8-1-1997

The European Union’s Deposit Guarantee Directive: A Critical Analysis

Thomas S. Hornbaker

Follow this and additional works at: http://lawdigitalcommons.bc.edu/iclr
Part of the Banking and Finance Law Commons, and the European Law Commons

Recommended Citation

This Notes is brought to you for free and open access by the Law Journals at Digital Commons @ Boston College Law School. It has been accepted for inclusion in Boston College International and Comparative Law Review by an authorized editor of Digital Commons @ Boston College Law School. For more information, please contact nick.szydlowski@bc.edu.
The European Union’s Deposit Guarantee Directive: A Critical Analysis

INTRODUCTION

One of the fundamental objectives of the European Union (EU) is the creation of a single marketplace. Within the financial services sector, the EU has pursued its single market goal through the process of harmonization of national banking laws in conjunction with mutual recognition. The European Council has adopted directives covering matters such as regulatory capital, consolidated supervision, consumer credit, and money laundering. The Deposit Guarantee Directive, adopted on May 30, 1995, is the latest of these efforts to coordinate the banking policies of the Member States.

In addition to promoting a competitive and efficient market for banking services, the EU has sought to promote stability and confidence in the financial system. Deposit guarantee schemes serve the dual purposes of providing protection to depositors in the event of an institution-specific failure, as well as contributing to the stability of the banking system as a whole by reducing the risk of general runs. “[Deposit protection is as essential as the prudential rules for the completion of the single banking market.”

1 See JUllAN MAITLAND-WALKER, EC BANKING DIRECTIVES I–I (1994).
8 See id. pmbl. (1st recital).
9 See MARC DASSESSE ET AL., EC BANKING LAW 365 (1994).
Part I of this Note provides an overview of the primary legislative initiatives of the EU in the area of banking law. Part II discusses the major provisions of the Deposit Guarantee Directive. In addition, Part II considers the implementation of the Directive by Belgium, as well as the pending legal challenge brought by Germany in the Court of Justice. Part III contains an analysis of the conflicting policy objectives of home versus host country coverage of branch deposits, as well as the supervisory authority of host Member States over branches. Finally, this Note concludes, in Part IV, that while the Deposit Guarantee Directive appears to strike a balance between the policies underlying home versus host Member State coverage, the benefits of the Directive’s parameters would be further enhanced by strengthening the enforcement authority of host State regulators over branches participating in their guarantee schemes.

I. THE PRINCIPAL EU BANKING DIRECTIVES

The fundamental objective of the EU is the establishment of an integrated economy where goods, services, labor, and capital are permitted to move freely.11 This is frequently referred to as the single market objective. The Treaty of Rome12 is the basic blueprint by which the EU will achieve a single market.13 The EEC Treaty sets forth the basic rules for breaking down national barriers and harmonizing national laws.14 It was not, however, until the 1985 White Paper, *Completing the Internal Market*,15 and the adoption of the Single European Act in 1987,16 that the EU formulated a detailed plan for achieving an integrated common market.17

In the White Paper, the European Commission identified the harmonization of banking services as being critical to the success of the single market objective.18 Traditionally, banking, for prudential and monetary policy reasons, has been among the most highly regulated

11 See MAITLAND-WALKER, supra note 1, at 1–1.
13 See MAITLAND-WALKER, supra note 1, at 1–1.
14 See id.
15 Completing the Internal Market: White Paper from the Commission to the European Council, COM(85)310 final at 1.
17 See MAITLAND-WALKER, supra note 1, at 1–2.
18 See id.
The existence of different national regulatory policies governing the issuance of bank charters, cross-border sales of services, and capital requirements, *inter alia*, has been an impediment to the fundamental goal of a common market. Such disparate laws among the Member States are barriers to the free movement of services as well as the freedom of establishment sought under the Treaty of Rome.

The EU’s adoption of the First Banking Co-ordination Directive was the first major effort toward the harmonization of banking laws. Passage of the First Banking Directive achieved two important goals. First, it established common standards for the issuance of banking charters. Specifically, the standards addressed capital adequacy and the requisite quality of bank management. Second, the First Banking Directive called for the coordination of supervisory efforts among the regulatory authorities of the Member States. To that end, the multi-lateral Bank Advisory Committee was established to develop common definitions for regulatory capital and solvency ratios. The First Banking Directive also required Member State authorities to coordinate...
their efforts with respect to monitoring bank liquidity and solvency.32 In addition, the First Banking Directive provided for national treatment of non-Member State banks.33 With respect to non-Member State branches, the First Banking Directive left Member States full discretion to set conditions for their authorization, provided that no such branch was treated more favorably than a branch of a Member State institution.34

Despite the progress achieved by the First Banking Directive, significant barriers to the single market goal remained.35 To establish branches in all Member States, a credit institution was required to obtain separate authorizations from each Member State.36 Although not distinct legal entities, such branches were subject to host Member State regulations requiring the maintenance of a separate endowment for capital.37

The Council intended the Second Banking Co-ordination Directive38 to address these difficulties.39 The major accomplishments of the Second Banking Directive were the creation of the single banking license and the allocation of supervisory powers between home and host40 Member States.41 The single banking license permits a credit institution authorized in one Member State to expand its businesses in other Member States through the cross-border provision of services or the establishment of branches without the necessity of obtaining separate authorizations from each Member State.42 The single banking license is based on the mutual recognition by the Member States of the

32 See id. art. 7(1).
33 See id. art. 9. National treatment means offering the same competitive advantages to foreign businesses as are available to domestic businesses. See ANDREW GAMBLE & GORDON TRAVERS, EUROPEAN COMMUNITY LAW AFTER 1992, at 426 (Ralph H. Folsom et al. eds., 1993).
34 See First Banking Directive, supra note 25, art. 9(1).
35 See CLAROTTI, supra note 27, at 3.
36 See id.
37 See EGAN ET AL., supra note 26, at 3–4.
39 See CLAROTTI, supra note 27, at 3.
40 “Home Member State” means the Member State in which a credit institution has been organized under the First Banking Directive. See Second Banking Directive, supra note 38, art. 1(7). “Host Member State” means a Member State, other than its Home Member State, in which a credit institution has a branch or in which it provides services. See id. art. 1(8).
41 See EGAN ET AL., supra note 26, at 3–4.
42 See CLAROTTI, supra note 27, at 3.
adequacy of their respective standards for chartering and supervising credit institutions.\textsuperscript{43}

The Second Banking Directive is based on the universal banking model.\textsuperscript{44} Under the universal banking model, an institution is permitted to engage in both traditional commercial banking and securities activities.\textsuperscript{45} With the single banking license created by the Second Banking Directive, an institution can provide, throughout the EU, those services that its home State charter permits and that are listed in the Annex to the Second Banking Directive.\textsuperscript{46} For example, German banks, which are authorized under laws based on the universal model, can conduct securities activities in Germany as well as Member States which do not permit their own banks to do the same.\textsuperscript{47} This competitive inequality will increase pressure for the adoption of universal banking throughout the EU.\textsuperscript{48}

The Second Banking Directive also divides supervisory authority between home and host State regulators.\textsuperscript{49} It vests primary responsibility for supervising cross-border services and branches with home State authorities.\textsuperscript{50} Host State authorities, however, retain supervisory authority over branch liquidity,\textsuperscript{51} factors affecting monetary policy,\textsuperscript{52} and exposure to host State financial markets.\textsuperscript{53} In addition, host State regulators are vested with the general power to compel compliance with national regulations adopted for “the general good.”\textsuperscript{54} Although a host State regulator must first appeal to an institution’s home State regulator, the host State regulator can take dispositive enforcement action in the event that the home State regulator is unresponsive.\textsuperscript{55}

\textsuperscript{43} See Egan et al., supra note 26, at 3-4.
\textsuperscript{44} See id. at 5-6.
\textsuperscript{45} See id. at 3-5 to 3-6.
\textsuperscript{46} The services enumerated in the Annex to the Second Banking Directive include: deposit taking, lending, leasing, funds transfer, payment systems, guarantees and letters of credit, securities trading, securities underwriting, mergers and acquisitions advisory services, money brokering, asset management, securities clearance and safekeeping, credit reference services, and safe custody services. See Second Banking Directive, supra note 38, annex.
\textsuperscript{47} See Egan et al., supra note 26, at 3-4.
\textsuperscript{48} See id.
\textsuperscript{49} See Second Banking Directive, supra note 38, art. 13(1).
\textsuperscript{50} See id.
\textsuperscript{51} See id. art. 14(2).
\textsuperscript{52} See id.
\textsuperscript{53} See id. art. 14(3).
\textsuperscript{54} See Second Banking Directive, supra note 38, art. 21(5).
\textsuperscript{55} See id. art. 21(4).
II. THE DEPOSIT GUARANTEE DIRECTIVE

A. Explanation of Major Provisions

On July 1, 1995, the Deposit Guarantee Directive (Directive) took effect.56 The Directive requires each Member State to establish one or more deposit protection schemes.57 Subject to certain narrow exceptions, all credit institutions must participate in a guarantee scheme established under the laws of the Member State in which they are chartered.58 In addition, the Directive provides for enforcement authority; however, in the case of noncompliance by a branch, primary enforcement authority is vested in the home State rather than the host State.59 As discussed below, this allocation of enforcement authority presents a potential problem area for host State regulators. In the event that an institution fails to comply within the time frame and in accordance with any conditions dictated jointly by the home and host State regulators, the Directive authorizes the institution’s home State regulators to revoke its charter.60 The other major standards prescribed by the Directive address: (1) the allocation of financial responsibility among the protection schemes of the Member States; (2) the level and scope of coverage; and (3) the manner in which the guarantee schemes are to be administered.

1. Allocation of Financial Responsibility

The Directive provides that Member States’ deposit guarantee schemes shall cover the domestic deposits of institutions they have chartered, as well as the deposits in branches of those institutions located in other Member States.61 Until December 31, 1999, the coverage provided for branches shall not be more comprehensive, in terms

56 See Deposit Guarantee Directive, supra note 7, art. 14(1).
57 See id. art. 3(1).
58 See id. An institution which belongs to a protection scheme that guarantees the solvency of the institution itself may be exempt from participation in a deposit guarantee scheme. See id. art. 3(1). This exemption is mainly for the benefit of certain German savings banks and credit cooperatives. See SYDNEY J. KEY, AMSTERDAM FINANCIAL SERIES 15 (Martijn van Empel ed., 1994). In addition, the Directive provides transitional rules for certain institutions chartered in Spain or Greece. See Deposit Guarantee Directive, supra note 7, art. 12.
59 See id. art 4(4).
60 See id. art. 3(5).
61 See id. arts. 3(1), 4(1).
of level and scope, than the coverage provided by the guarantee scheme adopted by the host State.\textsuperscript{62} Furthermore, where the coverage extended to a branch by its home State guarantee scheme is less favorable than the coverage provided by the host State's scheme, the credit institution can voluntarily elect for its branch to participate in the host State's scheme.\textsuperscript{63} Supplementary coverage, however, only extends protection to the extent that the host State's coverage is more favorable than the home State's coverage.\textsuperscript{64} This is known as the "topping up" provision.\textsuperscript{65} A credit institution makes an election for supplemental coverage by submitting a request to the host State regulators.\textsuperscript{66} Member States are authorized to establish objective conditions to membership in their guarantee schemes on a bilateral basis with the home Member States of foreign institutions electing supplemental coverage.\textsuperscript{67} Annex II sets forth "guiding principles" addressing such matters as supervisory authority, financial reporting, certification of insolvency, rights of set-off, and guarantee assessments.\textsuperscript{68}

For example, if the Belgian guarantee scheme offers insurance protection up to ECU 20,000 for qualified deposits, then deposits booked at the domestic offices of Belgian-chartered institutions are covered to ECU 20,000.\textsuperscript{69} In addition, branches of Belgian institutions are also covered by the Belgian protection scheme to ECU 20,000.\textsuperscript{70} Assuming the guarantee scheme in Spain provides deposit protection to only ECU 15,000,\textsuperscript{71} a Spanish branch of a Belgian institution would receive only the level of coverage available to Spanish chartered institutions, namely, ECU 15,000.\textsuperscript{72}

Belgian bank branches could choose supplemental coverage in those Member States where coverage is greater than that of Belgium.\textsuperscript{73} For

\begin{footnotes}
\item[62] See id. art. 4(1).
\item[63] See Deposit Guarantee Directive, supra note 7, art. 4(2).
\item[64] See Key, supra note 58, at 17–22.
\item[65] See id.
\item[66] See Deposit Guarantee Directive, supra note 7, art. 4(2)–(4).
\item[67] See id. art. 4(3), annex II.
\item[68] See id. annex II.
\item[70] See id. at 215.
\item[71] See Deposit Guarantee Directive, supra note 7, art. 7(1) (transitional coverage of ECU 15,000 through December 31, 1999).
\item[72] See id. art. 4(1).
\item[73] See id. art. 4(2).
\end{footnotes}
example, in Germany the level of protection greatly exceeds the Directive’s ECU 20,000 minimum. So, a German branch of a Belgian bank would have the benefit of protection under the Belgian plan to ECU 20,000. In addition, the branch could elect supplemental coverage under the German scheme to the extent that German coverage is greater. This example illustrates the hybrid nature of deposit protection under the Directive where the level of protection offered by Member States is not uniform.

Article 6 prescribes the framework for non-EU credit institutions. Specifically, Member States may require the branch of a non-Member State bank to join an appropriate guarantee scheme within its territory if the guarantee scheme of its chartering country provides less protection than the host Member State scheme. For example, Belgian law requires the Belgian branch of a U.S. bank to join its deposit guarantee scheme because the U.S. deposit insurance scheme does not insure deposits booked at the foreign branches of U.S. institutions. The Directive does not preclude a non-EU bank from obtaining coverage for a subsidiary bank.

2. Level and Scope of Coverage

Member States’ protection schemes may also contain differences in terms of level and scope of coverage. The primary purpose of deposit guarantee schemes is to protect unsophisticated depositors, such as ordinary consumers. The Council defined the minimum level and scope of protection set forth in the Directive with this fundamental purpose in mind.

Article 7(1) of the Directive provides for a minimum level of coverage of ECU 20,000 in aggregate deposits per depositor. Subparagraph 2 of Article 7(1) provides a transitional rule: until December 31, 1999,

75 See Deposit Guarantee Directive, supra note 7, art. 4(1).
76 See id. art. 4(2).
77 See Key, supra note 58, at 10–14.
78 See Deposit Guarantee Directive, supra note 7, art. 6.
79 See id. art. 6(1).
81 See Key, supra note 58, at 7–8.
82 See id. at 9.
84 See id. art. 7(1).
the minimum level of coverage provided shall be no less than ECU 15,000.\textsuperscript{85} With respect to home State deposits, the Directive does not impose a maximum level of coverage.\textsuperscript{86}

The Directive does not cover all depositors and deposits.\textsuperscript{87} The Directive provides for mandatory\textsuperscript{88} and optional\textsuperscript{89} exclusions which determine the scope of coverage provided by a Member State’s protection scheme. The optional exclusions permit the Member States to exclude certain depositors from coverage entirely or, in the alternative, extend a lower level of coverage.\textsuperscript{90}

Article 2 of the Directive enumerates three types of deposits required to be excluded from coverage by a guarantee scheme.\textsuperscript{91} The first and second exclusions are deposits made by other credit institutions for their own account and all instruments classified as “own funds” in Article 2 of Council Directive 89/299/EEC of April 1989.\textsuperscript{92} These exclusions are based on the notion that parties who support the risk-taking activities of the institution or who are in a better position to assess the risk of the institution should bear the risk of insolvency.\textsuperscript{93}

85 See id.
86 See id. art. 7(3).
87 See id. arts. 2, 7(2).
88 See Deposit Guarantee Directive, supra note 7, art. 2.
89 See id. art. 7(2).
90 Annex I to the Directive provides a list of depositor and deposit types which can be excluded from coverage at the discretion of the Member States. They are as follows:

(1) Deposits by financial institutions as defined in Article 1(6) of Directive 86/646;
(2) Deposits of insurance companies;
(3) Deposits by government and central administrative authorities;
(4) Deposits by provincial, regional, local and municipal authorities;
(5) Deposits by collective investment undertakings;
(6) Deposits by pension and retirement funds;
(7) Deposits by certain senior managers, officers, directors, and principal shareholders;
(8) Deposits by close relatives of the individuals referred to in item 7;
(9) Deposits by affiliates;
(10) Non-nominative deposits;
(11) Deposits of borrowers who obtained credit on terms detrimental to the institution;
(12) Debt securities, acceptances, and promissory notes;
(13) Deposits in currencies other than that of the Member States or the ECU; and
(14) Deposits of large companies.

See id. annex I.
91 See id. art. 2.
92 The term “own funds” essentially refers to regulatory capital. See Own Funds Directive, supra note 3, art. 2.
93 See Tison, supra note 69, at 216.
The third exclusion contained in Article 2 denies coverage to deposits arising from money laundering activities.94

Annex I to the Directive provides a list of certain types of deposits or depositors for which exclusion is optional.95 These optional exclusions generally include debt securities, deposits denominated in non-Member State currencies, institutional investors and insiders.96

In addition, the Directive contains a limited co-insurance provision.97 Specifically, the Directive permits up to 10% of the risk to be borne by the depositor.98 For example, assuming a 10% co-insurance requirement, the depositor would absorb 10% of the loss up to ECU 22,222 and all of the loss in excess of that amount.99

3. Administration of Guarantee Schemes

Article 10 provides that guarantee schemes shall pay off depositors within three months of the date on which the bank is determined to be insolvent.100 Under exceptional circumstances, the regulators can permit up to three three-month extensions.101 The Directive also provides for subrogation rights.102 Lastly, the Directive grants depositors a cause of action against the guarantee scheme to ensure compensation in the event that the scheme does not meet its obligations.103

B. Belgian Implementation of the Directive

Belgium was among the first to implement the Deposit Guarantee Directive when its enabling legislation became effective on January 1, 1995.104 The Belgian scheme, which consolidated four deposit protection programs, preserves all of the major features set forth in the Directive.105

94 See Deposit Guarantee Directive, supra note 7, art. 2.
95 See id. art. 7(2).
96 See id. annex I.
97 See id. art. 7(4).
98 See id.
99 See Deposit Guarantee Directive, supra note 7, art. 7(4).
100 See id. art. 10(1).
101 See id. art. 10(2).
102 See id. art. 11. Subrogation rights are the rights of the deposit guarantee scheme to step in the shoes of the depositors, to the extent it has paid off the depositors, for the purpose of seeking recovery from the institution and any other culpable parties contributing to the bank’s failure. See Key, supra note 58, at 47.
103 See Deposit Guarantee Directive, supra note 7, art. 7(6).
104 See Tison, supra note 69, at 215.
105 See id.
Membership in a guarantee scheme is compulsory for Belgian char­
tered banks. In accordance with the hybrid financial responsibility
provisions of the Directive, the Belgian scheme provides coverage for
domestic deposits of its credit institutions, as well as deposits booked
in Belgian bank branches located in other Member States. With
respect to Belgian branches of non-EU country institutions—an area
left to the discretion of the Member States by the Directive—member­
ship is compulsory unless the branch is covered by a guarantee scheme
of its chartering country which affords depositor protection equivalent
to that of the Belgian scheme. The Belgian scheme incorporates, in
addition to the mandatory exclusions contained in Article 2 of the
Directive, all of the discretionary exclusions contained in Annex I to
the Directive.

The minimum level of deposit coverage was set at the Directive’s
minimum of ECU 20,000. This represents an increase from approxi­
mately ECU 13,150—the level of coverage previously available to de­
positors of private banks. At present the Belgian scheme does not
include a co-insurance provision, although the regulatory authorities
are empowered to adopt one.

Lastly, the guarantee scheme is funded by assessments based on the
size of the deposit base qualifying for coverage. Additional compul­
sory contributions, in the event that the scheme’s resources become
strained, are limited to twice the regular annual assessment.

C. German Legal Challenge to the Directive

On August 18, 1994 Germany brought an action against the Euro­
porean Parliament and the Council of the European Union in the Euro­
porean Court of Justice seeking to annul the Deposit Guarantee Directive
or, in the alternative, strike certain provisions concerning maximum
coverage, topping-up by branches, and compulsory membership.
Germany advocates annulment of the Directive on the basis that the

106 See id.
107 See id.
108 See id.
109 See Tison, supra note 69, at 216.
110 See id. at 217.
111 See id.
112 See id.
113 See id. at 218.
114 See Tison, supra note 69, at 218.
Council lacks a sufficient legal basis for adoption of the Directive. That is, the Directive cannot be based on the first and third sentences of Article 57(2) of the EEC Treaty alone as is represented in its recitals. Those references to the EEC Treaty, it is alleged, support only a harmonization of deposit guarantee schemes and not the improvement of depositor protection. The objective of improving depositor protection, it is further contended, requires reference to Article 235 of the EEC Treaty. In the alternative, the Germans object to the provisions limiting the coverage provided to branches of German banks in other Member States and to the requirement that supplemental coverage be made available to the branches of institutions authorized by other Member States.

The maximum coverage provision dictates that neither the scope nor the level of coverage provided to a branch by its home State scheme shall exceed the maximum scope or level of coverage provided by the host State guarantee scheme. The purpose of this provision is to promote competitive equality. Under its current deposit guarantee system, Germany offers the highest coverage of any EU country. Nearly all deposits are guaranteed. Therefore, the maximum coverage provision effectively restricts German branches located in all other Member States from offering the full protection available to their depositors than otherwise would be available if the deposits were booked in German territory. The German government argues that this restriction not only "reverses the principle of creditor protection," but also "compels the relinquishment of a competitive advantage resulting from better quality." Protecting domestic banks against competition is no justification for limiting deposit coverage. The larger concern should

\[116\] See id.
\[117\] See id. The first sentence of Article 57(2) of the EEC Treaty provides that the Council shall act on a proposal from the Commission and, after consulting the European Parliament, issue directives for the coordination of provisions laid down by law in Member States concerning "self-employed persons." EEC Treaty art. 57(2). The third sentence of Article 57(2) provides: "In other cases the Council shall act by a qualified majority, in cooperation with the European Parliament." Id. art. 57(2).
\[119\] See id. Article 235 of the EEC Treaty requires unanimous approval by the Council of any proposal not expressly provided for by the Treaty. See EEC TREATY art. 235.
\[121\] See Deposit Guarantee Directive, supra note 7, art. 4(1).
\[122\] See id. pmbl. (14th recital).
\[123\] See Schoenmaker, supra note 74, at 112.
\[124\] See id.
\[126\] See id.
be consumer protection, which is enhanced by more comprehensive coverage.\textsuperscript{127}

In addition, the German complaint also seeks to have the supplemental guarantee provision invalidated.\textsuperscript{128} The supplemental guarantee provision requires the extension of deposit guarantees by the German guarantee scheme to branches of non-German institutions that elect such coverage.\textsuperscript{129} The Bundesbank, the German central bank, objects to the topping-up provision because the primary regulatory authority for the branches lies with the institutions' home State regulators.\textsuperscript{130} It is contended that this supervisory structure imposes the risk of insolvency of foreign branches on the deposit guarantee scheme of the host country, while the host country lacks sufficient supervisory authority to manage that risk.\textsuperscript{131} Furthermore, it is contended that the Directive does not confer on the host State regulators any substantive enforcement authority.\textsuperscript{132}

III. ANALYSIS—HYBRID COVERAGE AND ENFORCEMENT AUTHORITY

A. Hybrid Coverage

As described above, the Deposit Guarantee Directive adopted a hybrid system of coverage with respect to branch deposits.\textsuperscript{133} Under the hybrid system, primary deposit coverage is provided by the credit institution's home State.\textsuperscript{134} Where host State coverage is more comprehensive than home State coverage, supplemental coverage is available and is provided by the host State guarantee scheme.\textsuperscript{135} This hybrid system balances the concerns with respect to pure home or pure host State coverage.

The chief concern of the proponents of pure home State coverage is that, under a host State coverage system, the host State regulator must rely on the home State regulators to monitor the safety and soundness of a participating institution and take prompt enforcement action when necessary.\textsuperscript{136} Branches are not legal entities distinct from

\begin{footnotesize}
\begin{enumerate}
\item[127] See id.
\item[128] See id. at 20–21.
\item[129] See Deposit Guarantee Directive, supra note 7, art. 4(2).
\item[131] See id.
\item[132] See id. at 21.
\item[133] See KEY, supra note 58, at 10–14.
\item[134] See Deposit Guarantee Directive, supra note 7, art. 4(1).
\item[135] See id. art. 4(2).
\item[136] See Schoenmaker, supra note 74, at 107–09.
\end{enumerate}
\end{footnotesize}
their home office.\textsuperscript{137} The assets of a branch are subject to all the liabilities of the institution as a whole.\textsuperscript{138} In addition, the Second Banking Directive precludes the imposition of capital equivalency or asset maintenance requirements by host Member States as a means to mitigate the effects of insolvency.\textsuperscript{139} Without the power to set prudential regulations and monitor and enforce compliance, the host States' schemes are at the mercy of inadequate home State supervision.\textsuperscript{140}

On the other hand, the proponents of host State protection are concerned with consumer awareness and the competitive distortions which may result from home State coverage.\textsuperscript{141} First, it is conceivable that a depositor may be faced with twelve different variations of deposit coverage from which to choose.\textsuperscript{142} The primary concern here is with consumer awareness—the ability of unsophisticated depositors to comprehend the different coverages available to them.\textsuperscript{143} Thus, the proponents of host State coverage assert a need for uniformity to promote consumer protection.\textsuperscript{144} If the coverage available to depositors is uniform throughout the host State, no inequity can result from lack of understanding.\textsuperscript{145}

Second, if a branch is covered by its home State guarantee scheme, without any limitation, and the home State scheme provides more comprehensive coverage than that of the host State, depositors might transfer deposits from institutions offering lower coverage to institutions offering more comprehensive coverage.\textsuperscript{146} The proponents of host State coverage characterize the potential deposit migration as a "competitive distortion."\textsuperscript{147} Home State coverage advocates counter with the argument that the added competition would result in a uniform and greater level of coverage.\textsuperscript{148} That is, the ensuing competition among credit institutions to maintain their deposit bases would be to the public's benefit since Member States with lower coverage would be pressured to increase coverage in order to stem the outflow of deposits

\textsuperscript{137} See id. at 108–10.
\textsuperscript{138} See EGAN ET AL., supra note 26, at 3–4.
\textsuperscript{139} See id.
\textsuperscript{141} See KEY, supra note 58, at 8.
\textsuperscript{142} See id.
\textsuperscript{143} See id.
\textsuperscript{144} See id.
\textsuperscript{145} See id.
\textsuperscript{146} See KEY, supra note 58, at 26–30.
\textsuperscript{147} Deposit Guarantee Directive, supra note 7, pmbl. (14th recital).
\textsuperscript{148} See KEY, supra note 58, at 26–30.
from their institutions.149 This is the argument asserted in the German legal challenge discussed above.150 That argument is further countered, of course, by the moral hazard argument.151 Under the moral hazard theory, more comprehensive coverage of deposits would induce institutions to take imprudent risks under the theory that the guarantee scheme will cover the losses of depositors.152 Moral hazard is the policy justification for many of the mandatory and optional coverage exclusions contained in the Directive.153

In short, the hybrid structure of deposit guarantees under the Directive is a pragmatic approach to balancing competing interests. The system promotes consumer protection while limiting moral hazard.154 With respect to host State schemes providing supplemental coverage, the risk to the schemes is partially mitigated by primary home State coverage.155 The risk concerns of certain Member States that offer protection in excess of the Directive’s minimum requirements could be further addressed by strengthening their enforcement authority over noncomplying institutions.

B. Enforcement Authority

Where the level and scope of coverage offered by a host Member State exceeds that of a bank’s home State, branches of the bank can elect supplemental coverage under the host State guarantee scheme.156 A branch must satisfy certain conditions in order to qualify for membership in the host Member State’s guarantee scheme.157 In the event of noncompliance with guarantee scheme membership requirements, however, host State regulators can initiate an enforcement action against the non-complying branch only in collaboration with the home State regulators.158 If the branch fails to comply with enforcement steps taken by the regulators, the host State regulators can exclude the branch from the guarantee scheme, but only with the consent of the

149 See id.
151 See Schoenmaker, supra note 74, at 107.
152 See id.
153 See Tison, supra note 69, at 216–17.
154 See Schoenmaker, supra note 74, at 111–12.
155 See id.
156 See Deposit Guarantee Directive, supra note 7, art. 4(2).
157 See id. art. 4(3).
158 See id. art. 4(4).
branch’s home State regulator.\textsuperscript{159} Exclusion from the deposit guarantee scheme will force the branch to cease operations.

Several Member States expressed concern about host Member State coverage in the aftermath of the collapse of the Bank of Credit and Commerce Internationale in 1991.\textsuperscript{160} The concern was that under host country coverage schemes the risk of branch insolvency is borne by the host Member State, which does not have effective supervisory authority over the participating institution.\textsuperscript{161} While the development of the hybrid coverage structure partially mitigates this concern, host State schemes remain at risk to the extent of the supplementary coverage elected by Member branches.\textsuperscript{162}

With respect to these branches, however, the host State lacks independent enforcement authority.\textsuperscript{163} The Directive mandates collaboration between the home State and host State regulators.\textsuperscript{164} In the event that either the home State regulators of the branch at question are unresponsive, or the branch fails to come into compliance, the host State regulators cannot unilaterally exclude the branch from coverage.\textsuperscript{165} Without the consent of the home State regulator, the host State regulator cannot exclude the offending branch and the host State’s guarantee scheme remains at risk for the deposits of the noncomplying branch.

Furthermore, this allocation of enforcement authority runs counter to that provided in the Second Banking Directive.\textsuperscript{166} Under the Second Banking Directive, the host Member State regulators have the authority to initiate enforcement actions against foreign institutions failing to comply with the laws of that Member State.\textsuperscript{167} In the event that the credit institution fails to respond to the host State’s action, the host State regulators must then seek the assistance of the institution’s home State regulators.\textsuperscript{168} However, if the institution continues to be in noncompliance the host Member State can unilaterally take further action including withdrawal of authorization, i.e., branch closure.\textsuperscript{169}

\begin{flushleft}
\footnotesize
\textsuperscript{159} See id.
\textsuperscript{160} See Key, \textit{supra} note 58, at 8.
\textsuperscript{162} See Deposit Guarantee Directive, \textit{supra} note 7, art. 4(4).
\textsuperscript{163} See id.
\textsuperscript{164} See id.
\textsuperscript{165} See id.
\textsuperscript{166} See Second Banking Directive, \textit{supra} note 38, art. 21.
\textsuperscript{167} Id. art. 21(2).
\textsuperscript{168} Id. art. 21(3).
\textsuperscript{169} Id. art. 21(4)–(10).
\end{flushleft}
In contrast with the Deposit Guarantee Directive, the Second Banking Directive reserves the ultimate enforcement power to the host State. Under the Deposit Guarantee Directive, host Member States are expressly precluded from taking independent enforcement action, yet must bear the risk of a noncomplying branches’ insolvency. Presumably, the foundation for this allocation of enforcement authority is the notion that home Member States should take an active role in enforcement since they provide the primary level of deposit guarantee coverage.

There appears to be no substantive impediment, however, to vesting both the home and host State regulators with concurrent enforcement authority. That is, in the event that an institution fails to comply with the laws of its home State, the home State regulators can take corrective action. Likewise, in the event that an institution is not in compliance with the laws of its host State, then the host State regulators could also take independent enforcement action. A system of concurrent enforcement authority would not subject an institution to any greater regulatory burden, but it would make institutions with foreign branches more accountable to host State regulatory authorities in a manner consistent with the Second Banking Directive.

CONCLUSION

In conclusion, the hybrid coverage structure, although not without limitations, balances the concerns of conflicting interests. The risk exposure of host Member States is partially mitigated by limiting their financial responsibility to supplemental insurance while the home State scheme assumes primary responsibility. In addition, the maximum limitation on home State coverage extending to branches addresses consumer protection concerns by providing uniformity of coverage. While this deposit guarantee regime appears fundamentally sound, it would be further enhanced by strengthening the enforcement authority of host State regulators over branches participating in their guarantee schemes. By granting concurrent enforcement authority, host State regulators would be better able to protect the interests of their guarantee scheme.

Thomas S. Hornbaker

170 Compare Deposit Guarantee Directive, supra note 7, art. 4(4) with Second Banking Directive, supra note 38, art. 2(4)-(10).
171 See Deposit Guarantee Directive, supra art. 7, art. 4(4).