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## Commission services' note on Article 8b DGSD – coverage of client funds deposits

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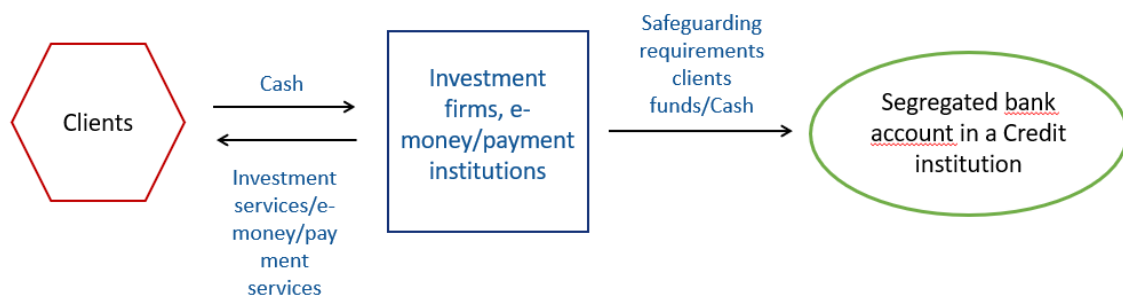
This non-paper has the purpose to clarify the objective, the scope and the practical implementation of the coverage of client funds deposits under new Article 8b of Directive 2014/49/EU on deposit guarantee schemes (DGSD). The non-paper addresses some of the questions submitted by Member States to the Council Presidency in June concerning the coverage of deposits where the ultimate beneficiary is not the account holder.

### 1. Definition

Article 2(20) of the DGSD proposal defines:

**‘client funds deposits’ means funds that account holders that are financial institutions as defined in Article 4(1), point (26), of Regulation (EU) No 575/2013<sup>1</sup> deposit in the course of their business with a credit institution for the account of their clients;**

The new Article 8b aims at protecting, via a see-through approach (figure below), client funds that financial institutions hold in bank accounts **on behalf or for the account of their clients** in order to comply with the **safeguarding requirements** applicable under the respective sectoral rules (such as, the Payment Services Directive, the E-money Directive and Commission Delegated Directive (EU) 2017/593 related to MIFID services)<sup>2</sup>.



<sup>1</sup> 'financial institution' means an undertaking other than an institution, the principal activity of which is to acquire holdings or to pursue one or more of the activities listed in points 2 to 12 and point 15 of Annex I to Directive 2013/36/EU, including a financial holding company, a mixed financial holding company, a payment institution within the meaning of Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market (1), and an asset management company, but excluding insurance holding companies and mixed-activity insurance holding companies as defined in point (g) of Article 212(1) of Directive 2009/138/E.

<sup>2</sup> Deletion of point (e) in Article 5(1) DGSD on the exclusion of investment firms is a technical amendment because investments firms are covered under point (d) of Article 5(1) [definition in point (26) of Article 4(1) of Regulation (EU) No 575/2013].

Hence, financial institutions that, for instance, offer investment services under MIFID, and put their client funds in segregated bank accounts, would fall in the scope.

There are three cumulative conditions for the protection of client funds under the DGSD proposal: (1) the ultimate client has to be eligible for the deposit protection and the account should be opened on his/her behalf and for his/her account; (2) sectoral legislation imposes an obligation on the financial institutions to protect client funds through safeguarding requirements; (3) and the ultimate clients must be identified or identifiable prior to the pay-out event.

## **2. Rationale**

Certain financial institutions (e-money institutions, payment institutions and investment firms) are obliged to comply with safeguarding obligations in line with applicable sectoral rules. In order to comply with these requirements, they can choose to deposit in separate bank accounts, often on a temporary basis, the funds received from their clients in exchange for electronic money that has been issued, for the execution of payment transactions or for the investment services listed in MIFID. Considering the growing role of these actors in the financial system and the potential financial stability implications in case of a failure of the credit institutions where client funds are deposited, DGSDs should protect client funds in line with a ‘see-through’ approach, protecting the ultimate owners of the funds held in the account, rather than the account holders.

Moreover, the fact that depositors are usually neither aware nor in control over the choice of the bank (selected by the account holder) would justify a derogation from the principle of the deposit protection ‘per depositor per bank’ whereby deposits are aggregated when calculating a repayable amount. Such separate protection is also necessary in view of preserving the continuous provision of services of these financial institutions to their clients. This is why the proposal provides for the coverage for potential other deposits the persons entitled for the client fund protection may have in addition to the coverage of their client funds.

## **3. Background**

According to Article 5(1)(d) of the current DGSD, deposits of financial institutions are excluded from the scope of deposit insurance. However, where the account holder is not absolutely entitled to the sum held in an account, Article 7(3) DGSD requires that the person (or several persons in the case of a joint account) who is absolutely entitled shall be covered by the deposit guarantee, provided that the person has been identified or is identifiable before the date when the deposits became unavailable. Member States apply this provision inconsistently as concerns the client funds held on segregated bank accounts by non-bank financial institutions and hence, the protection of these client funds varies across Member States and there is a lack of harmonisation in relation to the treatment of client funds across the EEA; in half of the Member States, the coverage depends on the type of entity that places the deposits. Because the current treatment of such funds is not homogenous, there are divergent degrees of consumer protection.

The provision in the new Article 8b is based on: (i) the analysis made by the EBA in its recommendations (EBA-Op-2019-10, EBA/Op/2021/11) on the basis of a previous court decision<sup>3</sup> linked to diverging interpretation of these two provisions, and hence of which deposits are covered by the DGS; the need to ensure consistency with other EU rules (safeguarding requirements under MIFID, payments services directive, e-money directive), and (ii) the fact that the Investor Compensation Scheme Directive 97/9/EC would not be applicable to provide compensation in case of failure of the credit institution where the investment firms safeguard client funds. The majority of views expressed by Member States experts in several EGBPI meetings held in 2020<sup>4</sup> supported the application of a see-through approach<sup>5</sup>.

#### **4. Objectives of the new provision in Article 8b protecting client funds**

- It addresses the concerns about risk of contagion effects and financial stability consequences following the failure of a credit institution as the payment/e-money institution/investment firm would not be able to use safeguarded money to provide services/or return it to their clients if the bank fails.
- It ensures legal certainty and consistency of treatment of client funds.
- It ensures consistency with MIFID, PSD and E-money Directives which require safeguarding client funds.
- It harmonises the approach followed to identify the person who is absolutely entitled to the deposit.

#### **5. Operational aspects related to the actual payout of client funds in the scope of Article 8b**

**Identification and repayable amount:** the coverage level of 100 000 EUR (Article 6(1)) applies to each of the clients that are identified or identifiable prior to the date on which the deposits are determined to be “unavailable” (Article 8b(1c)). The sums in beneficiary accounts are not aggregated with the sums on depositor’s regular accounts (Article 8b(2)), the protection of client funds is a separate protection compared to the coverage of beneficiary account by notary, lawyers, etc., which are covered under Article 7(3). As suggested by the EBA in its opinion, the review (Article 8b(3)) allows the flexibility on who should be reimbursed (the account holders on behalf of the client or the client directly (see some example in the table below), to reduce administrative burden in case carrying out the direct repayment of the client would not be readily available (due to lack of the necessary information on the ultimate

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<sup>3</sup> In its judgment in joined cases C-688/15 and C-109/16, the European Court of Justice concluded that “claims relating to funds debited from accounts that individuals held with a credit institution and credited to accounts opened in the institution’s name in respect of subscription of future transferable securities of which that institutions was to be the issuer, in circumstances where owing to that institutions’ insolvency, the securities were ultimately not issued fall with the scope of the [DGSD and the definition of a deposit]”.

<sup>4</sup> EGBPI meetings of 5 December 2019, 27 January and 23 June 2020, taking stock of the national approaches and collecting the views on the EBA’s recommendations, and further discussed on 15 October and November 2020, April 2021.

<sup>5</sup> In terms of impact on the overall amount of covered deposits, the EBA concluded that it would be limited, either because the amounts of client funds relative to covered deposits appear to be small, or because they are already covered, or both. A survey conducted by COM among EGBPI members also indicated that the size of client funds of payment and e-money institutions seems to constitute only a small portion of covered deposits (about 3%).

beneficiary/client) but also to avoid double payment of the same claim, which could happen depending on the business model of the financial institution concerned, and to preserve the continuity of their activity, protecting their business model.

	<b>Bank A</b>	<b>DGS Bank A coverage</b>	<b>Total protection</b>
<b>Depositor 1</b>	10 000 deposit	10 000 deposit	10 000
<b>Payment institution</b>	1 000 deposit on behalf of Depositor 1	1 000	1000
<b>Total protection Depositor 1</b>			11 000
<b>Depositor 2</b>	100 000	100 000	100 000
<b>Investment firm A</b>	130 000 on behalf of Depositor 2	100 000	100 000
<b>E-Money institution</b>	20 000 on behalf of Depositor 2	20 000	20 000
<b>Total protection Depositor 2</b>			220 000

**EBA mandate to develop RTSS:** The proposed Article 8b mandates the European Banking Authority (EBA) to develop draft regulatory technical standards to identify the clients for the repayment, to specify the criteria under which DGSs should repay to account holders or to the client directly, with the view to increase the preparedness of the DGS to assess claims of account holders or clients; to avoid multiple payments; to take into account the specificities of the specific financial institutions and the related treatment of client funds under sectoral rules (for instance, when the client funds become deposit).

**Transparency (Article 16(9c)):** The review improves transparency toward depositors in such situations. EBA is also mandated to develop draft regulatory technical standards on the procedures and the content of the information to be provided to depositors on the client funds protection, to avoid situations such as: (i) in case the account holder is reimbursed, the clients are not involved (and potentially even not aware) in the failure of the bank. (ii) it would be incomprehensible, for the clients, to receive money from a bank they do not know, and could be alarming.

Moreover, Member States shall ensure that DGSs, at any time and upon request, receive from their affiliated credit institutions all information necessary to prepare for a repayment of depositors, in accordance with the identification requirement laid down in Article 5(4), including the information for the purposes of Article 8b (Article 16a(1)).

**Repayment period** (Article 8(3)): the review also harmonises the longer repayment period allowed for client funds, which shall not exceed 20 working days from the date on which those DGSs received the complete documentation they requested from a depositor to examine the claims and verify that the conditions for repayment are met.

## ANNEX:

### **Interaction between the coverage of client funds deposits under Article 8b and the coverage under Article 7(3):**

Some Member States raised questions/issues concerning the coverage of deposits where the ultimate beneficiary is not the account holder. Those issues concern three types of deposits:

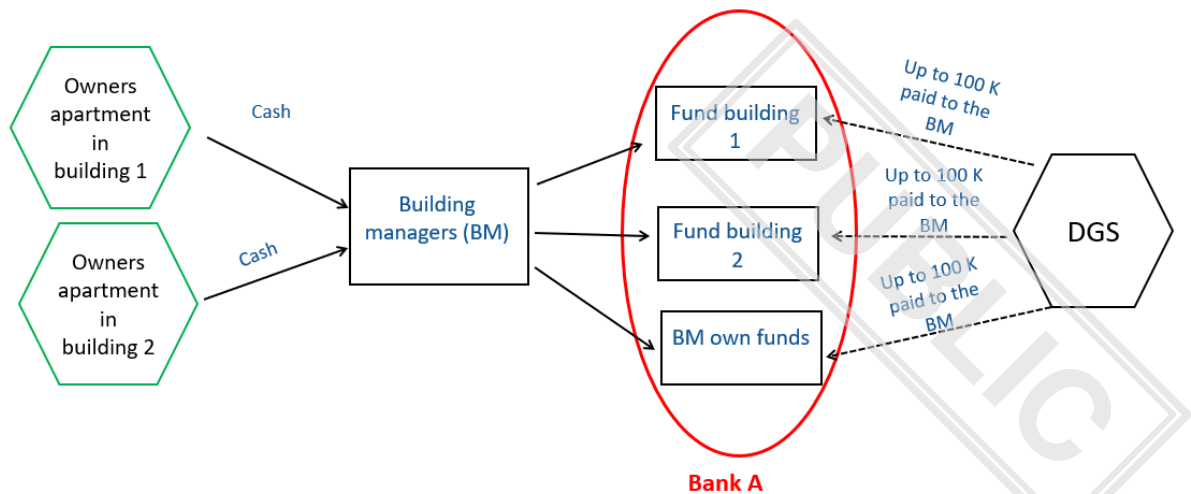
- i) deposits in beneficiary accounts held by notaries, lawyers, and other entities depositing money on behalf of their clients;
- ii) deposits put in a bank account held by managers of real estate building which deposits are tied to an apartment in the building, regardless of the change of the ownership;
- iii) deposits in beneficiary accounts held by attorneys in connection to real estate transactions when there is a transfer of the ownership of the property, while the attorney, as the account holder, would still identify as beneficial owner of the deposit the person depositing the funds the first time, before the sale of the property to a new owner.

#### (i) Deposits in beneficiary accounts held by notaries, lawyers, or other entities:

These deposits fall under the scope of Article 7(3) meaning that the ultimate beneficiary(ies) is entitled to the amount held in the bank account. Differently from the new Article 8b - when calculating the covered amount for a depositor which is a beneficiary of amounts held in such account, but also may have other deposits in the same credit institution – the coverage limit under Article 7(3) would apply to the aggregate amount of all deposit to which the depositor is entitled. However, such different treatment is justified by the fact that holding of client funds by notaries, lawyers, or other similar entities is only ancillary to their primary professional activities, these entities are not regulated by the strict financial regulations and their clients normally know in which credit institutions their money is deposited. Adding those deposits in the scope of Article 8b might have unintended adverse consequences on the amount of covered deposits and would require a dedicated impact assessment.

#### (ii) Money deposited by building managers:

The existing Article 7(2) DGSD allows Member States to provide that deposits in an account to which two or more persons are entitled as members of a business partnership, association or grouping of a similar nature, without legal personality, may be aggregated and treated as if made by a single depositor for the purpose of calculating the limit provided for in Article 6(1). This would cover deposits made by managers of real estate building where the deposited funds are collected from the owner/residents of a building and linked to the apartments they own.



BM manages separate fund for each building. Funds building 1 and 2 in Bank A could be treated as separate entities for the purpose of depositor protection as a Member State option under Article 7(2)

Regardless of whether the fund collected by the building manager, for more than one building, are put in a same bank account or in different bank accounts, each fund can be treated as a separate depositor under Article 7(2) DGSD and the coverage limit would be calculated per fund.

(iii) Deposits held by attorneys in beneficiary accounts in relation to real estate transactions:

The question of who would be the person entitled to receive payment by the DGS in such situations is a matter of each Member State' general civil law and should not be regulated through amendments to the DGSD.

In addition, funds related to real estate transactions are protected separately under the DGSD provisions for temporary high balances (THB). The proposal clarifies that the protection of THB is in addition to the coverage level of 100 000 EUR for the other deposit of the same depositor in the bank.