

Deposit protection and investor compensation in Germany

The EC Deposit Guarantee and Investor Compensation Directives were translated into German law by the 1998 Deposit Guarantee and Investor Compensation Act. This has led in Germany to the creation of statutory deposit protection schemes that comply with the harmonised provisions of the EU directives. These schemes coexist with the already-established voluntary deposit protection schemes operated by the various categories of banks, on which we last reported in the July 1992 Monthly Report of the Deutsche Bundesbank. This means that depositors continue to have their accustomed level of protection, while a special protection for investors has been created for the first time. The subject of the earlier article was deposit protection in Germany operated on the basis of the banks' own voluntary self-help schemes. The present article is intended to provide a supplementary account of the revised system of compensation for deposits and investment business following the entry into force of the Deposit Guarantee and Investor Compensation Act.

The Deposit Guarantee and Investor Compensation Act entered into force in Germany with effect from August 1, 1998 for the joint implementation of the EC Deposit Guarantee Directive (94/19/EC of May 30, 1994) and the EC Investor Compensation Directive (97/9/EC of March 3, 1997). The Deposit Guarantee Directive for harmonising the deposit guaran-

*Deposit
Guarantee
Directive*

tee schemes in the EU member states provided for its translation into national law by July 1, 1995. The delayed implementation of this directive in Germany was also due to an action filed by the Federal Republic of Germany against the Deposit Guarantee Directive at the European Court of Justice. A petition was made to declare the directive void. In the alternative, the action was directed against the directive's provisions on the "export ban" and on "topping-up", and against the principle of compulsory membership in a deposit guarantee scheme. The directive provided for credit institutions from countries with a higher level of cover being permitted to guarantee only the level of cover of the host country for their foreign establishments (export ban). Deposit protection schemes with a higher level of cover have to admit the branches of foreign credit institutions in order to guarantee them the same scope of cover in the host country as that of the institutions based there (topping-up). The action was rejected by the European Court of Justice in a ruling of May 13, 1997.

*Investor
Compensation
Directive*

The Investor Compensation Directive, which is largely modelled on the Deposit Guarantee Directive, was to be implemented by the member states before September 26, 1998. Unlike the situation pertaining to deposit protection, in Germany there had previously not been any voluntary investor compensation system for customers of undertakings – other than credit institutions – providing investment services. Harmonisation at the EU level now extends the scope of protection explicitly to investment services provided by credit institutions and financial services institutions (insti-

tutions). The scope of protection covers funds, securities, derivatives and money market instruments. Investor protection comes into play if an institution is no longer in a position to pay back funds that it owes investors in connection with investment business, or to return securities or financial instruments that belong to investors and which the institution holds in custody or manages for the investors. However, the act does not safeguard claims resulting from unsound investment advice or if the issuer of the securities becomes insolvent.

Following the rejection of the action by the European Court of Justice in 1997, the timing as well as practical considerations made it convenient to implement both directives together in one act in Germany, since both directives contain largely identical, harmonised minimum provisions in terms of the scope and amount of creditor protection.

The Act Implementing the EC Deposit Guarantee Directive and the EC Investor Compensation Directive (Deposit Guarantee and Investor Compensation Act) means that, for the first time in Germany, there are statutory provisions for the protection of deposits and of claims arising from investment business. Until the act came into force, deposits were protected solely by the voluntary private-law self-help schemes operated by the various associations of banks. Statutory provisions specifically governing deposit protection were not required in Germany in the past. In fact, the existing voluntary system of deposit protection strengthened the conviction that such private-law deposit protection systems in the

*Deposit
Guarantee
and Investor
Compensation
Act augments ...*

... existing
voluntary
deposit
protection
system

form of the banks' self-help schemes can ensure that bank creditors are provided with an adequate degree of protection that takes due account of the particular sensitivity to fluctuations in confidence in the banking industry, without having to have recourse to government if an institution collapses. The existing deposit protection schemes in Germany play a major part in fostering confidence in the stability of the German banking system. Small investors, in particular, should be adequately protected if their bank fails. A guarantee threshold, which may result in the loss – as a retention – even of parts of small deposit balances, would run counter to such a system-stabilising protection of depositor confidence. In this connection, too much emphasis is placed in most cases on the problem of moral hazard in banks' behaviour. It is assumed that a high degree of deposit protection will result in non-risk-oriented behaviour on the part of depositors when selecting a credit institution, and this is generally discussed as an argument for a perceptible limiting of individual guarantee thresholds. This problem has so far not become apparent in Germany. When weighing up the competing approaches, moral hazard behaviour by banks can be countered by means of efficient banking supervision and risk control by the private guarantee schemes themselves. The disciplinary effect of an individual assessment of a bank's solvency by its current and potential depositors – which is to be prompted by a low guarantee threshold or retention by the depositors – is, at all events, subject to many different qualifications.

Owing to positive experience of the system of private deposit protection in Germany, the le-

gislative intention when implementing the Deposit Guarantee Directive was geared to maintaining the voluntary system of deposit protection even after the Deposit Guarantee and Investor Compensation Act had entered into force, i.e. to ensure that statutorily required minimum cover was augmented. Even the Deposit Guarantee Directive does not call into question the retaining of established national systems. Given the structures of deposit protection that have evolved in Germany, the requirements of harmonisation contained in the directive have thus been implemented faithfully by the Deposit Guarantee and Investor Compensation Act.

Implementation of the harmonised provisions of the Deposit Guarantee and Investor Compensation Directives

Compulsory membership in a deposit guarantee scheme

Under the Deposit Guarantee and Investor Compensation Act, all deposit-taking credit institutions under private and public law as well as all securities trading firms are obliged to cover their deposits and liabilities arising from investment business through membership in a statutory compensation scheme. For constitutional reasons, institutions' compulsory membership in a guarantee scheme as prescribed by the directives requires a system of protection that is organised on the basis of public law. It was therefore not possible to implement the Deposit Guarantee Directive solely within the framework provided by the existing private-law self-help schemes of the

*Public-law
system required*

banking industry. Participation in a statutory compensation scheme is also compulsory for those institutions which already belong to the banking associations' voluntary protection schemes.

Categories of institutions exempted from the provisions of the Deposit Guarantee and Investor Compensation Act

In conformity with the Deposit Guarantee Directive, the Deposit Guarantee and Investor Compensation Act exempts members of schemes safeguarding the viability of institutions from compulsory membership in a statutory compensation scheme. Members of the schemes which safeguard the viability of institutions are exempt if, by virtue of their by-laws, the schemes protect the member credit institutions themselves, i.e. prevent impending insolvency through restructuring. The guarantee schemes of the Federal Association of German People's Banks and Raiffeisen Banks, or operated by the regional cooperative associations and the German Savings Bank and Giro Association or the regional savings bank associations, protect the institutions by virtue of their by-laws, and are therefore deemed to be systems which can substitute for compulsory membership in the statutory compensation scheme under the terms of the directive.

The German savings bank system has amended its specimen by-laws to bring them into line with the Deposit Guarantee and Investor Compensation Act: the Land banks/regional giro institutions and the regional building and loan associations have now been explicitly included in the protection of institutions provided by the savings bank schemes. Consequently, these institutions do not have to be

members of a statutory guarantee scheme either.

Implementing the two EC directives in the Deposit Guarantee and Investor Compensation Act also entailed amendments to the Banking Act. Section 23a (Guarantee scheme) now provides that an institution which conducts banking business within the meaning of section 1 (1) sentence 2 numbers 1, 4 or 10 of the Banking Act (deposit business, principal broking services, underwriting business) or which provides financial services within the meaning of section 1 (1a) sentence 2 numbers 1 to 4 (investment broking, contract broking, portfolio management, own-account trading) shall draw attention in its price list to its membership in a compensation scheme. New customers have to be informed about the guarantee provisions, including the amount and scope of the guarantee. Section 32 (3) and (3a) of the Banking Act now provides that, before granting the licence, the Federal Banking Supervisory Office shall consult the guarantee scheme appropriate for the institution, and shall, on granting the licence, inform the institution, if it is liable to pay contributions under the Deposit Guarantee and Investor Compensation Act, of the compensation scheme to which it has been assigned. Under the Deposit Guarantee and Investor Compensation Act the Federal Banking Supervisory Office may, in a closely restricted number of cases, assign an institution, on request, to a compensation scheme other than that provided for by law. Pursuant to section 35 (1) of the Banking Act, an institution's licence expires if the institution has been excluded from the relevant statutory

Amendment to the Banking Act

compensation scheme. In particular, this may be the case if an institution fails to meet the statutory contribution or cooperation requirements.

*Investor
protection
at credit
institutions*

Also, if credit institutions belong to a deposit protection scheme they are not obliged to be members of an investor compensation scheme as well, since the scope of their statutory protection also covers investment services.

Statutory compensation schemes

*Compensation
schemes for
three categories
of institutions*

The Deposit Guarantee and Investor Compensation Act provides for the establishment of different compensation schemes for three categories of institutions: private deposit-taking credit institutions including private building and loan associations, public deposit-taking credit institutions, and "other institutions". The last category includes those institutions which are not deposit-taking credit institutions: in other words, institutions (securities trading banks, financial services institutions, investment companies) which conduct investment and contract broking, portfolio management or own-account trading or principal broking or underwriting business, respectively. The Deposit Guarantee and Investor Compensation Act does not cover financial services institutions which are not securities trading firms, the business of which is geared solely to non-EEA deposit broking, money transmission services or foreign currency dealing.

Under the Deposit Guarantee and Investor Compensation Act, the statutory compensation schemes are set up at the Reconstruction Loan Corporation (*Kreditanstalt für Wiederaufbau*), a specialised bank of the Federal Government, as special Federal funds having no legal personality.

*Compensation
schemes ...*

The functions and powers of a compensation scheme may be assigned to a private-law entity, however, if the latter meets the requirements for performing the statutory functions of the compensation scheme pursuant to the Deposit Guarantee and Investor Compensation Act. By allowing such public-law functions to be assigned to private-law entities, the act has made it possible, firstly, to ease pressure on the public sector and, secondly, to make use of the private initiative and expertise that are available in the field of deposit protection. For this purpose, the function of an "entrusted compensation scheme" has to be assigned by regulation to private-law legal entities. The legal status of an entrusted compensation scheme is determined by public law under the statutory mandate of the Deposit Guarantee and Investor Compensation Act. The compensation schemes may take administrative action such as decisions on contributions and ordering audits. The Federal Banking Supervisory Office will take a decision on any objections to administrative acts. The compensation schemes have a partial legal capacity; in the course of their business operations they may themselves sue, or be sued, at an administrative court.

*... may be
operated by
private-law
entities*

The compensation schemes under the Deposit Guarantee and Investor Compensation

Act are subject to supervision by the Federal Banking Supervisory Office. The Federal Banking Supervisory Office is to counteract any irregularities which may impair the proper performance of the functions of a compensation scheme or jeopardise the assets accumulated. The alternative protection schemes of the savings bank and cooperative sectors are also subject to supervision. The Federal Banking Supervisory Office also oversees whether these schemes meet the requirements of the act – in particular, the requirements pertaining to solvency and liquidity, and the availability of the necessary assets. For this purpose, under the Deposit Guarantee and Investor Compensation Act there exist special requirements to provide information on the amount and investment of the funds, and the use of the funds for compensation paid. To that end, an approved annual report provided with an audit certificate is to be submitted to the Federal Banking Supervisory Office and the Deutsche Bundesbank. Furthermore, the Federal Banking Supervisory Office has the same rights to receive information and order audits as it has vis-à-vis an individual institution pursuant to section 44 (1) of the Banking Act. The Deposit Guarantee and Investor Compensation Act also gives the Federal Banking Supervisory Office authority to issue orders to the persons charged with the functions and powers of the compensation schemes for the purpose of preventing or helping to eliminate irregularities.

Compensation schemes of the deposit-taking credit institutions

In setting up the statutory compensation schemes for the deposit-taking credit institutions which come under the Deposit Guarantee and Investor Compensation Act, it was possible to use the established organisational structure of the relevant banking associations. The Federal Association of German Banks (*Bundesverband deutscher Banken*) and the Federal Association of Public Banks (*Bundesverband Öffentlicher Banken Deutschlands*) declared that they were prepared to assume the responsibilities and powers of an entrusted compensation scheme for the categories of private and public credit institutions, respectively. Those responsibilities and powers were assigned to them by the Federal Ministry of Finance by regulations of August 24, 1998. The Federal Association of German Banks has set up a private limited company for this purpose (*Entschädigungseinrichtung deutscher Banken GmbH*). Assigned to this compensation scheme are deposit-taking credit institutions under private law which are simultaneously members of the Federal Association of German Banks and of its voluntary Deposit Guarantee Fund, and whose deposits are additionally protected by that fund. The private building and loan associations and those private institutions which do not belong to any voluntary deposit protection scheme are additionally assigned to this compensation scheme. The Federal Association of Public Banks has set up a similar compensation scheme of its own for the category of public-law credit institutions, the *Entschädigungseinrichtung des Bundes-*

*Entrusted
compensation
schemes of
the Federal
Association of
German Banks
and the Federal
Association of
Public Banks*

verbandes Öffentlicher Banken Deutschlands GmbH. For the institutions, assignment to a statutory compensation scheme does not constitute membership comparable to the model of associations in the banking industry.

The newly established compensation schemes of the Federal Association of German Banks and the Federal Association of Public Banks are legally independent subsidiaries of the two respective associations. All shares in the subscribed capital are held by the respective association in question. The performance of the compensation schemes' functions is both legally and organisationally separate from the associations' own voluntary Deposit Guarantee Funds.

Under the act, there is adequate assurance that the claims of the persons eligible to be compensated will be satisfied if the entrusted compensation scheme has resources of its own equivalent to € 1 million or more. In setting up the compensation schemes for deposit-taking credit institutions, the minimum amount was provided by the transfer of funds from the voluntary deposit protection schemes of the Federal Association of German Banks and the Federal Association of Public Banks.

Compensation scheme of the securities trading firms

Unlike the credit institutions, the securities trading firms were not in a position to effect a solution at the association level. Under the Deposit Guarantee and Investor Compensation Act, therefore, a compensation scheme

(Entschädigungseinrichtung der Wertpapierhandelsunternehmen) was set up at the Reconstruction Loan Corporation. All other institutions that must belong to a guarantee scheme under the terms of the act are assigned to the compensation scheme at the Reconstruction Loan Corporation. A first-time contribution was needed to meet the minimum statutory provision of funds. Depending on the type of institution and the scope of the licence, this contribution amounted to 0.1% or 1% of the liable capital or of at least the statutory initial capital, respectively, of the institution in question and had to be paid within two months of the act coming into force.

Scope of the right to compensation

The deposit guarantee and investor compensation directives require no more than minimum harmonisation for the protection of depositors and investors. In terms of the scope and amount of the rights to compensation, the Deposit Guarantee and Investor Compensation Act is geared to these harmonised minimum requirements of the two EC directives. Deposits in the narrow sense are protected as well as certain investment services provided in principal broking, safe custody and underwriting business, investment and contract broking, portfolio management and own-account trading.

Under the act, a creditor's right to compensation arising from deposits and investment business is based on the following factors:

*Harmonised
minimum
requirements
of the EC
directives*

*Compensation
scheme set up
at the Recon-
struction Loan
Corporation*

*What is
protected?*

Essentially, account balances and claims arising from registered debt securities are deemed to be protected deposits. Claims arising from bearer or order bonds do not fall within the definition of protected deposits. No right to compensation exists if deposits or funds are not denominated in the currency of a country in the European Economic Area or in euro.

Claims for the transfer of ownership of securities or the disbursement of funds in connection with investment business, such as proceeds from the sale of securities, are deemed to be protected claims arising from investment business. If there exist claims arising from both deposits and investment services, these may each be asserted separately. In the case of deposit-taking credit institutions, claims for the disbursement of funds in connection with investment business are deemed to be deposits; with such institutions, the legal claim to compensation arising from investment business therefore covers solely the claim to surrender the securities. In investment business, the calculation of the amount of the claim to compensation is based on the market value of the financial instruments on the date when it is determined that compensation is payable.

*What amount is
protected?*

For both protected deposits and claims arising from investment business, the amount of the claim to compensation is limited to 90 % of the non-fulfilled claims (i.e. a retention of 10 %) and the equivalent of € 20,000 for each creditor.

The claims of certain groups of depositors, which do not require any special protection under the provisions of the directives, are also excluded from statutory compensation under the Deposit Guarantee and Investor Compensation Act. In particular, these are credit institutions, financial services institutions, other financial institutions and investment companies (including the special funds managed by them), public bodies, medium-sized and large incorporated enterprises, insurance enterprises, as well as creditors in certain group relationships.

If a credit institution is additionally a voluntary member of a deposit protection scheme operated by the banking associations, this supplements the statutory protection. The type and scope of the supplementary cover is based on the by-laws of the voluntary protection scheme in question. The scope of protection and the amount of deposit cover in the voluntary supplementary deposit protection scheme have not changed following the entry into force of the Deposit Guarantee and Investor Compensation Act.

The directives also call for the protection of customers of branches which institutions have established in other member states of the European Economic Area. Such branches do not require authorisation by the supervisory authority of the host country. The establishment of such branches merely has to be reported to the supervisory authority in question. In the single European market with freedom of establishment and cross-border transactions in services, the home-country banking

*Who is
excluded from
protection?*

*Voluntary
protection as a
supplement to
statutory
protection*

*Protection of
customers at
branches
abroad*

supervisory authority is responsible for these branches.

Protection of depositors at foreign branches in Germany

Under the Deposit Guarantee and Investor Compensation Act, branches in Germany of enterprises domiciled in another state of the European Economic Area have the right to join a statutory compensation scheme provided that the level or scope of statutory compensation exceeds the level of cover in the enterprise's home country (topping-up). As the Deposit Guarantee and Investor Compensation Act has implemented only the minimum requirements of the directives, there is virtually no need for increasing the branch offices' scope of cover.

"Topping-up" virtually irrelevant in Germany

The supplementary voluntary deposit protection schemes operated by the banking associations, which ensure a higher level of cover, are not affected by the act and, therefore, the statutory right of "topping up". However, branches of foreign private credit institutions may apply for membership in the voluntary Deposit Guarantee Fund of the Federal Association of German Banks. Branches of foreign institutions may be admitted if they meet the requirements for membership under the by-laws of the association's Deposit Guarantee Fund. For branches of EU credit institutions which are not additionally members of a voluntary German deposit protection scheme, sole responsibility lies with the deposit protection system in the home country.

Branches of enterprises domiciled in non-EEA countries, which are deemed to be a credit institution or a financial services institution pursuant to section 53 of the Banking Act, come

under the Deposit Guarantee and Investor Compensation Act and must belong to a compensation scheme in Germany.

The Deposit Guarantee and the Investor Compensation Directives initially provided for institutions from member states with a higher level of cover for their branches abroad granting only the level of cover of the host country (export ban). This provision was in force for a limited period until December 31, 1999 and was one of the points addressed by the Federal Republic of Germany's action at the European Court of Justice, but was not extended by the Commission. Since January 1, 2000 branches of credit institutions from other member states may therefore offer deposit guarantees in the host country that exceed the statutory level of cover of the host country. Section 14 of the Deposit Guarantee and Investor Compensation Act which implemented the export ban in respect of German institutions' branches in other states of the European Economic Area is therefore no longer required. It was of minor importance in any case as only the minimum requirements of the directives were implemented.

Protection of depositors at foreign branches of German institutions

Export ban expired

The table on page 38 gives an overview of the status and limits to cover of the deposit guarantee schemes in the European Economic Area.

Funding of the statutory compensation schemes

Under the Deposit Guarantee and Investor Compensation Act, protection schemes have

Status and cover limits of the deposit guarantee schemes in the European Economic Area

Country	Status 1	Compensation amount 2	
		euro	national currency
Austria	Priv.	6 20,000	
Belgium	M (Publ./Priv.)	3 20,000	
Denmark	Priv.	40,000	DKK 300,000
Finland	Priv.	25,000	
France	Priv./E	60,000	
Germany	Priv./E	4 20,000 (90 %)	
Greece	Publ./Priv.	20,000	
Iceland	Priv.	20,000	ISK 1,700,000
Ireland	Publ.	3 20,000 (90 %)	
Italy	Priv.	103,000	
Liechtenstein	Priv.	5 19,000	CHF 30,000
Luxembourg	Priv.	3 20,000	
Netherlands	Priv.	20,000	
Norway	Publ./Priv.	250,000	NOK 2,000,000
Portugal	Publ./Priv.	25,000	
Sweden	Publ.	25,000	SEK 250,000
Spain	M	3 20,000	
United Kingdom	Publ.	22,000 (90 %)	7 20,000 GBP (90 %)

Source: European Commission, COM (1999) 722, of December 22, 1999. — 1 Status: mixed: M; public: Publ.; private: Priv.; equivalent: E. — 2 For specific regulations on the amount of compensation and on the scope of protected liabilities and/or protected creditors, please refer to the national compensation scheme concerned. — 3 Compensation from January 1, 2000; € 15,000 up to December 31, 1999. — 4 90 % of the deposits, maximum € 20,000; institutional protection by the Federal Association of German People's Banks and Raiffeisen Banks, and German Savings Bank and Giro Association; supplementary cover by voluntary schemes operated, in particular, by the Federal Association of German Banks, the Federal Association of Public Banks, the private building and loan associations. — 5 No Commission data in euro; ECB euro reference exchange rate at end-April 2000. — 6 90 % of the deposits of legal persons are covered. — 7 90 % of the deposits up to a maximum amount of GBP 20,000.

ation of German People's Banks and Raiffeisen Banks, and German Savings Bank and Giro Association; supplementary cover by voluntary schemes operated, in particular, by the Federal Association of German Banks, the Federal Association of Public Banks, the private building and loan associations. — 5 No Commission data in euro; ECB euro reference exchange rate at end-April 2000. — 6 90 % of the deposits of legal persons are covered. — 7 90 % of the deposits up to a maximum amount of GBP 20,000.

Deutsche Bundesbank

Funds raised by the institutions assigned to the respective schemes

to pay compensation from the funds raised by contributions after the deduction of the costs. In line with the provisions of the directives, the funding of the statutory compensation schemes is to be ensured by all deposit-taking credit institutions and all other institutions conducting investment business. The funds for paying compensation therefore have to be raised by the institutions themselves. Funding can be ensured all the more effectively, the higher the number of institutions there are in any given compensation scheme. However, the compensation scheme operated by the Federal Association of Public Banks – like the voluntary Deposit Guarantee Fund of the public credit institutions – has no more than a comparatively small number of heterogeneous banks assigned to it. This would appear to make appropriate risk diver-

sification more difficult. Ultimately, however, the compensation scheme is still likely to have viable funding on account of the public-law character of the assigned institutions. The act does not provide for an "overflow arrangement" among the individual statutory compensation schemes.

The Federal Ministry of Finance has issued regulations on the contributions to the compensation schemes on the basis of the Deposit Guarantee and Investor Compensation Act. The regulations contain provisions on the annual contributions, special contributions and borrowing. The assigned institutions are obliged to pay annual contributions on September 30 each year. A compensation scheme may, with the prior agreement of the Federal Banking Supervisory Office, lower or

Contributions by the member institutions

suspend contributions, if the funds available for paying compensation suffice.

Deposit-taking credit institutions

*Contributions
of the deposit-
taking credit
institutions*

Pursuant to the regulation of the Federal Ministry of Finance of July 10, 1999 on the contributions to the compensation schemes of the Federal Association of German Banks and of the Federal Association of Public Banks in Germany, the annual contribution amounts to 0.008 % of the balance sheet item "amounts owed to customers" in the last annual accounts prepared before July 1. Certain liabilities contained in this balance sheet item, which have no relation to protected business within the meaning of the Deposit Guarantee and Investor Compensation Act, do not have to be included in calculating the deposits to be guaranteed. If an institution makes use of these possibilities of deduction, it must provide evidence – authenticated by an external auditor or accounting firm – of the amount of the items deducted. Notwithstanding this, institutions with significant special features in their business structure may pay an annual contribution amounting to 1 % of the potential scope of the compensation claims within the meaning of the Deposit Guarantee and Investor Compensation Act.

*Minimum
volume*

In accordance with the regulation, the minimum volume of funds required for the compensation schemes is staggered in relation to the contributions over an introductory period. Up to December 31, 1999 the required minimum volume of funds was 75 % of the contributions to be paid as start-up funding. In 2000, it is one and a half times the sum of

the most recently paid annual contributions, and from January 1, 2001 double the sum of the most recently paid annual contributions. The minimum volume is intended to ensure that funds are also available for compensation payments in the short term.

The compensation scheme is to raise special contributions from the institutions assigned to it or borrow funds if the compensation schemes' funds fall below the prescribed minimum volume, or if claims have become due against the compensation scheme and meeting them within two months would lead to such a shortfall. The amount of the special contributions or borrowing should be such that compliance with the minimum volume is ensured taking into account the expected return flows of funds and after deducting the existing claims against the compensation scheme and other costs. This implements the legislative aim of meeting the compensation claims of the credit institutions' creditors by means of the credit institutions' contributions to the compensation scheme. The level of special contributions for each institution is determined by the share most recently payable by the institution to the total volume of contributions. The respective compensation scheme may exempt individual institutions from all or some of their obligation to pay special contributions if there are grounds to fear that paying the special contribution in full would result in compensation having to be paid to the institution itself (domino effect). A decision on exemption has to be approved by the Federal Banking Supervisory Office. If the compensation scheme has borrowed funds, it may – likewise with the ap-

*Special
contributions*

proval of the Federal Banking Supervisory Office – demand appropriate special payments from the institutions assigned to it in order to meet interest payments and redeem the loan. The special contributions are also distributed in line with the respective shares in the most recently payable annual contributions.

Securities trading firms

Contributions to compensation scheme of the securities trading firms

The “Regulation governing contributions to the compensation scheme of the securities trading firms at the Reconstruction Loan Corporation”, issued by the Federal Ministry of Finance on August 19, 1999 provides for graduated contributions in line with the scope of the institution’s licence. The contributions are graduated depending on how the transactions requiring a licence are defined in the Banking Act, and on whether the licence authorises the institution to acquire ownership or possession of customers’ funds or securities, to trade in financial instruments for its own account or to conduct own-account trading for others. The annual contribution rate is:

- 1% for institutions liable to pay contributions which are authorised to acquire ownership or possession of customers’ funds and securities;
- 2% for institutions liable to pay contributions which are additionally authorised to conduct own-account trading for others or to trade in financial instruments for their own account;

- 0.3% for institutions liable to pay contributions which are not authorised to acquire ownership or possession of customers’ funds or securities;
- in all cases, however, a minimum contribution of € 200.

Only those institutions assigned to the compensation scheme of the securities trading firms on January 1 of any given year are liable to pay contributions.

The gross receipts from commissions and from financial transactions which are required to be shown in the annual accounts (i.e. the most recent annual accounts approved before July 1 of a given year) are used as the basis for calculating the contributions. If the annual accounts are unavailable on July 1, the compensation scheme may fix, as part payment, one and a quarter times the annual contribution, with the annual contribution being estimated taking account of the scale and structure of the business of the institution or a group of comparable institutions. In the case of a newly assigned institution, contributions are to be determined on the basis of the projected profit and loss accounts for the first accounting year to be submitted before the commencement of business. When determining the basis for calculating contributions, 90% of the gross receipts from transactions with customers who have no right to compensation under the Deposit Guarantee and Investor Compensation Act may be ignored if the institution presents evidence of this which has been authenticated by an external auditor. For a transitional

Basis for calculating contributions

period, the regulation makes additional concessions for the contribution years 1999 and 2000. These include the possibility of non-inclusion of 90% of the aforementioned gross receipts from financial transactions even if evidence is not provided. This is intended to prevent hardship in the case of securities trading firms which are liable to pay contributions to a compensation scheme for the first time.

*Initial
experience*

Initial practical experience of raising contributions from the securities trading firms assigned to their compensation scheme revealed isolated problems in defining the gross commission receipts, although this does not call into question their suitability as a basis for calculation. Rather, it should be possible to structure the institutions' accounting practices in such a way that the required earnings figures are modelled correctly. This does not preclude the possibility of an amendment to the regulation taking account of more detailed information on the size and volume of the contributions.

*Raising special
contributions*

The provisions on raising special contributions and on the special payments when funds are borrowed by the securities trading firm's compensation scheme correspond to those for the compensation schemes of the deposit-taking credit institutions.

Compensation

*Compensation
procedure*

The creditors of credit institutions and of certain financial services institutions, in the event of the institution's insolvency, can bring a civil

claim for compensation against the compensation scheme to which their debtor institution belongs. A legal right to compensation of this kind does not exist for the protected creditors under the by-laws of the private deposit protection schemes. The ruling that compensation is payable is made by the Federal Banking Supervisory Office and is published in the Federal Gazette. The compensation scheme checks the creditors' claims that have been submitted in writing and verifies their eligibility, and has to pay compensation to the creditors within three months of the date when it was determined that compensation is payable. The claim to compensation must be submitted by the creditor to the relevant compensation scheme within one year.

In cases where credit institutions do both deposit and investment business which come under the terms of the Deposit Guarantee and Investor Compensation Act, the claim to deposit protection and investor compensation applies in each case up to the respective cover limit. The calculation of the amount of the claim to compensation is based on the amounts of the deposits or funds and the market value of the securities on the date when it is determined that compensation is payable, including any interest accrued until the settlement of the claim.

*Compensation
claim*

Voluntary private protection schemes

In Germany, nearly all deposit-taking credit institutions were already members of voluntary deposit protection schemes on competi-

*Supplementary
deposit
protection*

tive grounds. This well-established system of voluntary protection schemes operated by the associations of the various categories of banks continues unchanged even after the Deposit Guarantee and Investor Compensation Act has entered into force. As private self-help schemes operated by the banks, these supplementary deposit protection schemes are not subject to the provisions of the act. We refer you to the article published in the July 1992 Monthly Report for an overview of the historical background to deposit protection in Germany and a general account of the Deposit Guarantee Fund of the private banks at the Federal Association of German Banks as well as the protection schemes in the savings bank and cooperative sectors.

Cover limit at the Deposit Guarantee Fund of the Federal Association of German Banks

As before, the deposit-protection limit per creditor at the Deposit Guarantee Fund of the Federal Association of German Banks is 30 % of the bank's liable capital as defined in section 10 (2) of the Banking Act, with the prudential supplementary capital being included only up to the level of 25 % of the core capital.

Protected liabilities

Protection is given to all liabilities to non-credit institutions (in particular: individuals, business enterprises and public bodies) which are required to be shown in the balance sheet item "amounts owed to customers", such as sight deposits, time deposits and savings deposits, including registered bank savings bonds. Liabilities are protected irrespective of the currency in which they are denominated. Furthermore, the protection of deposits also extends to branches abroad. Liabilities for which a bank has issued bearer instruments,

liabilities arising from securities repurchase or repo transactions, and obligations to return securities under stock lending transactions are not protected, however.

Since 1998, the institutions belonging to the Deposit Guarantee Fund have been subject to an annual classification. The principles for the classification procedure form part of the by-laws. Institutions are classified by their financial soundness using key figures on their financial position and profitability, and by an assessment of the quality of management. Classification is undertaken by a private limited company for assessing private banks, the *GBB (Gesellschaft für Bankbeurteilung im privaten Bankgewerbe mbH)*, which is a subsidiary of the Audit Association of German Banks (*Prüfungsverband deutscher Banken*). Banks are assigned to one of the classes A, B or C (with three sub-classes) depending on the outcome of the classification. Banks belonging to class C are rated as particularly risk-prone and require continuous and intensive assessment. Banks assigned to class B or C are required to pay a higher contribution which must not exceed two and a half times the current standard rate. The general annual contribution rate is 0.3‰ of the balance sheet item "amounts owed to customers" in the most recent annual accounts. The requirement to make an annual contribution may be suspended or its amount reduced if the assets of the Deposit Guarantee Fund have reached an appropriate level. Furthermore, banks which have paid more than 20 annual contributions and are assigned to class A may be exempted from the obligation to make contributions. The Deposit Guar-

Classification system

tee Fund has made use of this possibility of suspending the raising of contributions from banks which meet the above-mentioned requirements.

*Branches of
foreign banks*

The German branches of foreign banks basically have the possibility of cooperating in the private deposit protection scheme of the Federal Association of German Banks. On competitive grounds, the conditions that apply to them are the same as those for domestic banks. The foreign banks' branches which are members of the Federal Association of German Banks may be exempted, upon application, from the simultaneous obligation to cooperate in the Deposit Guarantee Fund if the protection scheme of their home state safeguards the deposits maintained in Germany to an extent equivalent to the EU directive.

*Other voluntary
protection
schemes*

By 1994, certain institutions which were not members of a deposit protection scheme in the past on account of their particular, low-risk business structure or owing to their public legal status had set up additional self-help schemes of their own operated by their respective banking associations. The main reasons for this were the transparency requirement of section 23a of the Banking Act (newly introduced as part of the fourth amendment to the Banking Act) if an institution is not a member of a deposit protection scheme, and the EU's efforts at harmonisation with regard to the call for making membership in a deposit guarantee scheme compulsory for all deposit-taking credit institutions. This means that the protection schemes for the private banks as well as the institutional protections of the savings bank and

cooperative bank sectors – which were already in existence in the early nineties – are now joined, in particular, by public credit institutions and private building and loan associations with protection schemes of their own. These schemes supplement statutory compensation on the basis of the Deposit Guarantee and Investor Compensation Act with voluntary guarantee payments. The Deposit Guarantee Fund established at the Federal Association of Public Banks safeguards – without prejudice to any guarantor's uncalled liability – all liabilities to non-credit institutions with the exception of liabilities for which bearer instruments have been issued. In the case of the private building and loan associations, all liabilities to customers arising from savings deposits under savings and loan contracts are protected. Liabilities arising from other deposits are safeguarded up to a total of DM 100,000 per depositor.

In setting up entrusted compensation schemes, a subsidiarity clause was added to the by-laws of the voluntary deposit protection funds of the Federal Association of German Banks and the Federal Association of Public Banks. This clause stipulates that compensation under the by-laws will be paid to depositors only if they do not already have a claim under the statutory deposit protection scheme. Any claims beyond that will be met by the voluntary deposit protection schemes up to the ceiling provided for under the by-laws.

*Subsidiarity
clause*

In general, supplementary protection comprises both deposits in Germany and those with branches abroad, irrespective of the currency in which they are denominated and

*Scope of
supplementary
protection*

Overview of deposit/investor protection in Germany

Institutions	Institutional protection; statutory depositor/investor protection	Voluntary deposit protection
Deposit-taking institutions		
under private law		
credit cooperatives and regional institutions of credit cooperatives	Institutional protection (operated by the Federal Association of German People's Banks and Raiffeisen Banks, regional cooperative associations) ¹	
other deposit-taking institutions	Statutory cover up to 90 % of a deposit ² (maximum € 20,000) and up to 90 % of a claim arising from investment business ³ (maximum € 20,000) (operated by the <i>Entschädigungseinrichtung deutscher Banken GmbH</i>) ¹	Supplementary cover for deposits not covered by depositor/investor protection ⁴ per depositor up to 30 % of the liable capital ⁵ of the institution concerned (operated by the Deposit Guarantee Fund of the Federal Association of German Banks) ¹
under public law		
savings banks, Land banks, public building and loan associations	Institutional protection (operated by the German Savings Bank and Giro Association, regional savings bank associations) ¹	
other deposit-taking institutions	as in the case of other deposit-taking credit institutions under private law (operated by the <i>Entschädigungseinrichtung des Bundesverbandes Öffentlicher Banken Deutschlands GmbH</i>) ¹	Voluntary supplementary cover of a deposit ⁶ up to the full amount (operated by the Federal Association of Public Banks) ¹
Other institutions		
Credit institutions with principal broking underwriting	Statutory cover up to 90 % of a claim arising from investment business ³ (maximum € 20,000) (operated by the compensation scheme of the securities trading firms (<i>Entschädigungseinrichtung der Wertpapierhandelsunternehmen</i>) at the Reconstruction Loan Corporation) ^{1, 7}	
Credit institutions and financial services institutions with investment broking contract broking portfolio management own-account trading		
Investment companies with asset management for others		

¹ Administration of a fund's assets for the settlement of claims, compulsory contributions by the cooperating/assigned institutions. — ² Protected deposits mainly account balances and registered debt securities denominated in euro or an EEA currency. Issued bearer bonds, in particular, are among the items which are not protected. The protected group of depositors/investors consists mainly of individuals; financial institutions, public bodies, medium-sized and large incorporated enterprises, in particular, are not protected. — ³ Protected claims arising from investment business are mainly claims to ownership or possession of funds (denominated in euro or an EEA currency) or financial instruments. Protected group of investors, see

footnote 2. — ⁴ Protected deposits are mainly sight, time and savings deposits as well as registered debt securities, irrespective of the currency in which they are denominated (amounts owed to customers). Issued bearer bonds, in particular, are not protected. The protected group of depositors includes all non-banks (especially individuals), business enterprises and public bodies. — ⁵ Sum of core capital and prudential supplementary capital, with the latter being included only up to 25 % of the core capital. — ⁶ See footnote 4; certain public bodies (Federal Government, Länder, their special funds) do not belong to the protected group of legal persons. — ⁷ Unless an institution is assigned to another scheme in specific cases.

whether the creditors are residents or non-residents. The protection provided by the voluntary deposit protection schemes covers not only the 10 % retention of the deposit-taking credit institutions' statutory compensation schemes and deposits over € 20,000, but also the deposits of those depositors who have no claim against the statutory compensation scheme concerned (public sector, investment companies with their fund assets, and all business enterprises with the exception of the banks).

The combination of statutory depositor compensation and supplementary voluntary de-

posit protection will ensure that a comprehensive and well-established level of protection against the loss of deposits will also be afforded to depositors in Germany in future in the event of their credit institution becoming insolvent. This will help to maintain the public's confidence in the stability of the German banking system – a confidence that has evolved over many years.

The most important statutory and voluntary protection schemes along with their essential features are shown in the table on page 44.

*Ongoing
established
comprehensive
protection*