPEAN UNION DEPOSIT INSURANCE SCHEME?  
AN OVERVIEW

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Abstract

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The purpose of this paper is to discuss and analyse the different aspects of the deposit insurance schemes in the EU and their harmonisation and compatibility with other Community regulations at the light of the start up of the third stage of the European Monetary System (EMS).

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Key Words and Phrases: Supervision, Deposit insurance, efficient financial markets, financial harmonisation in the EU, competitive restrictions.

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## 1. Introduction

Wherever financial institutions take deposits, it seems, governments provide some form of deposit insurance. In many countries (United States or the European Union members) this backing is formal and explicit. Elsewhere, insurance is simply an understanding that the government will not allow depositors to lose their savings. Depositors are supposedly less informed than the financial institutions and small investors, in particular, are very often financially unsophisticated. As a response to this problem of asymmetric information, under some circumstances and up to a certain amount, a deposit insurance guarantee [DIG from now on] is provided.

Traditionally, banks have provided a safe depository for savers and for many years banking was a comfortable and profitable oligopoly with limited room to maneuver, but with predictable earnings. Banks, although risky, have a unique position in the economy: a loss of confidence in the banking system can lead to a flight from deposits to cash and a credit crunch that has the potential to turn a mild recession into a downward economic spiral that feeds on itself. The deposit insurance schemes prevent the deepening of financial weakness and economic recession, by protecting financial institutions from runs and the payment system as a whole. Nevertheless, its microeconomic and global objectives complement each other: when the savers are protected, the financial system is indirectly also protected.

To reconcile the "saver protection systems" the European Union regulation passed in May 1994 (Directive 94/19/EC) helps to simplify the working of individual markets by allowing the credit companies of the European Community to offer services in a restriction-free environment. This regulation attempts to set up a European system for minimal bank deposit protection in case of insolvency. Member States [MS from now on] will have to adapt to it by 1999, following a transitory period of five years.

The purpose of this paper is to discuss and analyse the different aspects of the deposit insurance, the harmonisation of the schemes and their compatibility with other Community regulations regarding the start up of the third stage of the European Monetary System (EMS).

After this introduction, in section two, the foundations of an efficient deposit insurance scheme, widely developed by doctrine, are addressed after studying the problem of asymmetric information and moral-hazard, as well as the "agency-theory". Section three is dedicated to the explanation of the Community's norms linked with banking supervision and deposit insurance, developing principally the changes to be introduced in different schemes of the Member State countries. Section four presents the schemes of Deposit Insurance of the countries that now are in the EU. Finally, a summary is provided in section five.

## 2. Deposit insurance foundations

The existence of DI must allow the operations of the financial sector to be conducted in a freely competitive environment and with the assignment of efficient resources, so that, in principle, all depositors will be indifferent to the alternative of depositing their savings in a public or private institution, large or small, national or foreign, etc.

The cover mechanism may also suppose an increase in the incentives for the appearance of an excessively risky banking or credit activity that operates against the protection or safety of deposits, moving the financial cost to the depositors, to the insurer or to society as a whole (the designated problem of "moral-hazard").

In the absence of DI, only the public entities can count on "implicit" state support and the large credit entities on the guarantee of being "too big to fail". Since DI is a basic pillar to reach the stability of the system, its main characteristics will be analyzed:

### *2.1. Public or private nature and subscription system*

When the subscription system is voluntary, the entities not included in it, even though they do not incur the cost of the premium, nevertheless should face the payment of higher interest rates to attract savings. In this manner the problem outlined by the agents who participate in the system's benefits without contributing to the same (free-rider problem) is reduced. When the subscription is obligatory, the possibility of this opportunistic behaviour is reduced, thus the election of the depository entity amongst those who adhere to the system, and those who do not, can lead to discrimination that can affect the stability of the financial system forming structures in the banking sector that will be generally over-concentrated with an average dimension too big, in general, for the needs of depositors and competition.

Government intervention in the DI system must be understood as an additional means to guarantee the operation and integrity of the financial system and to protect the depositors. State intervention, although extended to all the industrialized countries, is debatable in terms of economic efficiency. This objective can be equally reached by letting the market act by means of the formation of mutuals or consortiums(1) [Chamorro et al. 1994:32]. However, financial insolvency, that finds its origins in macro and micro-economic changes, produces chain effects, so that in the opinion of Merton and Bodie [1992] what is optimum "ex-ante" (e.g.: non intervention) cannot be "ex-post" (when there is already a crisis). Nevertheless, the building up of technical reserves involves, in any case, high opportunity costs for the guarantors.

### *2.2. Functions of the insurer organization and relationship to other authorities*

The establishment of limits of protection and the supervision of the interest parties are mechanisms directed to reduce the problems of "moral-hazard".

One answer to this problem is to combine DI with vigorous banking regulations which broadly involves two kinds of objectives: i) *systemic stability* of the financial system, which includes, among other characteristics, avoiding the payment and settlement risks on regulated banks and associated financial institutions, and ii) *investor protection* (limited insurance). The limits on the amount to be insured give larger, and therefore more sophisticated depositors, an incentive to monitor bankers' behaviour, although regulation manages risks more directly, by forbidding, or making more costly, certain kinds of lending [Shoenmaker:1992a].

Both competitive distortions and an increase in financial fragility will occur under the present directive due to some well-known problems induced by asymmetric information and moral-hazard [Grossman, 1992:802; Berlin, et al., 1991:747]. The minimum level of coverage should not be too high to deter the depositors from being virtually indifferent to the soundness of their credit institutions. The pricing and funding procedures of deposit insurance schemes are crucial factors in this situation.

Asymmetric information and adverse selection are amongst the main consequences of high transaction costs in the financial markets (the costs of gathering information and monitoring behaviour). Bank runs should not be irrational outbreaks but perfectly rational responses to lack of information, since it is costly for outsiders to obtain accurate information about the bank's financial conditions.

In order to neutralize, or at least minimize, the moral-hazard problems there are several instruments that shareholders, insurers or depositors may use: to monitor the behaviour of the insured party by the insurer; to adjust the insurance premium according to that behaviour; to require the insured party to avoid risky activities. However, the objectives of these groups are very different; while the shareholders want to maximize the value of the firm assuming its limited responsibility, depositors (and insurers) want the money to be in a safe institution, whether profitable or not, in the long run.

In the conceptual framework of the "agency-theory", DI can be envisaged as a set of financial contracts. The contracts between depositors, internal and external shareholders under the direction of the company, and the insurer, originate a conflict of interest in addition to that already existing due to the separation of property and control. The agency-theory struggles with the minimization of the costs derived from the "agency's relationships" between agent and principal.

In the presence of DI, the role of the principal falls back on the shareholders, bondholders, depositors and the insuring body, while the credit entity is the agent. The external shareholders --who have limited responsibility-- have as a principal objective the maximization of the value of the company and, consequently, their profitability. Internal shareholders' objectives are not always, however, of a pecuniary nature, but also of control and the exercise of power. Depositors aspire to maximize profitability and to minimize risk and, in the absence of DI, they will demand adequate compensation --premium risk-- in accordance with a risk level derived of the operations of the credit entity. But in the presence of DI, the risk factor is moved to the insurer, this being so, the credit entity will have the principal interest in observing the behaviour of the assured.

The protection of the interests of the internal and external shareholders, savers and bondholders is achieved through control activities --including supervision costs-- internal audit looks out for the interest of the internal shareholders; while external audit protects the interests of the external shareholders and bondholders. In any case the conflict of interest does not disappear for those who have contracted the supervision services. In the presence of DI the tasks of supervision are shared by the insurer --who is in fact the one who assumes the direct cost of the insolvency-- and the Central Bank, which in addition to responsibilities for the monetary policy, is the lender's last resort.

### *2.3. Deposit insurance coverage*

Far from protecting the system, the existence of DI permits banking insolvency situations to arise in the market because of the risky performance of the assured entity. A partial DI (coinsurance) compels the depositors to sustain part of the losses derived as a consequence of banking insolvency [McKenzie, 1994:172-78].

Concerning the coverage's reach, that is, if the coverage is based on the consideration of individual deposits or comprises all the operations carried out by the depositor, we will see that the system is more efficient in the latter case. If the scope of the coverage were by deposits, the large saver would have access to a guarantee diversifying his deposits in different credit entities, so that, in the case of one or the other's insolvency where he has his savings, he would collect the maximum

guaranteed as many times as he has deposits in each entity, being a value exceeding the maximum limit covered, a cost that is transmitted to the insurer. While, if the scope of the coverage is by the depositor, he will only collect this covered maximum limit once.

#### *2.4. The valuation of the premium*

The valuation of the premium to be paid by the insurer may be the most relevant aspect of deposits security, even more so, when the credit entities enjoy limited responsibility. The determination of an economic and socially "fair" premium has been one of the most analyzed and contrasted aspects of DI. The research done up to now [Dermine, 1992:1-2] has been developed from Black and Scholes' innovative work [1973] on the valuation of options. Thus, initially Merton [1977, 1978], and later Pennachi [1987], Allen and Saunders [1987] amongst others, applied the mentioned model for the valuation of DI.

Merton analyzed the existing relationship between the guarantee of the deposits and a European put-option. Pyle [1986], Ronn and Verma [1988] used this, as a basis work to determine the needs of capital; while Gorton and Santomero [1990] applied it to the evaluation of the premium-risk of the underlying debt of the banks.

Amongst the most outstanding empirical projects are those of Marcus and Shaked [1984], who carried out a study in which they applied Merton's model to a sample of 40 banks in order to determine if the premium value imposed by the FDIC was approximated to the theoretical value of the coverage premium [Tasca, 1992:46]. Although applying a fair valuation model of the assets of depository entities does not imply that the same result would reflect the insolvency situation in case the entity had its yields reduced by bad management [Chamorro, 1993:94-95]. Ronn and Verma [1986] accomplished "various transverse or interbanking comparisons", that is to say, determined if the premium providing the funds of the DI was in conformity with the solvency levels of the depository institutions. McCulloch [1984] and Crouhy and Galai [1986, 1991] created a model for the transformation of the role of banks and calculated a sensitive-risk premium for interest rates. Dermine [1992] analysed the deposit premium of sensitive insurances, and also, the commercial-risk.

In the inefficient determination of the premium levels, several problems, such as moral-hazard, adverse selection, and equity links may be considered [Chamorro, et al., 1994; Suárez B. de Quirós, 1993], since:

a.- The banking entities that count on the support of DI can accomplish high risk investment operations. For the deposits to be assured, the entity obtains funds at, generally, lower costs than they would have in the absence of insurance and, in the event of insolvency, [Garrido, 1991:35] "the sum or part of the assured responsibility of its clients is moved to the insurer entity". Furthermore, when positive results are obtained as a consequence of risky behaviour, those will be for their own entity; while, if as a consequence of such behaviour it descends into an insolvency situation, the system turns normally, to its defense, in particular when it is considered a large entity.

b.- The contribution criteria of the guarantee deposit fund with uniform rates involve an "equity" problem. If the contribution is carried out in the function of the solvency levels of credit entities, the problem subsists, although a fair redistribution of the yields is reached. Larger credit entities have a smaller insolvency probability since they are better trained to diversify the risk. Nevertheless, in the event of insolvency the system will come to its defense covering all their creditors, while, when the insolvency of small entities is considered, the most viable option can be their liquidation, covering only the assured deposits and excluding part of their creditors. Moreover, with a sole premium system

where the reparation cost of the larger credit entities falls, totally or in part, in the guarantee system, the small entities are subsidizing the large ones. However, if we consider two entities of a similar size, the one having financially prudent behaviour contributes to the guarantee deposit fund that operates as subsidies to those adopting a risky behaviour, since in the event of insolvency, both will be protected by the system.

A possible solution may be found in the application of different premium rates according to the risk level of the operations undertaken by the credit entities: a system applied in the US since 1993. The FDIC [McKenzie, 1994:177-78] replaced the sole premium for all financial entities applied until 1992, by a premium system related to risk levels. The banks were classified according to their capitalization level: well-capitalized, adequately-capitalized or infra-capitalized. At the same time each bank's category was divided according to the supervisory level to which each is submitted: A (secure), B (under supervision) and C (under strict supervision), so that a high ratio of capital in relationship to the assets involves a smaller insolvency probability and consequently a smaller probability of using the funds for guaranteeing deposits. In this manner the system gives incentives to banks to be well capitalized.

### *2.5. Deposit Insurance financing systems*

In the opinion of Revell [1985] and Garrido [1991], two DI financing for DI systems stand out. (i) Funds financed with anticipated and periodic contributions from beneficiaries used in the event of insolvency. McCarthy [1980] estimated that this system counts amongst its principal advantages that of transmitting confidence to the savers and the knowledge that the existence of a fund guarantees the refund of their deposits. The main disadvantage is derived in the difficulties of calculating the amount of the deposit insurance fund in the light of the impossibility to determine future insolvency situations. Within this financing system one must differentiate the mechanisms according to the moment of intervention: those which act before the statement of liquidation, assuring the continuity of the entity, and those which may act afterwards. (ii) Mutual coverage funds or those that perform "ex-post"; that is, which operate in the event of difficulties in one of the associated banks, when specific contributions are undertaken. The drawback this system presents is that it should be accomplished by disbursements for all the associates at critical times, when a generalized insolvency problem exists.

## **3. Banking supervision and deposit insurance**

The Community regulation tends to create a freely competitive environment; in that sense, the harmonisation norms of DI have been preceded by others with similar importance such as (i) the liberalization of the movement of capital (Directive 88/361/EEC, 24 June); (ii) the authorization of branch entity operations in all the MS (Second Directive of Banking Coordination, 89/646/EEC, 15 December) and, finally (iii) measures related to the supervision of credit entities (Directive March, 1993; Directive December, 1989 relative to the solvency coefficient; Directive April, 1992, which amongst other things, makes the supervision fall back on the authority of the MS of origin which authorizes the development of activities; and Directive December, 1992 on the control of very risky operations).

### 3.1. The Community regulation on banking supervision.

Finds its origin principally in the Basle Concordat [Group of Ten; 1975]. The supervision tasks of the credit entities might be shared between the home country authorities, which are responsible for the solvency supervision, and the host country authorities, which are responsible for the liquidity entity supervision.

On the other hand, the Second Community Directive, that came into effect on the 1st of January, 1993, allows any credit entity to move freely in any MS. The moment the credit entity has received authorization from the home country, (single banking licence) it can work in its home or host country, and apply the same principles of the Agreement of Basle. A close collaboration between the different supervisory authorities of both countries is needed, which can be reached by bilateral agreements.

The application of home country principle for the supervision of the credit entity responds to a logical consequence of the headquarter's, ultimate responsibility for the proper functioning of all the entities and their dependencies; in practice, this is not easy to apply. Therefore, according to the Annual Report of the European Monetary Institute, 1994, [1995; pp. 92-94] the application of the Second Community Directive could be complicated in certain situations:

*i) Crisis.* In a crisis situation, all credit entities present in different MS, should count on a set of principles which would help the supervisors of the home countries to coordinate the flow of information and all supervisors actions. To accomplish this, the home country supervisor would be the "chief supervisor" of the host countries.

*ii) Insolvency.* In the same way, in the situation of insolvency, all credit entities present in different MS, could find themselves facing different problems: if the liquidation is initiated by a bank present in the MS, the different judicial measures and insolvency procedures applied in each MS create difficulties for the coordination of the supervisory action due to:

1. The lack of consistency between the home country principle for the precautionary supervision of the branches and the host country legislation for the application of the insolvency procedures.  
That is, if the supervisors of the EU countries, as authorities of the host country, can not have equal facilities to start a procedure against a foreign branch bank, this represents an obstacle to the coordination activities of the supervisors of other MS.
2. The possibility of the insolvency procedures started against a host bank being recognized in those countries where the bank has branches.
3. The possible existence of different liquidation systems that imply different treatments given to the assets (systems based on the universality or on the territory) that involves the EU depositors discrimination.

As a consequence of those aspects, the Committee of Governors impelled a harmonisation measure of Cleaning-up and Liquidation so that insolvency can be treated the same in different MS. countries.

### 3.2. Community Directive, application's effects and reforms to be introduced

The proposal for the harmonisation of DI in the EU dates back to 1986, when the Commission of the European Communities issued a Recommendation (22 December) concerning the DI systems established in the Community. This same regulation of the DI systems approved their immediate application where DIS. existed and, the study of the possibility of their creation, where they did not. That recommendation gave special attention to the coverage of branch deposits of credit entities, whose central headquarters were found in other MS.

Already, in May 1992, the approval of a directive's proposal to increase the protection of bank deposits, was discussed in depth at the European Commission. According to this preliminary outline DI had to be obligatory to an harmonised minimum. The norm referred mainly to the "principle of the home country", as well as, the limiting of assured depositors and the obligatory adhesion to the system and harmonisation of compensation up to 15.000 Ecus(2). Finally, the Community approved the Directive 94/19/EC of the European Parliament and the Council(3), naming a maximum guarantee of 20.000 Ecus per depositor and by credit entity. This regulation underlines the "principle of subsidiarity" in the following manner: "the deposit guarantee is a fundamental element for the accomplishment of the interior market and an indispensable complement to the credit entities' supervision system by the solidarity that is created between all the entities of a common financial center, in the event those are found in difficulties".

The norm regulates very relevant aspects of DI in terms of moral-hazard, asymmetric information and supervision problems. The harmonized insurance guarantee pursues both: the system and the depositor's protection.

- *Membership:* The norm imposes obligatory membership to the DI systems, unless that is accounted for by a private equivalent system officially recognized. The opportunist behaviour of agents is corrected with this measure. Practically all EU countries rely on obligatory membership mechanisms, except for Germany, Belgium, Spain, Italy and Luxembourg, all of which should modify their respective systems.

- *Maximum coverage limit:* Coverage is assured "up to ECUS 20.000 for the set of deposits of the same depositor". Temporarily, when the guarantee does not reach ECUS 20.000, depositors will be able to count on only ECUS 15.000. Although this limit will be in effect from 1999, there is a transitory period from 1st July, 1995, to the 31st December, 1999, during which the countries that have an inferior coverage to 15.000 Ecus, will have to increase their maximum to the stated limit. When deposits shared by different depositors are considered, these are computed in equal parts amongst these different depositors. The regulation has tried not to let an excessive number of depositors to be in the minimal protection threshold.

Those systems that cover deposits at an inferior level as opposed to the established ones, have to be increased to bring them up to par with the harmonised minimal. Inversely, when the national coverage levels are above those of the Community, the latter may be taken as a complement. The directive allows the possibility for the MS to establish a coinsurance system [those are the cases of Ireland, Portugal, the United Kingdom and Italy] where coverage must be at a minimum of 90%, a percentage that can never be inferior to ECUS 20.000. Other countries such as Belgium, Ireland, Luxembourg, Spain and Portugal should adjust their guarantees in the preliminary stage to ECUS 15.000. Thereafter, in a second phase and, in addition to these countries, also Austria, Holland and the United Kingdom, should adjust their coverage level until they reach ECUS 20.000. Spain will have to duplicate the DI in the next five years to reach this amount.

- *The system in action*: The coverage mechanisms operate when, in the judgement of the authorities of the financial entity, the restitution of the funds will be impossible, without any chance of achieving it in the short run, or when the judicial authorities may have declared the bankruptcy or the insolvency of such an entity.

By virtue of which judicial measure or administrative procedure (home or host country) will the system be in action?. Remember what we had said in relation to the cleaning-up and liquidation which has to be harmonised to balance the different judicial measures and administrative procedures. On the other hand, it could be that one branch is in the procedure of liquidation in accordance with the home country norms, but not with the host country norms.

There are countries that intervene before liquidation [i.e. Germany, Belgium, Spain, Finland, France, Ireland, Italy and Portugal] while others take action only in the event of liquidation (4).

- *The principle of "subsidiarity"*: This is applied when an entity within the same group is found to be having difficulties. The method of dealing with this question is, nevertheless, different depending on whether there is a branch or a subsidiary involved, thus:

a.- The "principle of home-country": In agreement with the Second Community Directive this principle is applied in the case of branches.

The existence of different levels of deposit guarantees that go beyond the minimum harmonised, permits the existence of different compensations (in each MS it would be as many systems as there are branches of other entities from other MS, so that the same competitive problems will be balanced between domestic and foreign entities.

-If the home country GD of the branch is lower than the host country GD; the first entity might be authorized to adhere to the host country system. It might be relevant to determine in which country the complementary fund will be formed. The forming of complementary funds in the home country, since branches are in different countries, will mean that difficult, technical problems have to be solved(5). If the entity contributes to the host country fund, another problem is present: the regulation of which country (home or host) will be used if an entity encounters insolvency, the insurance cost is in the host country authority hands, while the supervision is in the hands of the home country authority. In this sense the supervisory system of both countries must be coordinated so that the host country has the guarantee to pay a compensation to depositors of entities that have not been directly supervised.

-If the home country GD of the branch is higher than the host country GD during an initial period, the host MS countries only will offer (to branch depositors of other MS entities) the same level of compensation offered to their depositors (of the host country).

We can summarize this by saying that the host country principle is applied for Deposit Insurance harmonisation, however for supervisory schemes the home country principle will be used.

With respect to the branches of credit entities whose social headquarters are found outside the Community, an equivalent coverage to the one that governs in the MS is granted.

The "principle of the host country" will be applied in the case of subsidiaries.

[Here chart. 1]

The different treatment given to branches and subsidiaries together with the different levels of access to coverage, may be a distortive factor of competition. The credit entities will choose those organizational structures that provide them with greater competitive advantages [McKenzie et. al, 1994:188].

Amongst those aspects not harmonised yet by the current executive body, there are two of vital importance that are the subject of discussion for regulators and that affect the efficiency of the relationships between the EU and its members countries. These are:

- *Financing methods*: The Directive has regulated nothing in this regard, simply advising that the financing of the system should fall back on its own credit entities whenever possible; in addition to the procuring of the financial capacity of the systems that be proportionate to the obligations that pertain to them, without putting in danger the stability of the banking system of the MS as a whole. We believe that the norm should be more explicit, harmonising the commissioned organs of the managerial fund. This only demonstrates the subsidiary function of the State, which transfers its regulating of DI systems, implying additional situations of "rivalry or competition" [Chamorro, et al., 1994:40]. In insolvency situations, originating mainly in economic crises, if the insurance body is a private one, there is a greater probability that there will not be enough economic capacity to protect all depositors.

France, Germany, Italy and Luxembourg currently count on private DI systems. The rest of the countries have systems in which the State has a meaningful participation. Germany, Belgium, Denmark, Spain, Finland, Ireland, Portugal and the United Kingdom, count on accumulation funds, while, in the remaining countries, the deposit insurance fund is a mutual.

- *Fixed or variable premiums*: However, the most argued aspect of DI, has not been harmonised. The financing system of DI through participation quotas, fixed or variable has not been specified. The establishment of a variable contribution system depending of the risk levels might have permitted reaching the proposed objectives more fully.

Finally, before ending this section we want to point out the possible implications of an harmonised deposit insurance system, in the light of a possible unified Central Bank at the third stage of the European Monetary System (EMS).

-The European Central Bank will be the sole responsible entity of the liquidity and solvency of the credit entities, as well as the lender of last resort. To urge a financing system for the deposit insurance fund according to the different risk levels assumed by the financial entities is a clear need.

- The final stage includes the setting of permanently fixed exchange parties, the adoption of a single currency and the introduction of a common monetary policy set by a central banking institution [Johnson, R:1993].

#### **4. European Union Deposit Insurance Schemes**

The existing DI systems show presently a marked national character and a great diversity in their different normative aspects [see i.e., Annex Ia,b]. This diversity is explained by the different regulatory norms and the way countries understand the problem of banking insolvency.

**Annex Ia**  
**Deposit Guarantee Schemes in the EU**

Country	Creation's Year	Membership	Level of protection	Level of protection in ECUs (21/02/95)
AUSTRIA	1987	Compulsory	200.000 Schillings	15,167
BELGIUM	1975	Voluntary	550.000 FB	14,215
DENMARK	1989	Compulsory	250.00 DKR	33,716
FINLAND	1969	Compulsory	Unlimited	
FRANCE	1980	Compulsory	400.000 FF	61,239
GERMANY	1966	Voluntary	30% of the bank's own funds	
GREECE	At the moment no deposit protection scheme exists.			
IRELAND	1989	Compulsory	< Irish Pounds 5.000 (80%) 5.000 to 10.000 (70%) 10.000 to 50.000 (50%) Maximun I.Pounds 10.000	12,440
ITALY	1989	Voluntary	< Lira 200 M (100%) following 800 M (80%) Max. coverage Lira 800 M	394,623
LUXEMBOURG	1989	Voluntary	500.000 LF	12,923
NETHERLANDS	1979	Compulsory	40.000 FLH	18,991
PORTUGAL	1992	Compulsory	< Esc 1,5 M (80%) 1,5 to 13 M (60%) Max. coverage Esc 2,1 M	10,784
SPAIN	1977	Voluntary	1.500.000 Pesetas	9,158
UNITED KINGDON	1982	Compulsory	Sterling Pounds 20.000 (75%) Max. coverage Lb. 15.000	18,660
Source: OCDE. Prudential Supervision in Banking; Schoenmaker, D. (1992a) p.16.				

Two basic forms in the limits of deposit coverage can be found in the different countries, with the following characteristics:

- Maximum limit: All deposits (Finland); a percentage of the entity's resources (Germany), or a given quantity (for the rest of the countries).
- Partial refund of all deposits (coinsurance). Depositors, anyone with whatever volume of deposits will experience a part of the loss in the event of bankruptcy of the entity (Ireland, Italy, Portugal and the United Kingdom).

All systems cover both resident and nonresident deposits, although differences exist in the extent of the coverage (deposits in foreign currency, deposits in branches of foreign banks and deposits in foreign branches of national banks) in addition to the financing of the system and the performance -previous or following the liquidation- on the part of the deposit insurance fund.

[Here Chart 2]

**Annex Ib**  
**Deposit Guarantee Schemes in the EU**

Country	Coverage of protection extended to:			Funding Contribution or Commitment to pay	Preventive Action by Dep.I Scheme prior to Liquidation
	Deposits in foreign currency	Deposits at branches of foreign banks	Deposits at branches of domestic banks abroad		
AUSTRIA	Yes	Yes	No	No	No
BELGIUM	No	Yes	No (1)	Yes	Yes
DENMARK	Yes	Yes	No (1)	No	
FINLAND	Yes	Yes	No	Yes	Yes
FRANCE	No	Yes	No	No	Yes
GERMANY	Yes	Yes	Yes	Yes	Yes
GREECE	At the moment no deposit protection scheme exists.				
IRELAND	(2)	Yes	No	Yes	Yes
ITALY	Yes	Yes	Yes	No	Yes
LUXEMBOURG	Yes	Yes	No	No	No
NETHERLANDS	Yes	Yes	No	No	No
PORTUGAL	Yes	Yes	No	Yes	Yes
SPAIN	Yes	Yes	No	Yes	Yes
UNITED KINGDON	No	Yes	No	Yes	No
Source: OCDE. Prudential Supervision in Banking; Schoenmaker, D. (1992a) p.16.					

- (1) Yes, if no compulsory deposit protection scheme exists in the host country.  
(2) Provisional coverage to some extent to other currencies.

## 5. Conclusions

Belonging or not to an obligatory system, the establishment of maximum protection for savers and minimal for all the MS plus the "subsidiarity principle" are the main aspects which most clearly have solved the harmonisation of DI in the EU in accordance with the general consensus of what must be a system of efficient DI. The different treatment given to the branches and subsidiaries can be, nevertheless, a distortive factor for competition giving credit entities the choice of those organizational structures that provide them with greater competitive advantages. Equally, the treatment of the "moment" in which the system must act, is another factor of distortion for competition between the different entities. Taking action previously to liquidation would give the system more stability than will be performance "ex-post", above all when what is intended in first place is the continuation of the financial entity, which in turn would avoid the "systemic" effect amongst savers.

Amongst the non-harmonised aspects there are two of vital importance: the financing of the system -public or private- and the amount of the contributive system -fixed or variable- which are the subject of discussion in different countries and EU regulators. The presence of the State in the operation mechanisms of the financial system means a competitive advantage for those MS with public systems given the additional guarantee that this implies, as well as a financing of DI in accordance with the degree of risk assumed by the credit entities that belongs to the same, which in turn reduces the moral-hazard problems associated with all kinds of insurance systems.

## Notes

(1) Nevertheless, the systems based on private insurance are not exempt from difficulties given the characteristics of the banking activity, amongst others: i) to find adequate organizations that will evaluate the risk level of the assured; ii) the determination of the premium to provide for the system and; (iii) the determination of the banking risk in as much as this is atypical within the very actuarial calculations of the insurance agencies.

(2) The determination of the minimal standard level to harmonise amongst European countries was solved averaging the existing levels in the same (the countries with high protection levels such as Germany and Italy were excluded). In spite of the fact that the average was about 22.000 Ecus, it can be deducted that it was not the Commission's idea to even out the protection of the deposits between the community countries and other countries, as in the US (78.200 Ecus) and Japan (60.400 Ecus) [Schoenmaker, 1992b:9].

(3) Published on 31 May, 1994 in the Official Daily of the European Communities.

(4) [McKenzie et al., 1994:177] One of the German system's weaknesses is that the insurer intervenes in the event of insolvency, not of non-liquidity, so "total coverage" is apparent, since the insolvency is superior to the non-liquidity, and it is very probable that, at the moment of intervention, the bank's value descends to levels which may be seen as minimal coverage. The contribution of resources to form a deposit insurance fund counts on the "apparent" advantage of having immediate access to resources in the event of a crisis, however, the Spanish experience shows how the above mentioned fund was insufficient, and had to be supported by the issuing Bank.

(5) Principally when the existing deposit guarantee systems between home and host country are quite different.

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Chart 1

# Home and Host country principles

EUROPEAN UNION

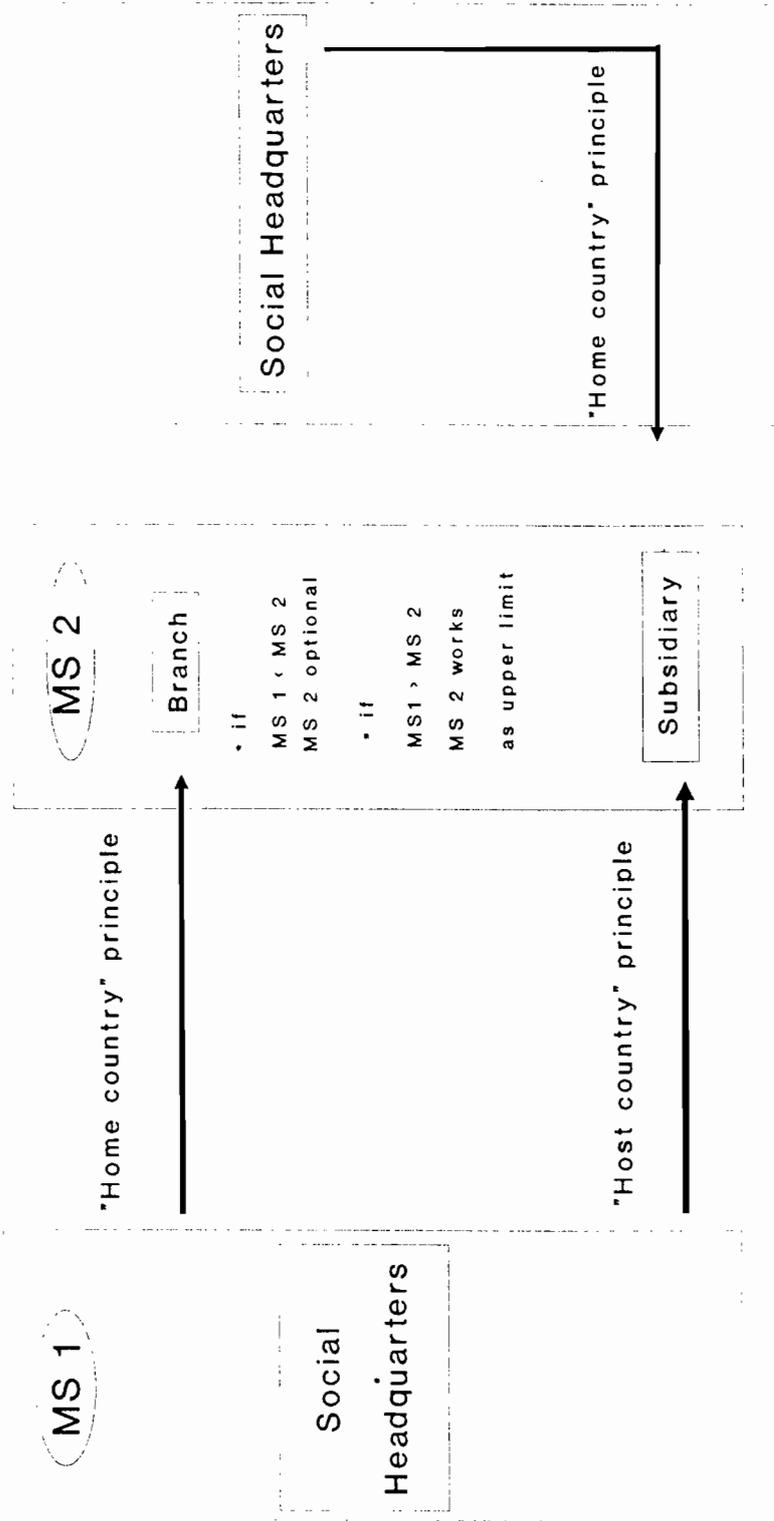
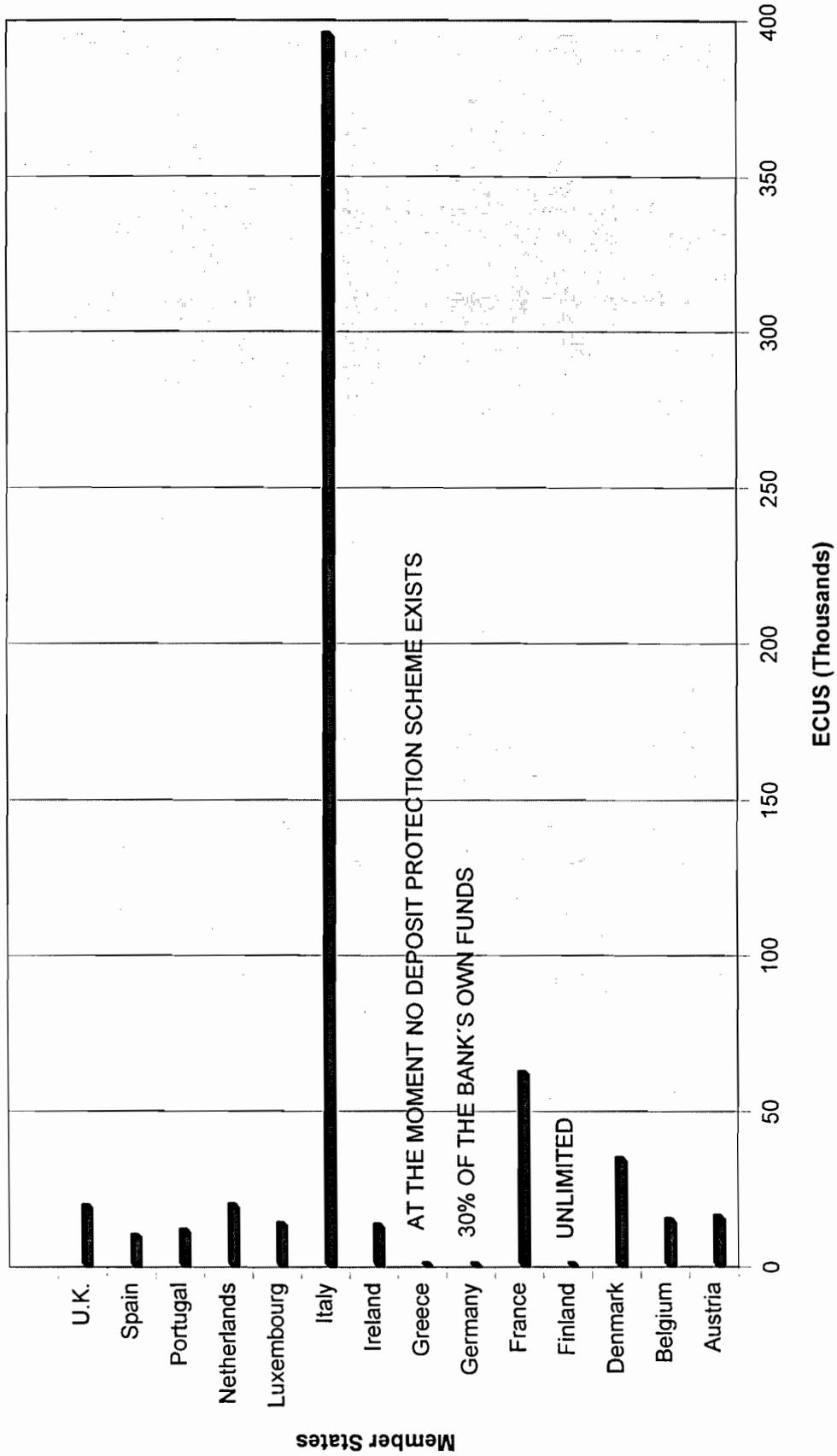


Chart 2

### Level of protection in ECUS



Source: Own computation (February - 95)