

DEPOSIT PROTECTION AND BANK RESOLUTION

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1

RATIONALES FOR CREATING A DEPOSIT PROTECTION SYSTEM*

1.1 Deposit Insurance Can Protect Depositors...	1.05	1.2.1 Because It Can Prevent Bank Runs	1.15
1.1.1 Because They Are Unsecured Creditors	1.05	1.2.2 Because It Can Complement Banks' Resolutions	1.21
1.1.2 Because They Are Financially Unsophisticated Creditors	1.10	1.2.3 Because It Can Limit the Use of Public Funds	1.26
1.2 Deposit Insurance Can Strengthen Financial Stability...	1.15	1.2.4 Because It Can Level the Playing Field	1.37
		1.3 Conclusions	1.41

The main objectives of prudential bank regulation have traditionally been the safety and soundness of the financial sector and the protection of depositors.¹ Depositors' protection is often cited as the most significant reason for introducing banking rules.² To this end, the deposit protection system has become a well-established component of prudential bank regulation, serving similar objectives. **1.01**

In the UK system, the direct rationale of deposit insurance has always been consumer protection.³ Its creation was a result of the growing influence of the consumer protection lobby,⁴ and its remit has been narrow, confining its mandate to the management of the deposit insurance fund and payment of eligible compensation **1.02**

* Some parts of this chapter have been published by Emerald Group Publishing Limited: see N. Klefouri 'Meeting the rationale of deposit protection system', *Journal of Financial Regulation and Compliance*, Vol. 22, No. 4, pp. 300–317 (2014).

¹ M. Dewatripont and J. Tirole, *The Prudential Regulation of Banks* (Cambridge, MA: MIT Press, 1995), p. 25.

² K. Spong, *Banking Regulation: Its Purposes, Implementation, and Effects* (5th edn, Kansas, MI: Federal Reserve Bank of Kansas City, 2000), p. 6.

³ R. MacDonald, *Deposit Insurance*, Bank of England Centre for Central Banking Studies Handbook in Central Banking No. 9 (August 1996), online at <http://www.bankofengland.co.uk/education/Documents/ccbs/handbooks/pdf/ccbshb09.pdf>, accessed 4 June 2013, p. 8.

⁴ M. J. B. Hall, 'The Deposit Protection Scheme: The case for reform', *National Westminster Bank Quarterly Review*, August, pp. 45–54 (1987).

claims.⁵ Such a scheme can also serve as a valuable regulatory tool to help to mitigate the financial system's instability. The introduction of this system in other countries has therefore been viewed as part of the drive for financial stability on both national and international bases.⁶ Trying to identify contracts which could prevent bank runs, Diamond and Dybvig showed that there are circumstances in which government provision of deposit insurance could produce superior contracts.⁷ In fact, in the United States, the protection of individual depositors is perceived to be a by-product of deposit insurance, because it primarily exists to prevent a dangerous level of instability in the banking system.⁸ Similarly, the purpose of the 1994 European Guiding Deposit Guarantee Schemes Directive (DGSD)⁹ was to 'complete the single banking market, strengthen the stability of the banking system and establish equal competition, whereas consumer protection was only an incidental effect, inherent in that purpose'.¹⁰

1.03 Blair, Carns, and Kushmeider explain that, unlike general laws of insolvency, a deposit insurance system guarantees that depositors will be swiftly reimbursed, and 'no amount of prudential supervision can provide protection against bank runs equivalent to the protection deposit insurance provides'.¹¹ These two attributes, the authors continue, present the distinct benefits that such a system adds to the safety-net structure.¹² In addition, this system may alleviate political pressures for a fuller government bailout and a hastier resolution of bank failure,¹³ creating a level playing field between different-sized banks. The 2007–08 global financial turmoil challenged the operation of deposit insurance frameworks in the United Kingdom—then recently reformed following the creation of the Financial Services Compensation Scheme (FSCS) in 2000—and European Union—following the DGSD—and underscored the need for further reforms to enable these schemes to meet their rationales. As a result, key design features of these frameworks, such as

⁵ Financial Services Authority, *Compensation*, Handbook Release 135 (11 March 2013), online at <http://www.fsa.gov.uk/library/policy/handbook/releases/2013/135>, accessed 28 November 2014, para. 2.2.2.

⁶ W. Allen and G. E. Wood, 'Defining and achieving financial stability', *Journal of Financial Stability*, Vol. 2, No. 2, pp. 152–172 (2006).

⁷ D. W. Diamond and P. H. Dybvig, 'Bank runs, deposit insurance and liquidity', *Journal of Political Economy*, Vol. 91, No. 3, pp. 401–419 (1983).

⁸ R. Cranston, *Principles of Banking Law* (Oxford: Oxford University Press, 2002), p. 78.

⁹ Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes, OJ L135/5, 31 May 1994.

¹⁰ Case C-233/94 *Federal Republic of Germany v. European Parliament and Council of the European Union* (10 December 1996), ECJ, Opinion of AG Léger, [29], online at <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?isOldUri=true&uri=CELEX:61994CC0233>, accessed 4 June 2013.

¹¹ C. E. Blair, F. Carns, and R. M. Kushmeider, 'Instituting a deposit insurance system: Why? How?', in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007), p. 73.

¹² *Ibid.*

¹³ L. Kryzanowski, 'Organizational design and positioning of the deposit insurance function in the financial system safety net', in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007), p. 96.

coverage level and financing arrangements, have been reviewed and significantly extended in recent years. Most notably, in 2012, European officials began discussions on the creation of a common European deposit insurance system as part of a European ‘banking union’. In 2013 and 2014, the European deposit insurance principles were retested, in the context of the Cypriot and Bulgarian banking crises, respectively.¹⁴ These cases have cast fresh doubt on the need and effectiveness of deposit insurance, calling for a deeper examination of its rationales.

The system’s rationale is a key starting point in order to fully understand its design and role within a financial safety-net system. A weighting towards the objective of depositor protection implies a system with low coverage level, while a weighting towards financial stability will lead to high coverage levels.¹⁵ Similarly, depositor protection often means the existence of a ‘pay box’ mandate,¹⁶ while financial stability requires broader powers for the deposit insurer in addition to its payout mandate. This chapter uses the UK regulatory regime as the main reference point and tries to explore the full potential of an effective deposit insurance system. The system’s objectives are divided into two broad categories: depositor protection (section 1.1), and financial stability (section 1.2). Section 1.3 concludes that a deposit insurance system could be effective only if designed to perform specific regulatory objectives; otherwise, authorities will continue to resort to other rescue measures, because this system will never be well equipped to respond to a bank failure. **1.04**

1.1 Deposit Insurance Can Protect Depositors...

1.1.1 Because They Are Unsecured Creditors

A person becomes a customer of a bank when he or she opens an account with it.¹⁷ The examination of this bank–customer relationship presents a key starting point for identifying depositors’ legal position within the UK financial system. This section builds **1.05**

¹⁴ See Chapter 5 for an analysis of those cases.

¹⁵ C. E. Blair, F. Carns, and R. M. Kushmeider, ‘Instituting a deposit insurance system: Why? How?’, in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007), p. 74.

¹⁶ The Financial Stability Board (FSB) has classified deposit protection systems into four broad categories: ‘pay box’ (narrow mandate systems that are responsible only for the reimbursement of insured deposits, e.g. those of Germany and Switzerland); ‘pay box plus’ (the deposit insurer has additional responsibilities, such as some specific resolution functions, e.g. those of Brazil and the United Kingdom); ‘loss minimizer’ (the insurer actively engages in the selection from a full suite of appropriate least-cost resolution strategies, e.g. those of Canada and France); and ‘risk minimizer’ (the insurer has comprehensive risk minimization functions, which include a full suite of resolution powers, as well as prudential oversight responsibilities, e.g. those of the Republic of Korea and the United States). See Financial Stability Board, *Thematic Review on Deposit Insurance Systems: Peer Review Report* (February 2012), online at http://www.financialstabilityboard.org/publications/r_120208.pdf, accessed 20 September 2013, pp. 16–17.

¹⁷ *Ladbroke & Co. v. Todd* (1914) 30 TLR 433; cf. *Tate v. Wilts and Dorset Bank* (1899) 1 LDAB 286, 20 JIB 376.

on Campbell and Singh's study of the legal aspects of depositor creditors' interests, which provide a solid basis for further analysis.¹⁸

- 1.06** *Edward Thomas Foley v. Thomas Hill and ors* (1848) authoritatively established a principle of banking law in an area that had previously been rather ambiguously treated: the relationship between a banker and customer, who deposits money with the bank, is the ordinary relationship of a debtor and creditor.¹⁹ It is not one of a principal and agent, hence is lacking a fiduciary character.²⁰ As Ellinger, Lomnicka, and Hooley explain, at the heart of a fiduciary relationship is the concept of 'selflessness', meaning that the fiduciary is expected to promote the interests of his or her beneficiary above his or her own interests.²¹ This is because a fiduciary has a duty of loyalty in addition to the duty of skill and competence expected of contracted parties. Therefore a bank should be expected to further its own commercial interests ahead of those of its customers, and English courts have well acknowledged this: '[B]anks are not charitable institutions.'²² In *Foley*: 'The money paid into the banker's [*sic*] is to all intents and purposes the banker's money. He makes what profit of it he can, which profit he retains to himself.'²³
- 1.07** Nevertheless, directors of banks are accountable for the way in which they conduct the affairs of the company and this is, inter alia, achieved by means of a number of duties imposed on them and owed to the company. A bank, like any other UK corporation, should be managed in good faith in the company's best interests. The common law has defined a company's interests, when solvent, as the interests of the present and future shareholders as a whole.²⁴ Creditors' and depositors' interests are therefore excluded from the scope of directors' duties. The revised section 172 of the Companies Act 2006 tried to move away from the objective of the company simply being one of maximization of shareholder value,²⁵ aiming instead to capture all stakeholders with an interest in the company, including creditors (the so-called 'enlightened shareholder value').²⁶ However, the relevant case law since

¹⁸ A. Campbell and D. Singh, 'Legal aspects of the interests of depositor creditors: The case for deposit protection systems', in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007).

¹⁹ *Edward Thomas Foley v. Thomas Hill and ors* (1848) 2 HLC 27, 9 ER 1002.

²⁰ *Governor and Company of the Bank of Scotland v. A Ltd* [2001] EWCA Civ 52, [25], per Lord Woolf CJ.

²¹ E. P. Ellinger, E. Lomnicka, and R. J. A. Hooley, *Ellinger's Modern Banking Law* (Oxford: Oxford University Press, 2009), p. 130.

²² *Ibid.*, quoting *National Westminster Bank plc v. Morgan* [1983] 3 All ER 85, 91, per Dunn LJ.

²³ *Edward Thomas Foley v. Thomas Hill and ors* (1848) 2 HLC 27, 9 ER 1002, 1005.

²⁴ *Percival v. Wright* [1902] 2 Ch 421 (Ch D); *Re Smith & Fawcett Ltd* [1942] Ch 304 (CA); *Howard Smith Ltd v. Ampol Petrol Ltd* [1974] AC 821 (PC).

²⁵ There is a more general tendency of questioning the Anglo-American 'shareholder wealth maximizing' model of corporation: see, e.g., C. A. Williams and J. M. Conley, 'An emerging third way? The erosion of the Anglo-American shareholder value construct', UNC Legal Studies Research Paper No. 04-09 (December 2004), online at <http://ssrn.com/abstract=632347>, accessed 4 June 2013.

²⁶ The provision led to more debate in the UK Parliament than any other provision contained in the whole Act, and the duty has given lawyers, companies and their directors the most concern: see,

the new codification of directors' duties seems to rely on pre-existing principles, demonstrating that it is quite likely that the *modus operandi* employed in the past by directors will continue.²⁷ As a result, banks' directors do not owe a duty to depositors and general corporate law provides limited assistance in this respect.

The creditors' 'weak' position, as noted above, is reversed when a company is experiencing financial difficulties that call its solvency into question: 'In an insolvency situation the interests of the company are in reality the interests of existing creditors alone.'²⁸ This logic recognizes the order of application of assets in insolvency, where the interests of creditors predominate over those of shareholders.²⁹ Creditors are paid first, in the order in which they are entitled to receive their funds. However, depositors of a bank fall into the category of unsecured creditors, which means that they queue for payment behind both preferred and secured creditors.³⁰ Because an insolvent bank is likely to have insufficient funds to repay all creditors, there is a strong case suggesting that depositors will rarely be paid. Even if they receive a part of their funds, there will be a significant delay before distributions to unsecured creditors can be made, in light of procedural obstacles, such as the verification of the existence of all claims, payment of the costs of the liquidation process, and repayment of preferred and secured creditors.³¹

1.08

In sum, a depositor's claim is only an unsecured contractual personal claim against the bank to repay the deposit, which does not attach to the proceeds of the deposit itself, whereas, for instance, an investor's claim against a failed investment services

1.09

e.g., House of Lords Standing Committee, *Debate on the Company Law Reform Bill* (11 July 2006), online at <http://www.publications.parliament.uk/pa/cm200506/cmstand/d/st060711/am/60711s01.htm>, accessed 4 June 2013.

²⁷ A. Key, 'The duty to promote the success of the company: Is it fit for purpose?' (2010), online at <http://www.law.leeds.ac.uk/assets/files/research/events/directors-duties/keay-the-duty-to-promote-the-success.pdf>, accessed 4 June 2013.

²⁸ *Brady v. Brady* [1986] 1 CLC 579.

²⁹ D. Petkovic, 'Directors' duties and the intrusion of creditors' interests', *Journal of International Banking Law*, Vol. 4, No. 4, pp. 166–170 (1989).

³⁰ Depositors' position differs in systems under which depositor preference exists. Depositor preference moves depositors above other unsecured liabilities in the creditor hierarchy and can take different forms, such as general, national, or insured depositor preference. In 2011, the UK Independent Commission on Banking recommended the adoption of insured depositor preference—that insured deposits should move above other unsecured creditors and above floating charge holders: Independent Commission on Banking, *Final Report: Recommendations* (September 2011), online at <https://www.gov.uk/government/news/independent-commission-on-banking-final-report>, accessed 4 June 2013. However, see Banking Liaison Panel, *Annual Report of the Banking Liaison Panel, 2011–2012* (June 2012), online at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/210269/banking_liaison_panel_annual_report2011_2012.pdf, accessed 4 June 2013, paras 4 and 8, where the Banking Liaison Panel warns that this policy may have a significant impact on senior creditors by placing them lower in the creditor hierarchy, which may ultimately lead to additional uncertainty for creditors, and higher borrowing costs and volatility for banks.

³¹ A. Campbell and D. Singh, 'Legal aspects of the interests of depositor creditors: The case for deposit protection systems', in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007), p. 47.

firm is a proprietary claim that attaches to the property that was entrusted to the investment firm to invest on behalf of the investor.³² Under UK law, a depositor is considered to be a creditor, who is neither a beneficiary of directors' duties, nor secured by general laws of insolvency. Therefore the deposit insurance system serves as a substitute—a necessary fill-in for deficiencies in depositor governance.³³ It is designed to guarantee that depositors will receive at least a minimum amount of their funds, irrespective of the quality of the bank's assets and more quickly than would otherwise be the case.³⁴ In this way, it constitutes a social provision addressed at protecting what used to be called in the banking industry 'widows and orphans'.³⁵

1.1.2 Because They Are Financially Unsophisticated Creditors

1.10 A curb on the high degree of discretion that the banker has over the way in which he or she can use depositors' money³⁶ is the fact that 'he has contracted, having received that money, to repay to the principal, when demanded, a sum equivalent to that paid into his hands'.³⁷ As a consequence, banks need to balance the interests of shareholders and depositors more than other corporations, given the large amount of funds that depositors provide to enable them to fund their business.³⁸ Depositors, by withdrawing their deposits on demand, have the ability to wield considerable influence over the decisions of bank management. This power is, however, limited as long as informational asymmetry in relation to a bank's business makes the timing of the decision to withdraw deposits 'virtually impossible'.³⁹ This

³² See K. Alexander, 'Safeguarding investors' interests by ensuring sound financing of an investor compensation scheme', in European Parliament, *Amending Directive 97/9/EC on Investor Compensation Schemes (ICS): Safeguarding Investors' Interests by Ensuring Sound Financing of ICS—Compilation of Briefing Notes* (February 2011), online at <http://www.europarl.europa.eu/document/activities/cont/201103/20110324ATT16420/20110324ATT16420EN.pdf>, accessed 4 June 2013.

³³ P. O. Mühlbert, 'Corporate governance of banks after the financial crisis: Theory, evidence, reforms', European Corporate Governance Institute Working Paper No. 151 (April 2010), online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1448118, accessed 5 June 2012.

³⁴ C. E. Blair, F. Carns, and R. M. Kushmeider, 'Instituting a deposit insurance system: Why? How?', in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007), p. 73.

³⁵ D. G. Mayes and G. E. Wood, 'Lessons from the Northern Rock episode', *Economie Internationale*, No. 114, pp. 5–27 (2008).

³⁶ A. Campbell and D. Singh, 'Legal aspects of the interests of depositor creditors: The case for deposit protection systems', in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007), p. 43.

³⁷ *Edward Thomas Foley v. Thomas Hill and ors* (1848) 2 HLC 27, 9 ER 1002, 1006.

³⁸ A. Campbell and D. Singh, 'Legal aspects of the interests of depositor creditors: The case for deposit protection systems', in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007), p. 45. Other corporations need not employ this kind of balance, because their value is unaffected by the way in which they are financed: see the 'Modigliani-Miller theorem', in F. Modigliani and M. H. Miller, 'The cost of capital, corporation finance and the theory of investment', *American Economic Review*, Vol. 48, No. 3, pp. 261–297 (1958).

³⁹ D. Singh and J. R. LaBrosse, 'Northern Rock, depositors and deposit insurance coverage: Some critical reflections', *Journal of Business Law*, No. 2, pp. 55–85 (2010).

information asymmetry provides a substantial justification for the regulation of financial services. It is often suggested that the answer to information asymmetry is more information, and regulators have required providers to offer more extensive descriptions of products and practices.⁴⁰

Assuming that depositors had the information needed at their disposal, it is thought unlikely that ordinary individuals have the expertise to assess banks' appetite for risks and to react accordingly to manage such risks. An individual depositor is, arguably, unable to make a judgement as to whether a bank represents a good credit risk and so mitigate the risk of bank failure. Banks' balance sheets are notoriously more opaque than those of firms in other sectors of the economy.⁴¹ The largest asset category of most banks is loans, which generate interest revenue. The quality of bank loans is not readily observable, whereas, for example, the quality of assets of industrial firms, such as machinery and plants, is more easily discernible by third parties. Furthermore, loans are made on a fixed-nominal value basis; the non-marketability of the asset portfolio creates uncertainty, making it difficult to assess the creditworthiness of the banks and to distinguish the riskiness of different strategies.⁴² The same holds true for the securities in which banks invest, such as asset-backed securities (ABSs), collateralized debt obligations (CDOs), and credit default swaps (CDSs). A bank holding a substantial portfolio of derivatives and securities with embedded options is subject to sharp changes in its risk profile, without the need for the bank to take new positions, since such complex investments share exposure to risk factors that are extremely sensitive to market conditions.⁴³ To ensure market confidence and stability, banks are required to have liquid reserves to meet any potential requests for repayment by depositors. However, it is unlikely that a retail depositor will understand whether a bank meets such requirements, given the lack of intimate business knowledge. In fact, even regulators and banks themselves were criticized for being unable to make informed judgements on those very measures or to assess banks' riskiness accurately in the run-up to the banking crisis.⁴⁴ Relying on the strength and reputation of a bank's brand is presumably the main way in which ordinary depositors will hope to gauge

⁴⁰ J. Kay, 'Narrow banking: The reform of banking regulation' (September 2009), online at <http://www.johnkay.com/wp-content/uploads/2009/12/JK-Narrow-Banking.pdf>, accessed 4 June 2013, p. 83.

⁴¹ A. Mullineux, 'The corporate governance of banks', *Journal of Financial Regulation and Compliance*, Vol. 14, No. 4, pp. 375–382 (2006).

⁴² R. M. Lastra, *Central Banking and Banking Regulation* (London: London School of Economics Financial Markets Group, 1996).

⁴³ P. O. Mülbart, 'Corporate governance of banks after the financial crisis: Theory, evidence, reforms', European Corporate Governance Institute Working Paper No. 151 (April 2010), online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1448118, accessed 5 June 2012.

⁴⁴ K. Swinton, 'A tale of two similes: "as safe as houses"; "Like money in the bank"', *Scottish Law Gazette*, Vol. 79, No. 3, pp. 68–71 (2011).

its financial health; tellingly, Northern Rock did well on that count—yet it failed.⁴⁵ All of these complexities lead to a creation of a kind of ‘elitism’ arising among those financiers who do understand a bank’s risks.⁴⁶

- 1.12** Another issue related to the above is that most people are not properly aware that their deposited money has been used to finance other activities, each of which has a risk attached.⁴⁷ Most bank depositors are ill-informed about their legal relationship with their bank: instead of being a lowly ranking unsecured creditor, the average bank depositor is likely to consider the relationship as being one in which the bank is actually looking after the depositor’s savings. This limited awareness produces a large group of ‘involuntary investors’ with inert interest in what the bank is actually doing with their money⁴⁸ and in diversifying their savings. In fact, most savers are likely to keep all, or a substantial proportion, of their savings at a branch of a single bank.⁴⁹
- 1.13** Even if customers had enough information, coupled with the analytical skills required to evaluate it, they might continue to lack the economic incentives to monitor financial institutions. The behaviour of depositors is likely to be influenced by the cost of tracking and analysing bank risk and the availability of alternatives for holding liquid funds; individuals would presumably shift some savings away from deposits rather than increase their monitoring activity. Large depositors and non-deposit creditors who supply unprotected short-term credit to large banking organizations might have the resources and analytical ability to distinguish among banks on the basis of their risk management. However, even these creditors may conclude that spending additional resources for these purposes is ineffective, on a cost–benefit basis.⁵⁰ Relying on individual depositors to carry out the monitoring function is likely to be more costly than centralizing such activity in either public or private facilities.⁵¹ Moreover, individual depositor assessments of bank risk would be more likely to lead to contagious runs than would better informed

⁴⁵ House of Commons Treasury Committee, *The Run on the Rock: Fifth Report of Session 2007–08, Vol. I* (January 2008), online at <http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtreasy/56/56i.pdf>, accessed 4 June 2013, p. 91.

⁴⁶ M. Bunting, ‘Outrage at the banks is everywhere, so why aren’t there riots on the streets?’, *The Guardian* (30 May 2011), online at <http://www.theguardian.com/commentisfree/2011/may/30/outrage-banks-riots-streets-muddled>, accessed 4 June 2013.

⁴⁷ J. R. LaBrosse and D. G. Mayes, ‘Promoting financial stability through effective depositor protection: The case for explicit limited deposit insurance’, in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007), p. 2.

⁴⁸ H. A. Garten, ‘Banking on the market: Relying on depositors to control bank risk’, *Yale Journal on Regulation*, Vol. 4, No. 1, pp. 129–172 (1986).

⁴⁹ A. Campbell and P. Cartwright, *Banks in Crisis: The Legal Response* (Burlington, VT: Ashgate, 2002).

⁵⁰ G. Hanc, ‘Deposit insurance reform: State of the debate’, *FDIC Banking Review*, Vol. 12, No. 3, pp. 1–26 (1999), online at http://www.fdic.gov/bank/analytical/banking/1999dec1_v12n3.pdf, accessed 4 June 2013, p. 8.

⁵¹ *Ibid.*, p. 7.

judgements;⁵² professional market participants would undoubtedly make better use of such information in monitoring bank risk.

Finally, individual depositors will lack the time to undertake a continuous assessment of the standing, riskiness, and reputation of several banks.⁵³ And assuming that depositors did have the expertise, will, resources, and time to monitor the banks, they would face a collective action problem because fellow depositors could freeride on their oversight.⁵⁴ Depositors therefore deserve some form of institutional response to their informational weaknesses and collective action problems,⁵⁵ to reduce their stake in the costs of monitoring and policing bank capital and loss exposures. Unlike investors, depositors are risk-averse, yet they face the possibility of bank insolvency.⁵⁶ Depositor protection mitigates the information externality problem that derives from depositors' limited access to banks' balance sheets and acts as an important counterweight to depositors' handling passivity, as well as their inability to distinguish confidently between solvent and insolvent institutions. 1.14

1.2 Deposit Insurance Can Strengthen Financial Stability...

1.2.1 Because It Can Prevent Bank Runs

Banks are socially valuable because they can use a costly monitoring technology to transform depositor funds into more productive investments.⁵⁷ This traditional business of banks of deposit-taking and lending—namely, borrowing short and lending long—gives rise to a distinct kind of risk, deriving from a potential sudden lack of available liquid funds: 'No bank, whether sound or ailing, holds enough liquid funds to redeem all or a significant share of its deposits on the spot.'⁵⁸ Although all financial institutions face asset-liability management problems, banks suffer a 1.15

⁵² Ibid.

⁵³ C. Goodhart, *The Evolution of Central Banks* (Cambridge, MA: MIT Press, 1988).

⁵⁴ J. E. Stiglitz, 'Introduction: S&L bailout', in J. R. Barth and R. D. Brumbaugh (eds), *The Reform of Federal Deposit Insurance: Disciplining the Government and Protecting Taxpayers* (New York: Harper Collins, 1992).

⁵⁵ K. Alexander, 'Safeguarding investors' interests by ensuring sound financing of an investor compensation scheme', in European Parliament, *Amending Directive 97/9/EC on Investor Compensation Schemes (ICS): Safeguarding Investors' Interests by Ensuring Sound Financing of ICS—Compilation of Briefing Notes* (February 2011), online at <http://www.europarl.europa.eu/document/activities/cont/201103/20110324ATT16420/20110324ATT16420EN.pdf>, accessed 4 June 2013.

⁵⁶ E. W. Bond and K. J. Crocker, 'Bank capitalization, deposit insurance, and risk categorization', *Journal of Risk and Insurance*, Vol. 60, No. 4, pp. 547–569 (1993), p. 548.

⁵⁷ A. D. Morrison and L. White, 'Deposit insurance and subsidized recapitalizations', *Journal of Banking and Finance*, Vol. 35, Iss. 12, pp. 3400–3416 (2011), p. 3401.

⁵⁸ European Commission, *Proposal for a Directive.../EU of the European Parliament and of the Council on Deposit Guarantee Schemes [recast]*, COM(2010) 368 final (12 July 2010), online at http://ec.europa.eu/governance/impact/ia_carried_out/docs/ia_2010/com_2010_0368_en.pdf, accessed 4 June 2013, p. 2.

particularly acute maturity mismatch, which is largely responsible for the particular problems of ensuring stability within the banking system.⁵⁹

- 1.16** Depositors' common law right to demand the deposited money at any time can result in the creation of a 'bank run'.⁶⁰ Sudden mass withdrawals of deposited funds in conjunction with loans' illiquidity, since they cannot be sold quickly without a loss in value,⁶¹ lead to a bank either experiencing liquidity problems or, in a worst-case scenario, being unable to meet its current liabilities and becoming insolvent. During a bank run, all depositors rush to withdraw their deposits in the fear that the bank will eventually fail. Yet sudden withdrawals of deposits could force even healthy banks to liquidate part of their assets at a loss and subsequently to fail: 'The belief that a bank run will occur is hence self-fulfilling.'⁶² McCoy explains that bank runs pose a classic prisoner's dilemma,⁶³ which results in two types of harm to depositors. The first is a matter of distributive justice: depositors at the end of the line lose their deposits altogether, while depositors at the front of the line receive their deposits in full. Second, depositors have a smaller pie to divide because the bank must liquidate assets at distress sale prices to try to satisfy the demand for withdrawals en masse.⁶⁴ The greater possibility of contagion at the banking industry level heightens the risks of unnecessarily large 'fire sale' losses caused by 'irrational' runs by depositors.⁶⁵ It follows that banking firms are in special need of external regulation because they are uniquely prone to runs, which could spread swiftly and bring down even solvent institutions.
- 1.17** Bank runs are costly because they interfere with the financial intermediation role—essential to the economy—that banks perform. Credit availability and economic activity can be adversely affected when loans are liquidated prematurely in order to meet depositors' claims.⁶⁶ Banks use the public's liquid funds to support productive illiquid investments; withdrawal of those funds leads to scarce

⁵⁹ R. M. Lastra, *Central Banking and Banking Regulation* (London: London School of Economics Financial Markets Group, 1996).

⁶⁰ D. W. Diamond and P. H. Dybvig, 'Bank runs, deposit insurance and liquidity', *Journal of Political Economy*, Vol. 91, No. 3, pp. 401–419 (1983).

⁶¹ R. M. Lastra, *Central Banking and Banking Regulation* (London: London School of Economics Financial Markets Group, 1996).

⁶² *Ibid.*, p. 82.

⁶³ In a prisoner's dilemma, individuals rationally refuse to cooperate even though cooperation would maximize everyone's benefit, because they cannot trust others to cooperate and they will suffer the worst result if they cooperate and others do not: P. A. McCoy, 'The moral hazard implications of deposit insurance: Theory and evidence', Seminar on Current Developments in Monetary and Financial Law (Washington, DC, 23–27 October 2006), online at <http://www.imf.org/external/np/seminars/eng/2006/mfl/pam.pdf>, accessed 4 June 2013, p. 6.

⁶⁴ *Ibid.*

⁶⁵ G. G. Kaufman, 'Bank failures, systemic risk, and bank regulation', *Cato Journal*, Vol. 16, No. 1, pp. 17–45 (1996).

⁶⁶ C. E. Blair, F. Carns, and R. M. Kushmeider, 'Instituting a deposit insurance system: Why? How?', in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007), p. 73.

allocation of savings to productive uses within the economy.⁶⁷ In the fear of runs, borrowers who may otherwise receive loans in a more favourable environment may not be funded, because banks are forced to maintain high levels of liquid assets.⁶⁸ During runs, if there are thousands of depositors with no access to their savings, this will also have a detrimental effect on the local economy and, in the case of a large bank, on the national economy.⁶⁹ Moreover, the panic that ensues from a bank run can spread to other similar banks as a result of a loss of mass confidence in the banking system, maximizing the risk of contagion. The random failure of a few banks could have wider implications for the banking system, since ‘investors worry not just about who is directly exposed to the bank, but also about who is exposed to anyone who is exposed’.⁷⁰ The loss of public confidence causes interruption of transactions and losses to creditor counterparties in interbank markets; this may in turn trigger a systemic crisis that not only endangers the health of the national financial system, but also creates imbalances at a cross-border level.

‘Though the specific purposes of banking regulation are to ensure the safety and soundness of the financial system and economic neutrality in the allocation of credit, the ultimate goal is to safeguard confidence in the banking system.’⁷¹ President Franklin Roosevelt, in his first ‘fireside chat’ to the people of the United States in 1933, noted that ‘there is an element in the readjustment of our financial system more important than currency, more important than gold, and that is the confidence of the people’.⁷² Public confidence in this context has a number of dimensions: it refers to the expectation that (a) deposits will be repaid in accordance with their terms; (b) normal banking services will continue to be available; (c) problems (or perceived problems) in one institution will not extend to other institutions (contagion); and (d) if an institution does fail, systems exist to protect the interests of depositors.⁷³ Diamond and Dybvig stressed that deposit insurance provides the security needed to ensure that problems of a bank in difficulty do not

⁶⁷ R. M. Lastra, *Central Banking and Banking Regulation* (London: London School of Economics Financial Markets Group, 1996).

⁶⁸ C. E. Blair, F. Carns, and R. M. Kushmeider, ‘Instituting a deposit insurance system: Why? How?’, in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007), p. 73.

⁶⁹ A. Campbell and D. Singh, ‘Legal aspects of the interests of depositor creditors: The case for deposit protection systems’, in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007), p. 50.

⁷⁰ R. Rajan, ‘Too big to save? Bailouts hurt capitalism—How we can keep from needing them in the first place’, *TIME* (30 January 2012).

⁷¹ R. M. Lastra, *Central Banking and Banking Regulation* (London: London School of Economics Financial Markets Group, 1996), p. 71.

⁷² Federal Deposit Insurance Corporation, ‘A brief history of deposit insurance in the United States’, Prepared for the International Conference on Deposit Insurance (Washington, DC, 10 September 1998), online at <http://www.fdic.gov/bank/historical/brief/brhist.pdf>, accessed 4 June 2013, p. 1.

⁷³ HM Treasury, *Banking Act 2009 Special Resolution Regime: Code of Practice* (November 2010), online at <https://www.gov.uk/government/publications/banking-act-2009-special-resolution-regime-code-of-practice>, accessed 28 November 2014, para. 3.10.

spread to a general loss of confidence and lead to run on the banks as a whole.⁷⁴ Deposit insurance makes late withdrawal as profitable as early withdrawal for depositors with no short-term consumption needs and prevents welfare-reducing bank runs from occurring.⁷⁵ As a result of the knowledge of the existence of this facility, a shock is much less likely to be converted into a crisis. Deposit protection is therefore necessary to restrain the banking industry from a tendency to collapse, by preventing the failure of individual institutions from triggering a wider failing process.⁷⁶ Gortsos explains that the failure of coordination among depositors under adverse market conditions, leading to runs and panics, could be solved either by suspending the convertibility of deposits into cash or by offering deposit guarantees.⁷⁷ Moreover, deposit insurance represents an expression of government support for a nation's banking system that reflects a concern about the potential for costly bank runs.⁷⁸

- 1.19** Morrison and White note that the value of deposit insurance is twofold: it contributes to keeping the banking sector at a socially desirable size; and, in this way, it stimulates bank investment.⁷⁹ In their model, the banking sector exhibits both adverse selection and moral hazard, which implies that the social benefits of bank monitoring must, for incentive reasons, be shared between depositors and banks. Nevertheless, socially, too few deposits are made in equilibrium and therefore deposit insurance corrects this market failure. Deposit insurance makes bank investment more attractive for depositors and improves social welfare. Morrison and White put emphasis upon sustaining bank lending at a socially optimal level,⁸⁰ while under the traditional view of Diamond and Dybvig, deposit insurance is a response to liquidity shocks.⁸¹
- 1.20** Summing up, whereas deposit insurance can protect banks from runs driven by depositors, it does not insulate them from other liquidity shocks, for example

⁷⁴ D. W. Diamond and P. H. Dybvig, 'Bank runs, deposit insurance and liquidity', *Journal of Political Economy*, Vol. 91, No. 3, pp. 401–419 (1983).

⁷⁵ A. D. Morrison and L. White, 'Deposit insurance and subsidized recapitalizations', *Journal of Banking and Finance*, Vol. 35, Iss. 12, pp. 3400–3416 (2011), p. 3402.

⁷⁶ S. E. Kenneth, 'Deposit insurance and bank regulation: The policy choices', *Business Lawyer*, Vol. 44, No. 3, pp. 907–933 (1989).

⁷⁷ C. Gortsos, 'Financial stability roles: Checks and balances', Presentation at the Joint Conference of International Association of Deposit Insurers and European Forum of Deposit Insurers (Rome, 30 September–1 October 2010), online at <http://efdi.eu/index.php?id=5&tx-filelist-pi1-37%5Bpath%5D=EFDI%20meeting%20documents&cHash=ff551ac7b6e763436f7f136aa0d80cbc>, accessed 3 June 2012.

⁷⁸ C. E. Blair, F. Carns, and R. M. Kushmeider, 'Instituting a deposit insurance system: Why? How?', in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007).

⁷⁹ A. D. Morrison and L. White, 'Deposit insurance and subsidized recapitalizations', *Journal of Banking and Finance*, Vol. 35, Iss. 12, pp. 3400–3416 (2011), p. 3401.

⁸⁰ *Ibid.*

⁸¹ D. W. Diamond and P. H. Dybvig, 'Bank runs, deposit insurance and liquidity', *Journal of Political Economy*, Vol. 91, No. 3, pp. 401–419 (1983).

should their interbank lenders refuse to roll over their loans. Notwithstanding the presence of deposit insurance, the justification for other safety-net arrangements still applies.⁸²

1.2.2 Because It Can Complement Banks' Resolution

The power to intervene in a timely way in the affairs of a troubled bank and manage an orderly resolution was the Achilles heel of most countries' official safety-net arrangements during the recent financial crisis. While preventive regulation and supervision are critical for reducing the frequency and severity of bank failure, they cannot and should not eliminate the risk of failure completely; an effective resolution framework is therefore an integral component of an effective regulatory framework.⁸³ **1.21**

According to Lastra, 'bank supervision', in a broad sense, can be defined as a process with four stages or phases: licensing; supervision, *sensu stricto*; sanctioning; and crisis management. Crisis management comprises the central bank's role as lender of last resort (LOLR), deposit insurance schemes, and bank insolvency proceedings.⁸⁴ A well-designed explicit deposit insurance system can facilitate the process for dealing with bank failures, adding to the resolution mechanisms. By swiftly meeting insured depositors' claims, a faster and more orderly closing procedure could be achieved. When the liquidation is not the preferred route and stabilization tools are applied in turn (for example transfer to a private purchaser or a bridge bank), deposit insurance could fund the use of these tools by contributing to the costs incurred. **1.22**

When having an explicit deposit insurance system, authorities' obligations to depositors are clear, limiting the scope of discretionary decisions or forbearance that may result in arbitrary actions. A rule-based system is more likely to be well established, eliminating delays and offering certainty to participants on where they would stand in a resolution process for failed banks. A basis for contingency planning is thus created, under which the role of each authority in the resolution of banks is defined.⁸⁵ Most importantly, depositors' claims are met within **1.23**

⁸² C. M. Kahn and J. A. C. Santos, 'Allocating bank regulatory powers: Lender of last resort, deposit insurance and supervision', Bank for International Settlements Working Paper No. 102 (August 2001), online at <http://www.bis.org/publ/work102.pdf>, accessed 5 June 2012, p. 3.

⁸³ E. Hüpkes, 'Allocating costs of failure resolution-shaping incentives and reducing moral hazard', in R. Lastra (ed.), *Cross-border Bank Insolvency* (Oxford: Oxford University Press, 2011), p. 105.

⁸⁴ R. M. Lastra, *Central Banking and Banking Regulation* (London: London School of Economics Financial Markets Group, 1996). As Lastra explains in her book, at p. 125: 'In theory, the lender of last resort role of the central bank is applied to cases of temporary illiquidity, whereas deposit insurance is applicable to situations of insolvency. In practice, it is often difficult to distinguish between illiquidity and insolvency because of the non-marketability of loans and the existence of information asymmetries.'

⁸⁵ J. R. LaBrosse and D. G. Mayes, 'Promoting financial stability through effective depositor protection: The case for explicit limited deposit insurance', in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007), p. 13.

certain parameters by a scheme focused on serving depositors and contributing to institutions' resolution. To this end, as Laeven notes, deposit insurance appeals increasingly to policymakers, because it sets the rules of the game on coverage, participants, and funding,⁸⁶ and different stakeholders have a better chance of knowing where they are likely to stand in the event of difficulty.⁸⁷

- 1.24** A regulatory or supervisory authority's ability to close troubled banks promptly has been seen as one of the highest assets amidst the latest financial turmoil.⁸⁸ Along these lines, there have been calls for extending deposit insurer's powers to reform the institutional structure of financial oversight and minimize forbearance in banks' resolution process.⁸⁹ Beck and Laeven show that bank stability can be better in countries in which the deposit insurer acquires broader supervisory responsibilities and the power to intervene in failing banks.⁹⁰ These powers may also include the ability to control entry and exit from the deposit insurance system, and responsibilities in other areas, including risk assessment and management.⁹¹ Since the deposit insurer will bear direct financial exposure to failures, typically being the largest creditor during liquidation, there is a case for acquiring a more important role in bank insolvency. Deposit insurers with a loss minimization mandate are required to decide on the most appropriate resolution method on the basis of a least-cost resolution principle. In contrast, the banking supervisor has a strong incentive to delay the closing of a bank, assuming an indulgent attitude, since a bank failure would also mean a supervisory failure, hence a negative impact on the supervisor's reputation. Such supervisory forbearance, in addition to increasing

⁸⁶ L. Laeven, 'Pricing of deposit insurance', in A. Demirgüç-Kunt, E. Kane, and L. Laeven (eds), *Deposit Insurance around the World: Issues of Design and Implementation* (Cambridge, MA: MIT Press, 2008).

⁸⁷ J. R. LaBrosse and D. G. Mayes, 'Promoting financial stability through effective depositor protection: The case for explicit limited deposit insurance', in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007), p. 4.

⁸⁸ For a detailed analysis of banks' resolution regimes, see Chapter 5.

⁸⁹ For the UK deposit insurer's new extended powers, see Chapter 2.

⁹⁰ T. Beck and L. Laeven, 'Resolution of failed banks by deposit insurers: Cross-country evidence', World Bank Working Paper No. 3920 (May 2006), online at http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2006/05/11/000016406_20060511121345/Rendered/PDF/wps3920.pdf, accessed 15 May 2013.

⁹¹ Existing deposit insurers have mandates ranging from narrow, so-called 'pay box' systems, to those with broader powers and responsibilities, such as loss or risk minimization or management, with a variety of combinations in between. Pay box systems are largely confined to paying the claims of depositors after a bank has been closed. Accordingly, they normally do not have prudential regulatory or supervisory responsibilities, or intervention powers. Nevertheless, a pay box system requires appropriate legal authorities, as well as access to deposit information and adequate funding, for the timely and efficient reimbursement of insured depositors when banks fail. On the other hand, a deposit insurer charged with loss or risk minimization or management is likely to have a relatively broad mandate and, accordingly, more powers. These powers may include: the ability to control entry and exit from the deposit insurance system; the ability to assess and manage its own risks; and the ability to conduct examinations of banks or to request such examinations. Such systems may provide financial assistance to troubled banks: Basel Committee on Banking Supervision and International Association of Deposit Insurers, *Core Principles for Effective Deposit Insurance Systems* (June 2009), online at <http://www.bis.org/publ/bcbs156.pdf>, accessed 4 June 2013, p. 10.

the costs of bank failures and in consequence funding demands for the deposit insurer, has detrimental effects on the financial system and economy as a whole.

Summing up, deposit protection contributes to the clarification and division of financial authorities' responsibilities for failed banks. The first objective of the new bank insolvency procedure, created by the Banking Act 2009, introduces a substantial change to the role of the deposit insurer in a bank's liquidation in the United Kingdom: under the previous regime, the bank liquidator had a duty of care towards all creditors of the bank; now he or she is protected and encouraged to give priority to deposit insurance claims.⁹² Using deposit insurance funds to support the exercise of the stabilization tools (such as transfer to a private purchaser or a bridge bank) is another key aspect of the new regime; an orderly resolution is value-preserving, and could avoid the uncertainties and delayed access to key banking functions involved in a depositor payout and a piecemeal liquidation of a failed bank's assets. Finally, as a result of the new regime, the deposit insurer participates in the Banking Liaison Panel, with the mandate of providing advice to HM Treasury about the effect of the new regime on banks, persons who do business with banks, and financial markets.⁹³ **1.25**

1.2.3 Because It Can Limit the Use of Public Funds

Whenever a crisis hits, interest in deposit guarantee arrangements arises, the current financial crisis being no exception.⁹⁴ According to data from the International Association of Deposit Insurers (IADI), during the 2007–08 global financial crisis, out of 51 jurisdictions, 19 adopted a blanket protection on a temporary basis (the UK government offered full guarantees to depositors of Northern Rock when the bank's failure in September 2007 caused a bank run) and 22 raised the insurance limit permanently, while 7 issued a temporary increase in insurance coverage.⁹⁵ **1.26**

Governments tend to take action to rescue failing banks, in light of the potential and unintended impact of bank failures on both the economy and society; contagion effects on other banks may lead to serious consequences, disrupting the payment system as a whole and causing discontent among a wide range of stakeholders. As a result, a government is always under political pressure to react to widespread banking problems to minimize their adverse effects at least on the **1.27**

⁹² HM Treasury, *Banking Act 2009 Special Resolution Regime: Code of Practice* (November 2010), online at <https://www.gov.uk/government/publications/banking-act-2009-special-resolution-regime-code-of-practice>, accessed 28 November 2014, para. 10.4.

⁹³ See Chapter 5 for a more detailed analysis of the Banking Act 2009.

⁹⁴ S. Schich, 'Financial crisis: Deposit insurance and related financial safety net aspects', *Financial Market Trends*, No. 2, pp. 1–39 (2008), online at <http://www.oecd.org/insurance/insurance/41894959.pdf>, accessed 4 June 2013.

⁹⁵ International Association of Deposit Insurers, *Handling of Systemic Crises: Research Paper* (July 2012), online at http://www.iadi.org/docs/Research_Paper-HSC-2012-08-final_for_public_consultation-clean.pdf, accessed 4 June 2013, p. 12.

weakest counterparties, such as depositors.⁹⁶ ‘In a panic, the authorities do not want to punish greedy or careless bankers, for many innocent people would suffer as well.’⁹⁷ In light of the intangible future benefits of teaching risk-loving bankers a lesson, they choose to avoid the possibility of being recorded for posterity as having left the system collapse.

- 1.28** A deepening crisis encourages a government to issue a blanket guarantee to fully protect and compensate all stakeholders. Implicit deposit insurance, as opposed to explicit deposit insurance, is a blanket guarantee for all sorts of depositors (insured and uninsured), other creditors, shareholders, and even the managing body of a bank:

A “blanket guarantee” is a declaration by authorities that in addition to the protection provided by limited coverage deposit insurance or other arrangements, certain deposits and perhaps other financial instruments will be protected.⁹⁸

Implicit deposit insurance often means that the bank remains in business either because it is ‘too big to fail’ (TBTF) or because it is politically difficult to close the bank, while explicit deposit insurance is applied *ex post*, following the closure of a bank.⁹⁹

- 1.29** The International Monetary Fund (IMF) and the World Bank stress that the precise form of a government guarantee has varied across countries, ranging from implicit guarantees and declarations of policy intentions, to a formal guarantee set out in legislation.¹⁰⁰

1. Implicit guarantees arise when the authorities make no public announcements, but in practice protect all creditors of each failed bank, thereby creating an expectation among market participants that similar steps will be taken in future cases of bank failure.

⁹⁶ ‘The political fallout from failing banks can be considerable. The reaction of politicians in many countries, particularly at the commencement of the crisis, demonstrated clearly that they wanted to be seen to be protecting banks and the banking system. Nowhere was this more evident than in the UK where the Prime Minister, Gordon Brown, continually made public pronouncements about what was being done to protect the depositing public: A. Campbell and R. M. Lastra, ‘Definition of bank insolvency and types of bank insolvency proceedings’, in R. M. Lastra (ed.), *Cross-border Bank Insolvency* (Oxford: Oxford University Press, 2011), p. 35.

⁹⁷ R. Rajan, ‘Too big to save? Bailouts hurt capitalism—How we can keep from needing them in the first place’, *TIME* (30 January 2012).

⁹⁸ Basel Committee on Banking Supervision and International Association of Deposit Insurers, *Core Principles for Effective Deposit Insurance Systems* (June 2009), online at <http://www.bis.org/publ/bcbis156.pdf>, accessed 4 June 2013, p. 13.

⁹⁹ R. Ayadi and R. M. Lastra, ‘Proposals for reforming deposit guarantee schemes in Europe’, *Journal of Banking Regulation*, Vol. 11, No. 3, pp. 210–222 (2010).

¹⁰⁰ International Monetary Fund and World Bank, *An Overview of the Legal, Institutional, and Regulatory Framework for Bank Insolvency* (April 2009), online at <http://www.imf.org/external/np/pp/eng/2009/041709.pdf>, accessed 4 June 2013, p. 64.

2. A declaration of policy intention is not formalized in law, but may, in some cases, prove sufficient to calm market fears—in particular when it represents a clear and credible indication of public policy.
3. Some countries go further by setting out in legislation a clear legal framework specifying how the guarantee will operate and providing market participants with an assurance that their claims will be repaid.

For example, on 17 September 2007, the UK government announced guarantee arrangements in respect of all existing retail savings in, and certain existing wholesale liabilities of, Northern Rock.¹⁰¹ This was a direct response to the large-scale withdrawal of deposits that followed Northern Rock's announcement on 13 September 2007 that it had asked for and received emergency financial support from the Bank of England.¹⁰² Notably, as Haldane highlights, expectations of state support have risen threefold since then.¹⁰³ **1.30**

The benefits of a blanket guarantee lie in its immediate impact on public confidence, hence eliminating incentives to withdraw deposits. Bank liability guarantees help to stabilize the financial system by increasing the likelihood that depositors and creditors will continue to provide a stable source of financing and high-quality investments at lower up-front fiscal costs relative to other options.¹⁰⁴ Moreover, the provision of blanket guarantees in periods of extreme financial distress is directed towards maintaining domestic and international confidence in the country's banking system.¹⁰⁵ The credibility of a blanket guarantee is the biggest benefit of this kind of support, because stakeholders' expectations stabilize immediately before other policies have time to take effect. Common determinants of a blanket guarantee's credibility include: the political commitment (and, sometimes, statutory backing) for the guarantee; the strength of the banking system and the bank **1.31**

¹⁰¹ HM Treasury, 'Statement by the Chancellor of the Exchequer on financial markets', Press Release No. 95/07 (17 September 2007), online at http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/press_95_07.htm, accessed 4 June 2013.

¹⁰² Similarly, in September 2008, the government put in place guarantee arrangements to safeguard certain wholesale borrowings and deposits with Bradford & Bingley, in order to provide 'assurance to wholesale depositors and borrowers, and preserve wider financial market instability and maximise proceeds in the downturn': House of Commons Treasury Committee, *Banking Crisis: Dealing with the Failure of the UK Banks—Seventh Report of Session 2008–09* (April 2009), online at <http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/416/416.pdf>, accessed 4 June 2013.

¹⁰³ A. G. Haldane, 'Have we solved "too big to fail"?', *VOX* (17 January 2013), online at <http://www.voxeu.org/article/have-we-solved-too-big-fail>, accessed 4 June 2013.

¹⁰⁴ S. Schich, 'Selected issues raised by the expansion of government guarantees for bank liabilities', Presentation at the Joint Conference of European Forum of Deposit Insurers and International Association of Deposit Insurers (Paris, 29–30 June 2009), online at <http://efdi.eu/index.php?id=5&tx-filelist-pi1-37%5Bpath%5D=EFDI%20meeting%20documents&cHash=ff551ac7b6e763436f7f136aa0d80cbc>, accessed 4 June 2012.

¹⁰⁵ Basel Committee on Banking Supervision and International Association of Deposit Insurers, *Core Principles for Effective Deposit Insurance Systems* (June 2009), online at <http://www.bis.org/publ/bcbs156.pdf>, accessed 4 June 2013, p. 13.

resolution framework; the perceived ability of the government to cover the resulting costs; and the strength and comprehensiveness of the authorities' communication strategy in describing the guarantee and how it will be financed.¹⁰⁶

- 1.32 Although a blanket government guarantee undoubtedly offers the best possible protection to depositors, it exposes ministries of finance to enormous costs.¹⁰⁷ Those forms of support might be much more effective than other forms, but only if such guarantees would not have to be used in practice.¹⁰⁸ Funding bank failures through government appropriations means reducing spending on social, infrastructure, and other needed programmes, hence adversely constraining a nation's future policy options.¹⁰⁹ It also means that taxpayers rescue banks that would otherwise fail. As *The Economist* says of the situation in Spain:

In the weeks before its listing last summer, Bankia inundated airwaves, bus stops and newspapers with an advertising campaign that invited viewers to buy shares and become a *bankero*. . . . On May 26th Spain's fourth-largest bank requested a €19 billion bail-out from the state. Like it or not, every Spanish taxpayer is now a *bankero*.¹¹⁰

Bebenroth, Dietrich, and Vollmer showed that the advantages of a bank-based financial system could be retained without the need to guarantee implicitly the survival of unfit banks; a bailout of troubled banks leads to even greater financial problems later and the eventual cost to the taxpayer cannot be known for many years.¹¹¹ Honohan and Klingebiel's analysis of 40 separate crises experienced between 1980 and 1997 indicated the trade-off between the fiscal costs caused by government guarantees and the speed of economic recovery.¹¹² Laeven and Valencia, using a sample of 42 episodes of banking crises, found that although blanket guarantees were successful in reducing liquidity pressures on banks arising from deposit withdrawals, they tended to be fiscally costly, in large part because

¹⁰⁶ International Monetary Fund and World Bank, *An Overview of the Legal, Institutional, and Regulatory Framework for Bank Insolvency* (April 2009), online at <http://www.imf.org/external/np/pp/eng/2009/041709.pdf>, accessed 4 June 2013, p. 63.

¹⁰⁷ J. R. LaBrosse and D. G. Mayes, 'Promoting financial stability through effective depositor protection: The case for explicit limited deposit insurance', in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007), p. 3.

¹⁰⁸ A. Campbell, J. R. LaBrosse, D. G. Mayes, and D. Singh, 'A new standard for deposit insurance and government guarantees after the crisis', *Journal of Financial Regulation and Compliance*, Vol. 17, No. 3, pp. 210–239 (2009).

¹⁰⁹ E. J. Kane and D. Klingebiel, 'Alternatives to blanket guarantees for containing a systemic crisis', *Journal of Financial Stability*, Vol. 1, No. 1, pp. 31–63 (2004).

¹¹⁰ *The Economist*, 'Spain's banking system: Teetering' (2 June 2012).

¹¹¹ R. Bebenroth, D. Dietrich, and U. Vollmer, 'Bank regulation and supervision in bank-dominated financial systems: A comparison between Japan and Germany', *European Journal of Law & Economics*, Vol. 27, No. 2, pp. 177–209 (2009).

¹¹² P. Honohan and D. Klingebiel, 'Controlling fiscal costs of banking crises', *Journal of Banking and Finance*, Vol. 27, No. 8, pp. 1539–1560 (2003).

they were employed in conjunction with extensive liquidity support and when crises were already severe.¹¹³

Most importantly, government guarantees exacerbate moral hazard: a government guarantee limits the incentive of banks to manage their risks prudently and of depositors to monitor banks' levels of risk. This is because a guarantee compensates everyone, including those with the foresight to monitor their deposits earlier in the process, as well as those who lacked such foresight:¹¹⁴ 'The longer the blanket guarantee remains in place, the more likely it is to give rise to additional moral hazard.'¹¹⁵ However, the negative effects on market discipline remain the case, even where the guarantee is retained for a short period of time.¹¹⁶ Furthermore, once implemented, it is difficult for the authorities to eliminate it and abstain from adopting it again in the future as a policy response; if banks and creditors have benefited from a blanket guarantee in one crisis, it is unlikely that they will act in the belief that they will not get such support in future crises. **1.33**

As long as there are no statutory rules specifying the eligibility of bank liabilities, the level of protection, and the form that reimbursement of funds will take,¹¹⁷ the payout is discretionary, and often depends on the government's willingness and ability to access public funds.¹¹⁸ In the case of a large failure, the generosity of the payout may be inadequate to meet the number of claimants, creating inequalities that exacerbate financial instability.¹¹⁹ **1.34**

Another challenge that a guarantee may pose is regulatory competition. If all deposits in a country's banks receive the benefit of complete government protection, then those banks will attract deposits, weakening those banking systems in **1.35**

¹¹³ L. Laeven and F. Valencia, 'The use of blanket guarantees in banking crises', International Monetary Fund Working Paper No. 250 (October 2008), online at <https://www.imf.org/external/pubs/ft/wp/2008/wp08250.pdf>.

¹¹⁴ J. R. LaBrosse and D. G. Mayes, 'Promoting financial stability through effective depositor protection: The case for explicit limited deposit insurance', in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007), p. 6.

¹¹⁵ Basel Committee on Banking Supervision and International Association of Deposit Insurers, *Core Principles for Effective Deposit Insurance Systems* (June 2009), online at <http://www.bis.org/publ/bcbs156.pdf>, accessed 4 June 2013, p. 14.

¹¹⁶ Financial Stability Forum, *Guidance for Developing Effective Deposit Insurance Systems: Final Report of the Working Group on Deposit Insurance* (September 2001), online at <http://www.fdic.gov/deposit/deposits/international/guidance/guidance/finalreport.pdf>, accessed 4 June 2013.

¹¹⁷ S. H. Talley, 'Deposit protection and the spread of deposit insurance: Some guidelines for developing countries', World Bank Note No. 12 (June 1994), online at <http://documents.worldbank.org/curated/en/1994/06/441490/deposit-protection-spread-deposit-insurance-some-guidelines-developing-countries>, accessed 5 June 2012.

¹¹⁸ A. Campbell, J. R. LaBrosse, D. G. Mayes, and D. Singh, 'A new standard for deposit insurance and government guarantees after the crisis', *Journal of Financial Regulation and Compliance*, Vol. 17, No. 3, pp. 210–239 (2009).

¹¹⁹ J. R. LaBrosse and D. G. Mayes, 'Promoting financial stability through effective depositor protection: The case for explicit limited deposit insurance', in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007).

other countries that are not dependent on such guarantees. This happened, for example, on 30 September 2008 in Ireland, where, to restore confidence, the government announced a blanket guarantee on all deposits of the six largest banks. Although this move did avert bank runs and the risk of disorderly withdrawals from the banking system, it caused consternation in other European countries, since there was a concern that the Irish actions might prompt deposit flight out of other banks and into Irish ones.¹²⁰ It is noteworthy that France, Germany, Italy, the Netherlands, Spain, and the United Kingdom announced liability guarantee programmes in the beginning of October 2008.¹²¹ As another example, in 2008, the Icelandic government announced a blanket guarantee for only domestic deposits, excluding deposits in banks' foreign branches, and this distinction gave rise to the Icesave dispute between the Icelandic authorities, on the one hand, and the Dutch and British authorities on the other.¹²² As described by the Investment Management Association (IMA), 'a blanket guarantee goes against the intention of the deposit protection legislation'.¹²³

- 1.36** Against this background, an effective deposit protection system limits government fiscal exposure, because it protects depositors without an immediate impact on the government budget and signals that failing banks must pay the cost of their own mismanagement. Formal deposit insurance is used to limit the payout to depositors in a situation in which there would otherwise be demands for full compensation.¹²⁴ Limiting public expectations of blanket coverage in bank failures reduces the political risks of allowing banks to close down. Ayadi and Lastra argue that:

...a third rationale of explicit deposit insurance (in addition to consumer protection and prevention of bank runs) is that it allows the public authorities to close banks more easily, as it becomes politically acceptable to liquidate insolvent institutions, in the knowledge that unsophisticated depositors are protected.¹²⁵

¹²⁰ C. Enoch, 'Crisis management and guarantees in Europe', in J. R. LaBrosse, R. Olivares-Caminal, and D. Singh (eds), *Financial Crisis Containment and Government Guarantees* (Cheltenham: Edward Elgar, 2013), p. 63.

¹²¹ F. Panetta, T. Faeh, G. Grande, C. Ho, M. King, A. Levy, F. Signoretti, M. Taboga, and A. Zaghini, 'An assessment of financial sector rescue programmes', Bank for International Settlements Paper No. 48 (July 2009), online at <http://www.bis.org/publ/bppdf/bispap48.pdf>, accessed 5 June 2012.

¹²² M. Guðmundsson, 'The fault lines in cross-border banking: Lessons from the Icelandic case', J. R. LaBrosse, R. Olivares-Caminal, and D. Singh (eds), *Financial Crisis Containment and Government Guarantees* (Cheltenham: Edward Elgar, 2013), p. 121. For a detailed analysis, see Chapter 4.

¹²³ House of Commons Treasury Committee, *Banking Crisis: Dealing with the Failure of the UK Banks—Seventh Report of Session 2008–09* (April 2009), online at <http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/416/416.pdf>, accessed 4 June 2013.

¹²⁴ R. Dale, 'Deposit insurance in theory and practice', in R. Dale, F. Bruni, and C. de Boissieu (eds), *Strengthening Financial Infrastructure: Deposit Insurance and Lending of Last Resort* (Amsterdam: Société Universitaire Européenne de Recherches Financières, 2000), p. 11.

¹²⁵ R. Ayadi and R. M. Lastra, 'Proposals for reforming deposit guarantee schemes in Europe', *Journal of Banking Regulation*, Vol. 11, No. 3, pp. 210–222 (2010).

As a result, it incentivizes banks and other creditors to act more prudently and to take measures to protect themselves from loss, given the ambiguity over whether the state will step in.¹²⁶

1.2.4 Because It Can Level the Playing Field

During the 2007–08 financial crisis, competition in the UK retail banking sector was criticized for being rather ineffective; it was argued that the lack of competition was a key contributor to the financial turmoil.¹²⁷ Markets for personal current accounts and banking services for small and medium-sized enterprises (SMEs) were seen as highly concentrated, and conditions for well-informed customer choice were perceived as poor, in part because of the difficulties of switching between banks.¹²⁸ **1.37**

Deposit insurance can stimulate retail banking competition, as small banks compete with the big ones, as well as public with private ones, on the basis of the same depositor protection. In the absence of deposit insurance, small institutions struggle to survive, since they need to pay higher rates of interest to attract deposits and hence take on much riskier activities. At the same time, depositors prefer to deal with large banks, in the expectation that those kinds of institutions will never fail, either because they are more stable as a result of their size or because the authorities will rescue them in light of the massive impact on the economy of their potential failure.¹²⁹ By favouring established firms, innovation in products and business processes is damaged.¹³⁰ Moreover, within those firms, senior management is encouraged to focus on trading activities at the expense of customer service, since customer choice is absent.¹³¹ Hüpkes explains that big firms enjoy an unfair competitive advantage over not only their smaller competitors, but also their rivals in other jurisdictions, where the authorities are more reluctant or constrained to use public money.¹³² **1.38**

¹²⁶ S. H. Talley, 'Deposit protection and the spread of deposit insurance: Some guidelines for developing countries', World Bank Note No. 12 (June 1994), online at <http://documents.worldbank.org/curated/en/1994/06/441490/deposit-protection-spread-deposit-insurance-some-guidelines-developing-countries>, accessed 5 June 2012.

¹²⁷ See Independent Commission on Banking, *Final Report: Recommendations* (September 2011), online at <https://www.gov.uk/government/news/independent-commission-on-banking-final-report>, accessed 4 June 2013.

¹²⁸ Ibid.

¹²⁹ The accusation of unfair competition has certainly been raised within the UK banking industry in relation to the fully nationalized Northern Rock: A. Campbell and R. M. Lastra, 'Definition of bank insolvency and types of bank insolvency proceedings', in R. M. Lastra (ed.), *Cross-border Bank Insolvency* (Oxford: Oxford University Press, 2011), p. 42.

¹³⁰ J. Kay, 'Narrow banking: The reform of banking regulation' (September 2009), online at <http://www.johnkay.com/wp-content/uploads/2009/12/JK-Narrow-Banking.pdf>, accessed 4 June 2013, p. 58.

¹³¹ Ibid.

¹³² E. Hüpkes, 'Allocating costs of failure resolution-shaping incentives and reducing moral hazard', in R. Lastra (ed.), *Cross-border Bank Insolvency* (Oxford: Oxford University Press, 2011), p. 105.

1.39 The existence of TBTF financial institutions has generated a lot of discussion following the recent global contagion.¹³³ The access to future government guarantees constituted a valuable asset of the largest banking organizations. It enhanced their value, for example given the rise of stock prices of TBTF banks that incurred in response to announcements of US government aid.¹³⁴ Calomiris cautions that TBTF protection in 2008 discouraged banks' proper increases of capital in response to losses, which were in fact feasible at that time.¹³⁵ Kaufman explains that TBTF is also relevant where a resolution regime is in existence: it refers to those cases in which, notwithstanding the resolution regime, governments intervene and do not permit select insolvent large firms to be resolved through the usual resolution processes that apply to other firms in the same industry, at least with respect to allocating losses.¹³⁶ Huertas stresses that TBTF is doubly damned: it is damned if governments do decide to support systemically important firms, because moral hazard erodes the correct pricing of risk, distorts competition, and creates fiscal burdens for governments and ultimately taxpayers; and it is damned if governments decide not to support a financial institution when the market had expected it to do so.¹³⁷ There is thus a consensus among policymakers that TBTF should

¹³³ According to Lastra, the term 'too big to fail' was coined after the open bank assistance offered to Continental Illinois in 1982 in the United States: R. M. Lastra, 'Systemic risk, SIFIs and financial stability', *Capital Markets Law Journal*, Vol. 5, No. 2, pp. 197–213 (2011). While the US government had provided assistance to large banks before, the experience with Continental Illinois set off the debate regarding institutions that are TBTF. Until the financial crisis of 2007–08, the term was mostly associated with size and with banks. The problems in Bear Stearns in 2008 brought a new dimension to this doctrine: some institutions were too interconnected to fail; American International Group, Inc. (AIG) confirmed this dimension. Bear Stearns and Lehman Brothers were investment banks (registered broker-dealers), whereas AIG was an insurance company. The TBTF doctrine had moved from (commercial) banks to securities firms and insurance companies. Then, the problems in Iceland in 2008 showed that some institutions were too big to *save*. In addition, the current debate about systemically important financial institutions (SIFIs) shows that some institutions are considered to be too important to fail and/or too complex to manage, and if they are too complex to manage, they are obviously too complex to control or supervise, since supervision should never have to be a substitute for good management. Similarly, according to Kaufman—'In banking, TBTF frequently also goes by other names, such as: "too big to unwind", "too big to liquidate", "too important to fail", "too complex to fail", "too interconnected to fail", and, most recently, "too big to prosecute or jail": G. G. Kaufman, 'Too big to fail in banking: What does it mean?', Presentation at the International Association of Deposit Insurers Research Conference on Evolution of the Deposit Insurance Framework: Design Features and Resolution Regimes (Basel, 9–10 April 2013), p. 3.

¹³⁴ E. Brewer III and A. M. Klingenhagen, 'Be careful what you wish for: The stock market reactions to bailing out large financial institutions—Evidence from the USA', *Journal of Financial Regulation and Compliance*, Vol. 18, No. 1, pp. 56–69 (2010).

¹³⁵ C. W. Calomiris, 'Why meaningful bank reform is so unlikely', Presentation at the Centre for Economic Policy Research Lunchtime Finance Forum (London, 17 January 2013), online at http://www.voxeu.org/sites/default/files/file/Calomiris_presentation.pdf, accessed 4 June 2013.

¹³⁶ G. G. Kaufman, 'Too big to fail in banking: What does it mean?', Presentation at the International Association of Deposit Insurers Research Conference on Evolution of the Deposit Insurance Framework: Design Features and Resolution Regimes (Basel, 9–10 April 2013).

¹³⁷ T. F. Huertas and R. M. Lastra, 'The perimeter issue: To what extent should *lex specialis* be extended to systemically significant financial institutions? An exit strategy from too big to fail', in R. Lastra (ed.), *Cross-border Bank Insolvency* (Oxford: Oxford University Press, 2011), p. 251.

become an outdated concept and that financial systems should have the means to allow those functions vital for financial stability to continue while permitting bank failure:¹³⁸ ‘When losses for the “very big” become socialised, capitalism not only loses its key virtue of allocating resources well and incentivizing their proper use, but it, most importantly, loses public legitimacy.’¹³⁹

As noted earlier in the chapter, deposit insurance can substantially curtail government guarantees and therefore prevent the bailing out of financial institutions of any size. As a result, any bank could fail and cease to receive the competitive advantages deriving from government support. Depositors enjoy a wider choice among equally secured institutions, irrespectively of whether they are new or established.¹⁴⁰ Moreover, a well-designed deposit insurance system, which imposes risk-based levies on banks, can facilitate the monitoring of banks for supervisors, as well as other market participants.¹⁴¹

1.3 Conclusions

The UK deposit insurance scheme—the FSCS—has been viewed as being inadequate to prevent the Northern Rock run in 2007, which led to government blanket guarantee arrangements.¹⁴² In 2008, the FSCS reimbursed the depositors of five banks that were declared in default by the Financial Services Authority (FSA)—Bradford & Bingley, Heritable Bank, Kaupthing Singer and Friedlander, Landsbanki Islands/Icesave, and London Scottish Bank¹⁴³—but actions were also taken by HM Treasury in respect of these banks to guarantee any deposits greater than the formal deposit protection limit.¹⁴⁴ In 2009, the FSCS contributed to the costs of the Dunfermline Building Society’s resolution, funding its transfer to Nationwide.¹⁴⁵

¹³⁸ See, e.g., D. G. Hayes, ‘Banking crisis resolution policy: Lessons from recent experience’, CESifo Working Paper No. 2823 (October 2009), online at <https://www.cesifo-group.de/portal/page/portal/96843356FF030D9FE04400144FAFBA7C>, accessed 5 June 2012.

¹³⁹ R. Rajan, ‘Too big to save? Bailouts hurt capitalism—How we can keep from needing them in the first place’, *TIME* (30 January 2012).

¹⁴⁰ Federal Deposit Insurance Corporation, *History of the Eighties: Lessons for the Future* (December 1997), <http://www.fdic.gov/bank/historical/history/>, accessed 4 June 2013.

¹⁴¹ C. E. Blair, F. Carns, and R. M. Kushmeider, ‘Instituting a deposit insurance system: Why? How?’, in A. Campbell, J. R. LaBrosse, D. Mayes, and D. Singh (eds), *Deposit Insurance* (Basingstoke: Palgrave Macmillan, 2007).

¹⁴² House of Lords, *Banking Supervision and Regulation: Second Report of Session 2008–09* (2009), online at <http://www.publications.parliament.uk/pa/ld200809/ldselect/ldeconaf/101/10108.htm#a20>, accessed 4 June 2013, para. 145.

¹⁴³ The FSCS paid out about £20 billion for them, borrowing also from HM Treasury: House of Commons Treasury Committee, *Banking Crisis: Dealing with the Failure of the UK Banks—Seventh Report of Session 2008–09* (April 2009), online at <http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/416/416.pdf>, accessed 4 June 2013, para. 86.

¹⁴⁴ *Ibid.*, para. 89.

¹⁴⁵ Financial Services Compensation Scheme, ‘Dunfermline Building Society: Authorities step in to safeguard savers’ (30 March 2009), online at <http://www.fscs.org.uk/news/2009/march/>

- 1.42** These recent examples lead to the conclusion that the FSCS was unable to meet its objectives to prevent bank runs and to protect depositors in full, and that its primary function was to serve as a source of funding in resolution or as a means of depositor compensation in the event of insolvency of small banks or credit unions. In 2010, the FSA decided to increase deposit insurance protection to £85,000;¹⁴⁶ such a high coverage level points towards a broader mandate for the deposit insurer, which encompasses financial stability considerations. Moreover, a deposit guarantee scheme serves different regulatory objectives from a resolution fund, which aims to finance resolution needs. Given the systemic risk and increased demands on banking regulator and supervisor, the financial safety net needs to be designed with clear mandates for each participant, and the goals of financial stability and depositor protection need to be viewed as highly interconnected. In a different scenario, authorities will continue to resort to other rescue measures, because the regulatory structure will not be well equipped to respond to a bank failure.
- 1.43** Bearing all of these factors in mind, the objectives and design of the deposit guarantee scheme need careful consideration.

dunfermline-building-society-authorities-step-in-to-safeguard-savers/index.html, accessed 4 June 2013.

¹⁴⁶ Financial Services Authority, *Compensation Sourcebook (Deposit Guarantee Schemes Directive Amendments) (No. 2) Instrument 2010*, FSA 2010/71 (16 December 2010), online at http://media.fshandbook.info/Legislation/2010/2010_71.pdf, accessed 28 November 2014.