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From:	Presidency
To:	Working Party on Financial Services and the Banking Union (CMDI) Financial Services Attachés
Subject:	Item 5: Presidency non-paper on "DGSD selected topics"

Presidency non-paper on selected DGSD topics

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1. Introduction

This non-paper covers a selection of articles from the Commission's DGSD proposal. These articles have already been discussed under the Spanish Presidency, at the Council Working Parties of 7 July 2023 (WK 9018/2023) and 31 October 2023 (WK14054/2023). This non-paper provides an overview of the Member States' principal observations as well as some options and questions for Member States.

2. Selected topics and drafting proposals

2.1. Article 5(1) j on eliminating the non-eligibility of public authorities' deposits

Summary of previous discussions

The Commission's proposal included, under the scope of Deposit Guarantee Schemes (DGS) protection, all public sector entities, as opposed to the current situation where Member States may extend the protection to public entities with an annual budget equal or lower than EUR 500,000 as a national option.

Initially, Member States held varying opinions on the Commission's proposal, including on the relevance thereof. The Presidency, however, discerned the following trends in their responses to the proposal presented by the Spanish Presidency in October 2023:

- On the relevance of protecting deposits of public entities: a couple of Member States consider there is no need to protect such deposits as they cannot cause bank runs. A majority of Member States, however, seem to be favouring DGS protection for deposits of all public entities, or at a minimum the least sophisticated segment thereof. One Member State flagged the specific case of provident funds of public organisations (i.e. public SMEs not engaged in an economic activity), and argued that their current exclusion from DGS coverage should be reconsidered.
- On the need for a definition of public entities deserving DGS protection: certain Member States in favour of a broad protection of deposits of public authorities also suggest leaving to national discretion the exact scope of entities benefitting from DGS protection. A significant number of Member States, however, underline that, should public entities' deposits benefit from any form of DGS protection, a harmonised definition of such entities would be warranted to level the playing field and facilitate cross-border payouts.

Proposed way forward

In light of the experience of certain Member States highlighting the systemic impact of imposing losses on public entities' deposits, the Presidency would see merit in including in the DGS' scope of protection the deposits of the most vulnerable segment of public entities, namely local and regional ones but excluding central governments authorities.

In order to ensure similar standards of DGS protection across the EU, the Presidency would suggest a uniform definition of public authorities whose deposits would be excluded from DGS protection. Such definition should be generic enough to cover national peculiarities, including the specific case of provident funds. Following the suggestion of certain Member States, the definition of central and state governments stated in points 2.114[1] and 2.115[2] of Regulation (EU) No 549/2013 on the European system of national and regional accounts in the European Union could serve this purpose.

Drafting suggestion

Article 5(1) DGSD would be amended as follows:

j) deposits by ***central and state governments, as defined under points 2.114 and 2.115 of Regulation (EU) No 549/2013 on the European system of national and regional accounts in the European Union.***

2.2. Article 7(3) and article 8b on ultimate beneficiaries and client funds

Summary of previous discussions

The Commission proposed a definition of client funds deposits (article 2, point 20) and a protection of client funds deposits under DGSD (article 8b). Under this regime, client funds deposits placed by financial institutions at credit institutions would be protected under three conditions:

1) deposits are placed on behalf and for the account clients who are themselves eligible for DGS protection;
2) deposits are segregated in compliance with safeguarding requirements laid down in Union law; and
3) clients are identified or identifiable before the deposits become unavailable.

Under the Commission's proposal, DGSs would be allowed to pay funds directly to the account holder or to the client. For calculating the amount repayable, the client funds deposits would not be aggregated with the client's own deposits placed at a failed credit institution. Based on EBA estimates, protecting client funds deposits would not significantly increase the volume of deposits under coverage[3].

[1] Art. 2.114 (***Central government (excluding social security funds) (S.1311)***): *Definition: this subsector includes all administrative departments of the state and other central agencies whose competence extends normally over the whole economic territory, except for the administration of social security funds. Included in subsector S.1311 are those non-profit institutions which are controlled by central government and whose competence extends over the whole economic territory. Market regulatory organisations which are either exclusively or principally distributors of subsidies are classified in S.1311. Those organisations which are exclusively or principally engaged in buying, holding and selling agricultural or food products are classified in S.11.*

[2] Art. 2.115 (***State government (excluding social security funds) (S.1312)***): *Definition: this subsector consists of those types of public administration which are separate institutional units exercising some of the functions of government, except for the administration of social security funds, at a level below that of central government and above that of the governmental institutional units existing at local level. Included in subsector S.1312 are those non-profit institutions which are controlled by state governments and whose competence is restricted to the economic territories of the states.*

[3] In terms of impact on the overall amount of covered deposits, the EBA concluded that it would be limited, either because the amount of client funds relative to covered deposits appears to be small, or because they are already covered, or both.

A majority of Member States expressed support for the protection of client funds deposits. Two Member States nuanced their support based on the risk of additional contributions. Another Member State voiced support but insisted on a clear definition of deposits falling under the proposed client funds protection regime. One Member State expressed doubts on the relevance of protecting client funds deposits on operational complexity grounds.

Based on the discussions and written comments, the Presidency identified three outstanding issues, which are dealt with in more detail below:

(i) the application of similar protection for beneficiary accounts held by non-financial entities;
(ii) The inclusion of specific accounts from financial entities in the client funds' protection regime; and
(iii) the possibility to repay either the account holder or the ultimate client.

(i) The application of similar protection for beneficiary accounts held by non-financial entities

Summary of previous discussions

During the Council Working Party of 7 July 2023, two Member States suggested to extend the beneficiary accounts' protection regime to specific accounts held by non-financial entities, including accounts for the maintenance of residential buildings and deposits held by notaries or attorneys, primarily for the purpose of real estate transactions. These Member States indicated that, for calculating the amount repayable, such accounts should be considered separate from the ultimate beneficiaries' own accounts at the concerned credit institution. A substantial number of Member States supported this proposal, while one Member State supported it as long as (a) the ultimate beneficiary would have no control on the choice of account by the account holder and (b) legal segregation requirements apply.

The Commission, however, flagged that the use cases mentioned could, in general, already be accommodated under their initial DGSD proposal:

(i) deposits made by managers of private residential properties, and collected from owners or residents of such properties would fall under article 6(2); and
(ii) deposits related to real estate transactions relating to private residential properties benefit from separate protection and a higher coverage limit under the temporary high balance regime.

In line with the Member States' comments on beneficiary accounts, the previous Presidency proposed to modify article 7(3) DGSD on beneficiary accounts[4]. A significant number of Member States supported this approach. One Member State urged for an adequate definition of '*an account held for professional purposes*'. Other Member States, however, opposed this approach because of (i) concerns of abuse, (ii) holding client funds is an ancillary activity to the primary activity of non-financial entities, and the failure of a credit institution is unlikely to put such professional activity at risk, and (iii) clients also have the possibility to proactively enquire about the bank account(s) used by the account holder. Two other Member States

[4] Spanish Presidency proposal for amendment of 7(3): *Where the depositor is not absolutely entitled to the sums held in an account, the person who is absolutely entitled shall be covered by the guarantee, provided that that person has been identified or is identifiable before the date on which a relevant administrative authority makes a determination as referred to in point (8)(a) of Article 2(1) or a judicial authority makes a ruling referred to in point (8)(b) of Article 2(1).* ***In account held for professional purposes, and by way of derogation from Article 7(1), when determining the repayable amount for an individual client, the DGS shall not take into account the aggregate fund deposits placed by that client with the same credit institution.***

enquired about the impact of such extension on DGS contributions and target level. In response, the Commission noted that the proposal's impact has not been quantified.

Proposed way forward

To strike a balance between the Member States' viewpoints, the Presidency suggests retaining the extension of the DGS scope of protection to specific accounts held by non-financial entities, while introducing two additional safeguards:

(i) National provisions governing the activity of professionals opening beneficiary accounts should require that these funds be segregated from the beneficiary account holder's own accounts. This segregation could be framed similarly to the requirement for payment institutions and e-money institutions under the Payment Services Directive and the E-money Directive[5]. This would limit the risk of DGS protection abuse by maintaining an artificially high number of beneficiary accounts with the same credit institution for the sake of benefitting from separate DGS protection, in addition to the deposit protection ceiling.

(ii) DGS means are better protected when credit institutions are in a position to identify the ultimate beneficiaries of deposits held on specific accounts by non-financial entities before such deposits are declared unavailable. Indeed, this is necessary for the DGS to levy contributions from credit institutions on the basis of these deposits, and to estimate its potential liabilities stemming from these accounts. The Presidency notes, however, that the same approach might be more difficult to replicate for client funds deposits referred to in article 8 DGSD on beneficiary accounts held by financial institutions. These institutions might be competing directly with credit institutions on certain activities. As a result, a look-through system, according to which financial institutions must provide credit institutions with nominative information on the ultimate beneficiaries of these client funds, could have unintended consequences. In contrast, the account holders targeted under article 7(3) DGSD would not be expected to be in direct competition with banks, account holding being ancillary to their core professional services.

Drafting suggestion

Article 7(3) DGSD would be amended as follows:

*Where the **account holder** ~~**depositor**~~ is not absolutely entitled to the sums held in an account, the person who is absolutely entitled shall be covered by the guarantee, provided that that person has been identified or is identifiable before the date on which a relevant administrative authority makes a determination as referred to in point (8)(a) of Article 2(1) or a judicial authority makes a ruling referred to in point (8)(b) of Article 2(1).*

In the case of funds held by an account holder on behalf of the absolutely entitled persons in a separate account for professional purposes as defined by national law, and where those funds are insulated in accordance with national law in the interest of that person against the claims of other creditors of the account holder, in particular in the event of insolvency, when determining the repayable amount, the DGS shall not take into account the aggregate amount of deposits placed by that person with the same credit institution if that person is identified by the credit institution.

[5] Article 10 of 2015/2366/EC, Article 7 of 2009/110/EC.

(ii) The inclusion of specific accounts from financial entities in the client funds protection regime

Summary of previous discussions

One Member State asked to extend DGS coverage to crypto providers, crowdfunding service providers and credit servicers. Another Member State expressed concerns that not all accounts held by financial institutions would, despite holding client funds deposits, be covered by the dedicated regime under article 8b DGSD. This Member State also called to grant DGS protection to transactional accounts, which are not segregated accounts and where deposits can be held temporarily before being re-routed to an actual client funds segregated account.

Proposed way forward

The Presidency believes the proposed definition of client funds deposits would be sufficiently broad to cover future regulatory and technological developments while ensuring business model neutrality. The deposits of any financial institution[6] meeting the three requirements under article 8b(1) DGSD would qualify for protection under DGSD. This would also include client funds deposits of crypto providers meeting the requirements under article 8b(1) DGSD. Moreover, the text proposed by the Commission does not specifically refer to segregated beneficiary accounts, meaning that clients funds placed in any type of account necessary to meet the safeguarding requirements according to the operational process of the failed institution would also be protected by the DGS. For the avoidance of doubt, however, the Presidency suggests clarifying the text proposal in this vein. Finally, the DGSD proposal only outlines the condition that client funds should be safeguarded to benefit from the protection under article 8b DGSD. It does not set operational details related to the processing of deposits in transit that have not yet reached their final account destination.

Drafting suggestion

Article 8b(1) DGSD would be amended as follows:

(b) such deposits are made to ***safeguard*** ~~***segregate***~~ *client funds in compliance with safeguarding requirements laid down in Union law regulating the activities of the entities referred to in Article 5(1), point (d);*

(iii) The possibility to repay either the accountholder or the ultimate beneficiary

Summary of previous discussions

The dedicated client funds deposits protection proposed by the Commission allows the DGS to repay either the account holder for the benefit of the client, or the end client directly (article 8b(3) DGSD). Both options are possible because, depending on the type and business model of the financial institution, there might be circumstances where reimbursing the client directly could be detrimental for the business of the account holder[7]. The Commission proposal suggests to define via an RTS the criteria under and the circumstances in which repayment is to be made to the account holder for the benefit of each client or to the client directly.

[6] See new definition of 'financial institution' under Article 4(1), point (26) CRR.
[7] Recital 14 DGSG

One Member State indicated that paying the ultimate beneficiary should be the DGS' default approach, and that paying the account holder should only be an option. Other Member States proposed to include the option to reimburse either the account holder or the ultimate beneficiary for the other specific accounts (from non-financial institutions) that would be included in the regime.

Proposed way forward

The Presidency recognises that, under specific circumstances, deposits should be repaid to the account holder instead of the ultimate beneficiaries. This is for example the case when deposits held in escrow accounts may only become available to the ultimate beneficiary when certain conditions are met, which does not necessarily coincide with the moment of a DGS payout. Given that those funds are segregated and bankruptcy remote from the estate of the account holder, there should be no risk whatsoever of depriving the ultimate beneficiary of its reimbursement entitlement, even when the payment passes through the account holder.

Currently, article 7(3) DGSD does not regulate whether the DGS needs to pay out funds to account holders or directly to absolutely entitled persons. Both options are possible. Extending the EBA mandate under article 8b DGSD to also cover article 7(3) in the RTS could be a way forward to provide more clarity on the circumstances under which reimbursement of these deposits should be made to the account holder or to the absolutely entitled person. At the same time, specific accounts under article 7(3) DGSD concern ancillary services and can be held by account holders that are not regulated under EU law but under national laws. Given those national specificities, this can make it more challenging for the EBA to specify such circumstances under a RTS mandate.

Drafting suggestion

- Option 1: no further specification on whom to reimburse in the content of article 7(3) DGSD

- Option 2: extension of the EBA RTS mandate under article 8b DGSD

  Article 8b(4) point b DGSD would be amended as follows:

  4. The EBA shall develop draft regulatory technical standards to specify:
  (b) the criteria under, and the circumstances in which the repayment is to be made to the account holder for the benefit of each client or to the client directly ***in the cases referred to in paragraph 3 and in Article 7(3), second subparagraph.***

2.3. Recital 19 and article 10(2), second subparagraph on categorisation of different funds as qualifying for DGS target levels

Summary of previous discussions

The Commission proposed to amend to article 10(2) DGSD to specify that only available financial means (AFM) directly contributed by, or recovered from, members of the DGS may count towards the DGS' minimum target level. The Commission's proposal further clarifies that certain sources of DGS financing, including loans and repayments not claimed by eligible depositors during the payout process, are too contingent to qualify for the DGS target level and should be distinguished from funds collected through contributions from the industry. In addition, loans between DGSs cannot be considered to be 'available' as

they cannot be liquidated within seven working days[8], and therefore should not count towards the DGS target level. The amendments proposed by the Commission are in line with the EBA opinions on this topic[9] and the EBA Guidelines on the delineation and reporting of available financial means of Deposit Guarantee Schemes.

Some Member States explicitly supported the proposed clarification on the type of funds qualifying as AFM counting towards DGS target levels. One of these Member States suggested adding explicitly funds recovered from the bankruptcy estate. Another one suggested clarifying further that not only loans between DGSs, but funds originating from loans regardless of the lender should not count. Another Member State agreed that the AFM counting toward the target level should be limited to funds stemming from contributions and exclude all borrowings (or debt liabilities) between DGSs. The same Member State, however, believed that loans given to another DGS should still count toward the target level, as long as these loans are financed by funds stemming from contributions. According to this Member State, this approach would ensure consistency with the current treatment of loans between resolution funds (article 106(6) BRRD) and foster financial solidarity between DGSs.

Proposed way forward

In light of the current practices based on the EBA guidelines and the Member States' positions, the Presidency would suggest further clarifying that AFM that count toward the target level (i) include funds recovered from the bankruptcy estate, and (ii) exclude financial means borrowed by the DGS regardless of the originator.

As regards the treatment of loans between DGSs, the Presidency would like to seek Member States' views as the issue has not yet been discussed in the Council Working Parties.

The Presidency suggests two potential approaches:

- Option 1: the approach to avoid AFM 'double counting'.
  This would occur if the lent amount were to be counted as AFM by both the lending and the borrowing DGSs. Therefore, a loan that a DGS provides to another DGS should not count towards the lending DGS's AFM and hence also not to its AFM that count for meeting the target level or other AFM. On the other hand, funds that a DGS borrows from another DGS cannot count towards the borrowing DGS's target level, but they should be counted as other AFM.

- Option 2: the 'asset-based' approach.
  This approach is not based on the immediate availability of the DGS funds but on whether they are accounted as 'assets' or 'liabilities' of the relevant DGS. This approach would also be in line with the treatment of loans between resolution funds under article 106(6) BRRD. While worth considering, it is important to recognise that this approach deviates from the concept of AFM as defined in the DGSD and might blur the AFM of the DGS given potential challenges to swiftly liquidate some of these financial means.

[8] See definition (12) of AFM under article 2(1) DGSD and article 12 DGSD on borrowing between DGSs.
[9] The EBA recommended that: "The DGSD should be amended to unequivocally state that funds or low-risk assets stemming from or being financed by borrowed resources should not be included in a DGS's calculation of its available financial means and so do not count towards reaching the minimum target level. DGS's liabilities should not be included in the reported amount of available financial means. The DGSD should clarify the treatment of funds recovered in an insolvency, administrative fees, income from investment activities and unclaimed repayments, and whether these funds qualify as counting towards reaching the target level or not".

Drafting suggestion

- Option 1: Finetuning the Commission's proposal and incorporating Member States' suggestions to explicitly include DGS recoveries and exclude all funds borrowed by DGS.

  Article 10(2), second subparagraph DGSD:

  When determining whether the DGS has reached that target level, Member States shall only take into account available financial means directly contributed by, or recovered from, members to the DGS, net of administrative fees and charges. Those available financial means shall include investment income derived from funds contributed by members to the DGS ***and funds recovered by the DGS against its claims referred to in Article 9(2)*** *but shall exclude repayments not claimed by eligible depositors during payout procedures,* ***funds borrowed by the DGS*** *and* ~~***loans between***~~ ***funds lent*** *to other DGSs* ***in accordance with Article 12****.*

- Option 2: Amendments related to the inclusion of funds lent to other DGSs in the financial means that count towards the DGS target level

  Article 10(2), second subparagraph DGSD would be amended as follows:

  When determining whether the DGS has reached that target level, Member States shall only take into account ~~***available***~~ *financial means directly contributed by, or recovered from, members to the DGS, net of administrative fees and charges. Those* ~~***available***~~ *financial means shall include investment income derived from funds contributed by members to the DGS* ***and funds recovered by the DGS against its claims referred to in Article 9(2)*** *but shall exclude repayments not claimed by eligible depositors during payout procedures* ***and funds borrowed by the DGS****.*

2.4. Article 10(11) and Recital 22 on the sequencing of funding sources and the use of alternative funding arrangements financed through public funds as a last resort

Summary of previous discussions

The Commission's review of Article 10(11) DGSD foresees the possibility for the DGS to use the funds originating from alternative funding arrangements before using its available financial means and collecting extraordinary contributions. The Article however sets out that the alternative funding arrangements should only be used as a last resort, requiring the DGS to consider potential other sources of funds first such as available financing means from regular contributions, extraordinary contributions and privately funded alternative financing arrangements. This cascading of the use of the different funding options is foreseen in the context of all DGS financing measures (payout, resolution, preventive and alternative measures). The Commission specified that in many cases, the use of temporary public funding is an important way to ascertain sufficient funding would be available for a pay-out, and that Member States are still free to choose their own most suitable alternative funding arrangements. Framing public funding as a 'last resort' possibility intends to limit the use of public funds and is in line with international standards, the IADI principles.

On the cascading of funds, one Member State puts forward the need for flexibility and that the sequence could be framed as a Member States option. The same Member State would rule out this cascade of funds for other measures than payout, allowing only the available financial means of the DGS in resolution, preventive and alternative measures. On the reference to public funds being the last resort, one Member

State indicates that the funding source does not matter to the depositors while another expresses the need to prohibit the use of public funds in the Article. Some Member States consider that 'last resort' is an unclear concept and suggest clarifying it. One Member State strongly supports that choice of wording. Finally, several Member States indicate their full support for the Commission proposal.

Proposed way forward

In light of the Member States' positions and the suggested practices by international standards, the Presidency would suggest only further clarifying in recital 22 that short-term credit lines from public sources could be used in exceptional circumstances to ensure timely repayment, acknowledging thus as well the need for exceptional circumstances to revert to public funds.

On the use of the cascade of funds for resolution and other measures, the Presidency suggest not amending the Article to not pre-empt the Bridge the Gap discussion as well as the discussion on preventive and alternative measures.

Drafting suggestions

Recital 22 DGSD:

It is necessary to enhance depositor protection, while avoiding the need for a fire sale of the assets of a DGS and limiting possible negative pro-cyclical effects over the banking industry caused by the collection of extraordinary contributions. DGSs should therefore be allowed to use alternative funding arrangements that enable them to obtain at any time short-term funding from sources other than contributions, including before using their available financial means and funds collected through extraordinary contributions. Because credit institutions should primarily bear the cost and responsibility for financing DGSs, alternative funding arrangements from public funds should only be used as a last resort. ***This should not prevent the use of short-term loans from public sources before other alternative funding arrangements in exceptional circumstances to ensure timely repayment.***

Article 10(11) DGSD would not be amended.

3. Questions for Member States

To allow the Presidency to move forward to drafting suggestions, could you please indicate for:

Item 2.1 – Article 5(1) j on eliminating the non-eligibility of public authorities' deposits

Q1: if you agree with the proposed way forward?

Item 2.2 – Article 7(3) and Article 8b on ultimate beneficiaries and client funds

(i) *The application of similar protection for beneficiary accounts held by non-financial entities*

Q2: if you agree with the proposed way forward?

(ii) The inclusion of specific accounts from financial entities in the client funds protection regime

Q3: if you agree with the proposed way forward?

(iii) The possibility to repay either the account holder or the ultimate beneficiary

Q4: if you deem it appropriate to introduce DGS protection for beneficiary accounts held by non-financial entities, do you prefer option 1 or 2, and why?

Item 2.3 – Recital 19 and article 10(2), second subparagraph on categorisation of different funds as qualifying for DGS target levels

Q5: what is your preferred way forward and why?

Item 2.4 – Article 10(11) and Recital 22 on the sequencing of funding sources and the use of alternative funding arrangements financed through public funds as a last resort

Q6: if you agree with the proposed way forward?

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