An Evaluation of Deposit Guarantee Schemes: An EU Perspective and Extrapolation of the Maltese DGS Governance

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ABSTRACT

The Deposit Guarantee Schemes Directive (DGSD): Directive 2014/49/EU stipulates several requirements for deposit guarantee schemes (DGS) in order to achieve harmonisation for depositor protection. Furthermore, DGSs entail several distinct features and are administered by entities organised under private or public law taking into account the legal status and/or governance structure of the Member State. This administrative flexibility enables DGSs to be adapted to the distinctive legal structures and conditions prevalent in each jurisdiction.

The objective of this study is to compare, contrast, and evaluate different viewpoints on the designated structures of administration of EU DGSs and various factors which influence their adoption and design. In addition, this research shall assess the structure and implementation of EU DGSs vis-à-vis financial stability and consumer protection, while minimising moral hazard. Furthermore, this research shall determine whether the Maltese DGS should retain itself as a separate legal entity or otherwise, integrates with the national competent authority. The author evaluates the research questions through different perceptions from local and foreign relevant bodies through the results obtained in the analysis.

Finally, the author shall propose various recommendations on the best practices, with the intention of providing alternatives and improvements to make the structure and design of the DCS more efficient.

Keywords: Depositor Compensation Scheme (DCS), Deposit Guarantee Scheme (DGS), Deposit Insurance, Consumer Protection, Financial Stability

DEDICATION

I wish to dedicate this dissertation to my beloved parents, who with their unwavering support, sacrifices and endless belief, pushed me forward on this academic journey.

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LIST OF ABBREVIATIONS

AFA – Alternative Funding Arrangements

BCBS – Basel Committee on Banking Supervision

BRRD – Bank Recovery and Resolution Directive

BU – Banking Union

CA – Competent Authority

CB – Central Bank

CBM – Central Bank of Malta

CMDI – Crisis Management and Deposit Insurance

DCS – Depositor Compensation Scheme

DEF – Deferred File

DEPS – Data Exchange and Payment System

DGS – Deposit Guarantee Scheme

DGSD – Deposit Guarantee Scheme Directive

DIF – Deposit Insurance Fund

EBA – European Banking Authority

ECB – European Central Bank

EDIS – European Deposit Insurance Scheme

EEA – European Economic Area

EFDI – European Forum of Deposit Insurers

EU – European Union

FDIC – Federal Deposit Insurance Corporation

FOLTF – Failing or Likely to Fail

FSB – Financial Stability Board

FSF – Financial Stability Forum

GDP – Gross Domestic Product

GFC – Global Financial Crisis

IADI – International Association of Deposit Insurers

ICS – Investor Compensation Scheme

IMF – International Monetary Fund

LSI - Less-significant Institutions

MC – Management Committee

MFE – Ministry for Finance and Employment

MFSA – Malta Financial Services Authority

MOU – Memorandum of Understanding

MS – Member States

NCA – National Competent Authority

NPL – Non-Performing Loans

SCV – Single Customer View

SI – Significant Institutions

SRB – Single Resolution Board

SRF – Single Resolution Fund

SRM – Single Resolution Mechanism

SRMR – Single Resolution Mechanism Regulation

SSM – Single Supervisory Mechanism

SSMR – Single Supervisory Mechanism Regulation

TBTF – Too Big to Fail

US – United States

CHAPTER 1: INTRODUCTION

'Essential to a progressive financial system is prudential safety and soundness, competition and consumer protection which needs to co-exist to effectively serve the interests of various stakeholders.'

Dr. Zeti Akhtar Aziz, 2007

1.1 Introduction

Banks are one of the most significant players in the economy, and their actions may potentially influence the stability and credibility of the financial system.[1] Traditionally, banks served an important role as an intermediary between borrowers and lenders. In addition, banks have been key players in promoting economic development by providing investors with liquid assets and acquiring experts to evaluate and spread the risks of debtors.[2]

Following the GFC in 2008, the element of a financial safety net has become an essential requirement for consumer protection. Furthermore, the original Directive on Deposit Guarantee Schemes (hereinafter referred to as 'DGS'), established in 1994, remained unchanged for fifteen years and European (hereinafter referred to as the 'EU') legislators have articulated their obligation to the implementation of a harmonised and legitimate Single Rulebook.[3] Consequently, a thorough review of the Deposit Guarantee Schemes Directive (hereinafter referred to as the 'DGSD') gives clear evidence of such developments.[4]

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[1] Jessica Cariboni and others, 'The promptness of European Deposit Protection Schemes to face banking failures' (2010) 11 (3) JBR <https://doi.org/10.1057/jbr.2010.13> accessed 1 November 2022.

[2] Nick Ketcha, 'Deposit insurance system design and considerations' (1999) <https://www.bis.org/publ/plcy07o.pdf> accessed 1 November 2022.

[3] According to the International Association of Deposit Insurers (IADI), a financial safety net is a framework for prudential regulation, supervision, resolution, lender of last resort, and deposit insurance. In many jurisdictions, the financial safety net includes a government department (e.g., a Ministry of Finance or Treasury responsible for financial sector policy).

[4] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (recast) [2014] OJ L 173 (the 'DGSD').

Credit institutions are highly vulnerable to illiquidity and bankruptcy risks due to the structure of their portfolios. Due to such concerns, almost every jurisdiction has a DGS in charge of deposit insurance, whose main aims are to prevent bank runs in the economy, act in response to political exigencies of depositors, and ultimately, safeguard taxpayers' monies.[5]

The DGSD allows Member States the freedom to select their suitable design and structure for deposit insurance in their jurisdiction. Meanwhile, the DGS structure would always depend on many factors, including legal, political, economic, and cultural considerations of the jurisdiction in question.

1.2 Deposit Insurance

Deposit insurance, as defined by the Organisation for Economic Co-Operation and Development (hereinafter referred to as the 'OECD'), is a scheme which is generally established by law that aims to reduce depositor losses in the case of insolvency. Therefore, it aims to strengthen depositors' confidence in the banking sector and minimise the potential systemic failures brought on by irrational bank runs. Furthermore, deposit insurance may be administered privately or publicly run and funded.[6]

Therefore, the notion of deposit insurance protects retail depositors in the event of insolvency, reducing the likelihood of bank runs and contagion risk. Naturally, increased

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[5] Bruno M. Salama and Vicente Braga, 'The Case for Private Administration of Deposit Guarantee Schemes' (2021) <http://dx.doi.org/10.2139/ssrn.3694181> accessed 3 November 2022.

[6] OECD, 'Glossary of Statistical Terms - Financial Statistics' (2004) <https://stats.oecd.org/glossary/detail.asp?ID=6200> accessed 3 November 2022.

depositor confidence leads to a reduced propensity of causing liquidity issues through bank runs. Such bank runs can cause contagion and uncertainty in the banking industry if depositors lose trust, as occurred in various credit institutions during the 2008-2009 financial crisis.[7]

The evolution of the financial crisis highlighted the importance of preserving depositor confidence in the financial system and the essential role that deposit protection plays in achieving this objective.[8]

1.3 International Organisations

International organisations have been established in order to assist DGSs and promote international co-operation.

1.3.1 IADI

The International Association of Deposit Insurers (hereinafter referred to as 'IADI') was established in 2002 in order to encourage international guidance and participation of DGSs to increase the efficiency of deposit insurance schemes. It is thus a community among international DGSs that aims to exchange knowledge and experience in the sphere of deposit insurance. Its aims are to promote worldwide co-operation in the sphere of deposit insurance, provide recommendations for establishing new DGSs and

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[7] Marc Dobler and Attilla Arda, 'The Role for Deposit Insurance Funds in Dealing with Failing Banks in the European Union' (2022) IMF Working Paper No. 2022/002 <https://ssrn.com/abstract=4030021> accessed 4 November 2022.

[8] International Association of Deposit Insurers (IADI), 'Core Principles for Effective Deposit Insurance Systems' (2014) <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf> accessed 4 November 2022.

improving existing DGSs, and stimulate robust communication among DGSs.[9] Presently, IADI has ninety-two[10] members[11] from around the world.

1.3.2 EFDI

The European Forum of Deposit Insurers (hereinafter referred to as 'EFDI') has a similar role to IADI, with the exception that the organisation oversees DGSs at EU level. The organisation was established in 2002 and its primary goal is to promote discussion and the sharing of knowledge and experience among its EU members, with the overall goal of improving the role of the EU and global co-operation among DGSs.[12] Presently, EFDI has forty-nine member countries in Europe or a Member State of the Council of Europe.[13] Furthermore, the legislation governing the EU-wide DGSs is being developed with the assistance of EFDI.[14]

1.3.3 IMF

As a consequence of the 1930s Great Depression, the International Monetary Fund (hereinafter referred to as the 'IMF') was established in order to develop a global framework for economic co-operation.

The IMF constitutes one hundred and ninety jurisdictions from around the world, and aims to achieve economic growth and developments. In order to boost development,

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[9] IADI, 'About IADI' (2022) <https://www.iadi.org/en/about-IADI/> accessed 5 November 2022.
[10] IADI, 'List of members' (2022) <https://www.iadi.org/en/about-iadi/iadi-members-and-participants/list-of-members/> accessed 5 November 2022.
[11] Members are organisations with a deposit insurance system established by statute or agreement and have been granted membership to participate in IADI.
[12] EFDI, 'Who we are' (2022) <https://www.efdi.eu/page/who-we-are> accessed 6 November 2022.
[13] ibid Appendix 1.
[14] ibid (n12).

employment opportunities, and economic health, the IMF promotes economic measures that encourage monetary co-operation and financial stability.[15]

1.4 Research Questions

This research will seek to compare, contrast, and evaluate different perceptions of the designated modes of administration of EU DGSs and various factors which influence their adoption and design. The author will also investigate the structure and implementation of EU DGSs vis-à-vis financial stability and consumer protection, while minimising moral hazard. Effective regulation and supervision may reduce moral hazard when designing deposit insurance systems.[16]

The research questions are the following:

1. What factors influence the adoption and design of EU DGSs?
2. What are the advantages and disadvantages of each governance structure?
3. How can the particular DGS design and implementation system be organised in order to achieve financial stability and consumer protection, while minimising the risk of moral hazard?
4. What are EU DGSs' perceptions of their current governance structure?
5. In line with the above questions, what are the viewpoints of the local regulator and the Maltese DGS and what are the potential discrepancies, if any, between the different viewpoints?

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[15] IMF, 'What does the IMF do?' (2022) <https://www.imf.org/en/About/Factsheets/IMF-at-a-Glance> accessed 8 November 2022.

[16] David S Hoelscher and others, 'The Design and Implementation of Deposit Insurance Systems' (2006) IMF Working Paper 251 <https://doi.org/10.5089/9781589065031.084> accessed 15 November 2022.

1.5 Research Outline

The author shall primarily introduce the concept of deposit insurance, and shall evaluate the current theoretical and practical literature on the design and implementation of DGSs to identify potential areas where further research is required. The author shall adopt both a qualitative and quantitative approach due to the empirical feature to achieve the research objectives. Therefore, the author shall utilise questionnaires and conduct semi-structured interviews as the main instrument for this study. Questionnaires will be distributed to respondents representing DGSs in various EU jurisdictions. Meanwhile, semi-structured interviews shall be conducted locally with experts in the field, including representatives from the Malta Financial Services Authority (hereinafter referred to as the 'MFSA') and the Maltese DGS, the Depositor Compensation Scheme (hereinafter referred to as the 'DCS'). This study will also assess different perceptions and determine whether there are any discrepancies between different viewpoints of the respective representatives on the DCS structure and administration. Throughout this study, the author shall propose various recommendations on the best practices, with the intention of providing alternatives and improvements to make the structure and design of the DCS more efficient.

1.6 Motivation for the Research

Although various studies have been carried out on the design and implementation of DGSs, minimal empirical evidence has been sought to explain the reasoning behind the adoption and preferred design of deposit insurance. This has thus inspired the author to embark on this study. A comprehensive analysis of such literature has revealed that there is a need for more significant research in this sphere. Throughout this study, the author shall conduct a more comprehensive analysis of the design and structure of EU DGSs. Further research would improve the knowledge of deposit insurance, and aid in improving the efficiency and effectiveness of deposit insurance.[17]

Furthermore, additional research on the design and implementation of DGSs is a fundamental area of interest to the author in view of the fact that the lack of information about the subject matter may indicate certain misconceptions on the structure of DGSs. The author will dedicate part of this research to assess the advantages and disadvantages of various types of DGS administration while examining whether the Maltese DGS should retain its operational independence within the MFSA, or whether it should explore other alternatives concerning its autonomy. Furthermore, the DCS interacts on an ongoing basis with the Resolution department at the MFSA, where the latter is responsible for drafting resolution plans for banks and advising the Resolution committee on whether the bank should go into resolution or insolvency.[18]

This study will thus seek to analyse the local DCS regulations[19] and the EU Directive, the DGSD.[20] Furthermore, it will analyse factors on the organisation of EU DGSs design and implementation to increase consumer protection and strengthen financial stability, while preventing moral hazard.

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[17] John Raymond LaBrosse and others, 'Transitioning Issues for Deposit Insurance Practitioners' (IADI First Annual Conference May 2002).
[18] In Malta, the MFSA is the Resolution Authority; however, the Resolution Committee is the decision-making body, advising whether a credit institution should be put into liquidation or resolution.
[19] Depositor Compensation Scheme Regulations S.L. 371.09.
[20] Deposit Guarantee Scheme Directive (n 4).

1.7 Dissertation Outline

This dissertation is divided into five chapters. In the first chapter, the author introduces the concept of deposit insurance, while giving a general overview of various international organisations which contribute significantly to deposit insurance. The author also highlights the problem which emanates from lack of information about the subject matter, which may generate certain misconceptions on the efficiency of the structure of DGSs. Therefore, the author complements such problem with five research questions which have been established to achieve valuable insights throughout this study.

In the second chapter, the author elaborates on various academic literature, articles, and journals on elements and principles of deposit insurance. The author delves into the local and EU legal and regulatory framework of DGSs, while examining various literature on the determinants of adoption and design of various DGSs.

In chapter three, the author explains thoroughly the research methodology adopted for this study. In view of this, the author utilises a mixed-method approach, that is, data was collected through both qualitative and quantitative means from experts around the world and local regulators. The author also acknowledges the limitations of the study and the approach adopted to minimise the effects of such limitations.

In the fourth chapter, the author provides an overview of the results and findings from the data collected from worldwide practitioners and local regulators. This analysis elucidates and gives a better understanding of the benefits and challenges of the DGSs' current adoption and design, including different perceptions from practitioners and regulators.

The author concludes the final chapter by providing a general overview of the study, while illustrating the salient findings emanating from the analysis of the collected data. Finally, the author provides recommendations for further research in this field.

CHAPTER 2: LITERATURE REVIEW

'After all, 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.'

President Franklin D. Roosevelt, 1933

2.1 Introduction

The DGS holds a significant role in the industry as credit institutions do not hold enough liquidity to provide funds for their depositors immediately. In this chapter, the author gives a comprehensive overview of the history of deposit insurance, the importance of the establishment of deposit insurance, the implications of moral hazard, and, to an extent, financial stability. The author further examines various risks and consequences where deposit insurance may hinder capital markets, and the main theoretical justifications behind the implementation, design, and various structures of DGSs, while taking into consideration the legal regulatory framework.

2.2 History of Deposit Guarantee Schemes – A Global Overview

The starting point for several debates on the design and structure of a DGS involves primarily two factors. First is why a DGS is essential in the first place, and second, how various factors, such as economic and political factors, can be analysed. The need for deposit insurance is significant since credit institutions accept short-term deposits from their depositors and provide them to the market by accumulating such deposits as long-term credit. Consequently, credit institutions anticipate a specific average amount of withdrawals within a specific period of time. However, this implies that depositors are highly susceptible to the risk of not being able to withdraw their funds immediately. Consequently, if several depositors withdraw their money at once, a 'bank run' occurs, and the credit institution becomes illiquid at that point in time. Furthermore, there is concern that the closure of a credit institution may impact other credit institutions in the banking sector, thus possibly causing a 'domino effect'. Therefore, governments provide a safety net for credit institutions, which includes protection for depositors and a system of regulation and supervision.[21]

2.2.1 The Establishment of the FDIC

Deposit insurance was formerly established by the US Government with the aim of protecting small credit institutions. In 1933, the Banking Act was implemented which established the Federal Deposit Insurance Corporation (FDIC).[22]

Deposit insurance in the US became effective on 1 January 1934, and provided a maximum coverage of USD 2,500 in compensation for depositors of failed credit institutions. This instantly increased public confidence, and restored credibility and financial stability in the economy.[23]

The core fundamentals of deposit insurance were established in legislation bills through the experience of several states that established insurance programmes prior to federal deposit insurance. The FDIC Annual Report published in 1957 states that the '*systems of the 1908-1930 period were considered highly successful up to the time of the bank failures associated with the depression of 1921'*.[24]

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[21] Gillian G.H. Garcia, 'Deposit Insurance: A Survey of Actual and Best Practices' (1999) IMF WP/99/54 <https://www.imf.org/external/pubs/ft/wp/1999/wp9954.pdf> accessed 1 December 2022.
[22] The FDIC is an independent entity set up by US Congress to safeguard financial stability and public trust in the United States.
[23] FDIC, 'A Brief History of Deposit Insurance in the United States' (International Conference on Deposit Insurance 1998) <https://www.fdic.gov/bank/historical/brief/brhist.pdf> accessed 7 January 2023.
[24] FDIC, 'Annual report of the FDIC for the year ended 31 December 1956' (1957) <https://www.fdic.gov/about/financial-reports/reports/archives/fdic-ar-1956.pdf> accessed 8 January 2023.

Such fundamentals include the funding of the scheme, stringent bank assessments through supervision, and oversight to cap the fund's exposure, policies, and procedures for pay-outs and bank insolvencies, aimed to minimise the economic turbulence caused by bankruptcies.[25]

The severity of the 1930s Great Depression hasn't been replicated; however, deposit insurance was put into practice, and shown to be effective over the years. It was better adapted to the more volatile, riskier financial climate that emerged towards the end of the twentieth century with some legal reform.[26]

Nonetheless, a wave of financial troubles occurred in the 1980s recession, exposing the adverse consequences of deposit insurance on the banking industry, the major problem being moral hazard. However, the FDIC aimed to preserve and improve deposit insurance by reducing the effect of moral hazard.[27]

2.2.2 The Establishment of EU DGSs

The idea of providing deposit insurance for depositors naturally transpires following a severe financial crisis, complementing political, economic, and social crises. The first DGS in the EU was established in Czechoslovakia in the 1920s.[28]

Meanwhile, Belgium, Germany, Spain, and Italy established their DGSs in the 1970s, with several distinct features. In 1986, a recommendation by the EU Commission was

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[25] FDIC (n 23).
[26] ibid.
[27] Antoine Martin, *A Guide to Deposit Insurance Reform* Economic Review (Federal Reserve Bank of Kansas City 2003).
[28] Gillian G.H. Garcia, 'Deposit Insurance and Crisis Management' (2000) IMF Working Paper WP/00/57 <www.imf.org/external/pubs/ft/wp/2000/wp0057.pdf> accessed 9 January 2023.

published to introduce additional schemes in the EU and improve the functioning of existing schemes.[29]

Furthermore, the aim of this Recommendation was to harmonise DGSs across the EU, such as the level of coverage and the participation of credit institutions, which, at the time, was either voluntary or mandatory, and thus, it was up to the EU MS to decide which principles to adopt.[30]

For that reason, the EU Commission adopted Directive 94/19/EC in 1994 to set a standard for the performance of EU DGSs.[31] The Directive established the first framework for uniformity between EU DGSs principles, including, *inter alia*, mandatory participation, the concept of home-host co-operation, and minimum coverage level. Although the Directive created some form of harmonisation, EU MS were still allowed to select the appropriate measures for the functioning of the scheme, thus becoming a self-regulatory issue. The Directive ensured that a DGS was to be established in every EU MS with obligatory participation. The current Recast Directive does not preclude a MS from implementing more than one DGS in its jurisdiction.

Where various schemes are established in a MS, each scheme may represent a specific category of credit institutions, for instance, credit unions and public and private banks. In fact, Germany presently has four schemes[32] which are responsible for various specific

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[29] Jessica Cariboni and others, 'Deposit protection in the EU: State of play and future prospects' (2008) <https://publications.jrc.ec.europa.eu/repository/handle/JRC38190> accessed 9 January 2023.
[30] ibid.
[31] Directive 94/19/EC of the EU Parliament and of the Council of 30th May 1994 on deposit guarantee schemes [1994] OJ L 135/5.
[32] Appendix I.

categories, including co-operative banks, savings banks, private banks, and the deposit protection fund. The financial crisis of 2008 exposed significant flaws of the performance of DGSs at the time. In 2006, the EC published a Communication[33] to modernise the existing EU Directive on DGSs, and work was subsequently initiated in order to improve the performance of existing DGSs.[34]

In addition, the financial crisis raised further concerns on various supranational institutions on the structure, design, and implementation of DGSs. The Basel Committee on Banking Supervision (hereinafter referred to as 'BCBS') and IADI jointly initiated the process of a revised version of the 'Core Principle for Effective Deposit Insurance Systems'. In this study, a set of various principles were established to explain the functions and objectives of a modern DGS.[35]

From a global perspective, the IMF and World Bank have put forward several questions on the design and structure of DGSs due to the rapidly evolving conditions of the financial markets.[36]

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[33] Commission, 'Proposal for a Directive EU of the European Parliament and of the Council on Deposit Guarantee Schemes [recast]' COM (2010) 368 final.

[34] Cariboni and others (n 29).

[35] IADI, 'Core Principles for Effective Deposit Insurance Systems' (2009) <https://www.bis.org/publ/bcbs151.pdf> accessed 10 January 2023.

[36] Beat Bernet and Susanna Walter, 'Design, Structure and Implementation of a Modern Deposit Insurance Scheme' (2009) <https://www.econstor.eu/handle/10419/163489> accessed 7 January 2023.

2.3 Financial Stability

Following the GFC, DGSs were established in most countries as legislators and governments sought to maintain the financial system's stability and provide an urgent solution. For their part, the IMF and the World Bank endorsed the implementation of deposit insurance as a means of market stabilisation.[37]

Studies have highlighted that instability was to broaden the DGS coverage level, with provisional blanket guarantees on all deposits becoming widespread, while countries lacking DGS systems had to act fast to establish coverage.[38] Furthermore, the study also highlighted that GDP is an ideal indicator of economic conditions in jurisdictions with deposit insurance regimes in terms of banking sector stability. The study evaluated Europe and Asia, where the former exhibited fewer significant connections with economic control factors than the latter, and it was concluded that deposit insurance policies in Europe protect the banking sector from an economic recession.

Nevertheless, further factors need to be taken into consideration involving variances related to the jurisdiction; therefore, EU legislators may need to assess a range of economic issues, while also keeping deposit insurance in mind. In addition, the study has proven that financial stability has substantial connections with various control factors for the economy, policy structures, and the amount of DGS coverage in countries

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[37] Deniz Anginer and Asli Demirguc-Kunt, 'Bank Runs and Moral Hazard: A Review of Deposit Insurance' (2018) World Bank Policy Research Working Paper WPS8589 <http://documents.worldbank.org/curated/en/548031537377082747/Bank-Runs-and-Moral-Hazard-A-Review-of-Deposit-Insurance> accessed 15 January 2023.

[38] Deniz Anginer and others, 'How does deposit insurance affect bank risk? Evidence from the recent crisis' (1st edn 2014) Journal of Banking & Finance 312-321.

with established DGSs. Therefore, the presence of deposit insurance may influence financial stability, and thus, the design of DGSs can have an impact on the banking system, for better or worse.[39]

Regardless of the distinct elements of various financial intermediation structures, an extensive safety net is made up of five principles that work in concert to strengthen one another, as shown in *Figure 1* below.

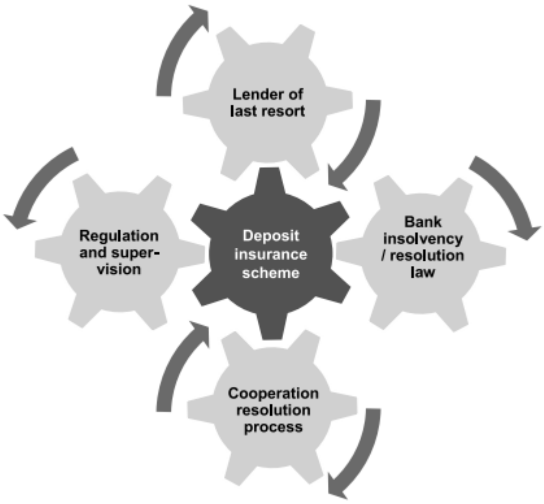

Figure 1: Principles of the financial safety net[40]

[39] Atilla Arda and Marc Dobler, 'The Role for Deposit Insurance Funds in Dealing with Failing Banks in the European Union' (2022) IMF Working Paper No. 2022/002 <https://ssrn.com/abstract=4030021> accessed 4 November 2022.

[40] Bernet and Walter (n 36) 13.

2.3.1 Regulation and Supervision

The stability of a nation's economic structure is based on effective regulation and oversight of financial institutions, primarily to avoid crises and minimise their impact. The significance of liquidity restrictions from banks and the maximum amount of deposit insurance protection, in particular, need to be taken into consideration to minimise moral hazard.

Strong resolution policies, competent regulation, and efficient DGS features necessitate more than just the enactment of banking legislation. They also require regular monitoring and implementation of such regulations, as well as transparency, independence from political meddling and corruption, and public accountability.[41]

2.3.2 Lender of Last Resort

In the event of a larger financial crisis, every national financial intermediation system requires and should have in place an explicit or implicit lender of last resort. This can be the government, the CB, or both. In addition, it is suggested that the CB should serve as the lender of last resort by indicating beforehand its willingness to provide unlimited funding at a cost to banks that are illiquid, yet solvent. In instances where a bank's financial situation is unclear, market mechanisms might fail to safeguard banks from unexpected liquidity issues.

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[41] Patricia A. McCoy, 'The Moral Hazard Implications of Deposit Insurance: Theory and Evidence' (2007) Seminar on Current Developments in Monetary and Financial Law Washington, D.C., October 23-27, 2006 <www.imf.org/external/np/seminars/eng/2006/mfl/pam.pdf> accessed 12 January 2023.

2.3.3 Insolvency Framework

Bank insolvency and resolution regime are significant legal provisions which regulate the conditions of bank insolvencies. In fact, the DGSD and the BRRD[42] stipulate that, if the conditions for resolution are fulfilled, the DGS funds may be utilised to contribute to the funding of bank resolution, and the responsibility falls on the Resolution Authorities to determine, in consultation with the DGS, the amount that the DGS would be accountable for.

2.3.4 Co-Operation Resolution Process

Furthermore, efficient co-operation is another significant factor which complements the feasibility of a financial safety net. This entails clear regulated provisions that are ideally also harmonised on an international level. In fact, the DGSD stipulates that regulators, designated authorities, and resolution authorities should co-operate effectively.[43]

2.3.5 Deposit Insurance Scheme

The last principle evaluates the deposit insurance scheme which covers the definition of 'eligible deposits' wherein specific categories have been established in the DGSD to minimise the potential risk of bank runs thereby preventing a liquidity crisis within the financial system. Therefore, it enhances, supports, and strengthens the measures of the

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[42] Directive (EU) 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council Text with EEA relevance (BRRD), art 104.

[43] DGSD art 3.

other four principles, while also complementing and supports the objective of a deposit insurance scheme.[44]

In addition, DGSs should achieve five key objectives in terms of this system.[45] The first objective is confidence whereby DGSs are established to create confidence in the financial system, particularly during a financial crisis, through credible communication mechanisms to depositors of credit institutions and to the whole financial system.

The second objective involves depositor protection by DGSs in case of a crisis against a loss of their covered eligible deposits in insolvent credit institutions. Implicitly, it protects the insured credit institution against a run, hence other banks from instability. Thirdly, DGSs are guaranteed to secure covered eligible deposits from the capacity of other stakeholders in the bank and thus, it verifies the privileges of depositors on the basis of covered deposits.

Meanwhile, the fourth objective involves adequate financing of the DGS in order to protect depositors' covered deposits in case of insolvency. It ensures that there is sufficient liquidity to cover the claims of eligible deposits in the event of a crisis. Finally, DGSs should support other authorities and other bodies in the financial safety net, in terms of co-operation and exchange of information to secure and improve the stability of the financial system.

A financial safety net may only serve its functions if every principle fulfils its objective. Ultimately, the net is only as powerful as its weakest link. Furthermore, explicit DGSs of

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[44] ibid art 2 (with reference to the list of exclusions pursuant to art 5).
[45] Bernet and Walter (n 36) 14.

various nations that became mandatory under the DGSD to protect eligible deposits indicate clearly that the current DGS regimes were unable to fully meet the expectations placed on them.[46]

2.4 Moral Hazard

Moral hazard occurs when banks are encouraged to take on additional risk since the related costs of such risk are, in whole or in part, borne by others. Although DGSs provide several benefits in stable economic conditions, there are also disadvantages in poorly designed DGSs.

Moral hazard arises when depositors are less cautious in selecting a credit institution, thus discouraging them from transferring funds to a more stable credit institution since they are aware that they are protected under the law if the bank goes insolvent. Furthermore, credit institutions are more inclined to take additional risk in their portfolios. In addition, the reduced concern of panic runs causes depositors to borrow funds from distressed credit institutions, rather than from sound and financially credible banks.[47]

In fact, if a sound DGS provides coverage for any potential shortfall in funds, the likelihood is that depositors would be more reluctant to monitor the bank's performance and stability. Conversely, the guarantor is more encouraged to oversee the financial conditions of the bank, and is expected to ratify robust capital requirements. Other experts argue that the establishment of a DGS results in low market discipline, while the

[46] ibid.
[47] Garcia (n 21) 6-7.

capping is excessively high, leading to a government subsidy for banks.[48] Although such arguments make a valid point, to some degree, the public remains confident that DGSs are essential as they have proven to be resilient, despite the severe economic upheaval. In fact, a study in 2014 revealed the importance of effective deposit insurance which became more extensive and with higher coverage since the financial crisis.[49] In addition, such measures ensured that DGSs are not an *Achilles Heel* in the financial safety net.[50]

Experts proposed that DGSs should be mandatory in each MS, and should be clearly defined and understood. In addition, coverage should be limited, political interference should be prevented, and premiums should be calculated on a risk-adjusted basis to reduce moral hazard. Between 1980 and 1997, a study was conducted on sixty-one jurisdictions to determine whether DGSs increase stability in the banking sector. It was highlighted that the potential of a crisis is exacerbated by DGSs, especially when interest rates are deregulated, coverage is extensive, and the DGS is controlled by the state, rather than operated independently.[51]

In addition, flat rate premiums could also impose moral hazard since credit institutions are likely to borrow additional risk equal to, or lower than, the risk-free rate by generating deposits for investments in high-risk assets. According to the EU, DGSs should not be subject to unrestricted capping as this may encourage banks to be more

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[48] Cariboni and others (n 29).
[49] Asli Demirgüç-Kunt and others, 'Deposit Insurance Database' (2014) IMF Working Paper WP/14/118 <www.imf.org/external/pubs/ft/wp/2014/wp14118.pdf> accessed 16 January 2023.
[50] Arda and Dobler (n 39).
[51] Asli Demirguc-Kunt and Enrica Detragiache, 'Does deposit insurance increase banking system stability? An empirical investigation' (2002) IMF Working Paper WP/00/3 <https://www.imf.org/external/pubs/ft/wp/2000/wp0003.pdf> accessed 11 January 2023.

incompetent. Furthermore, DGSs can significantly lower the risk of bank failures, but if they are not used wisely, they might trigger crises by encouraging financial institutions to take unwarranted risks. Therefore, jurisdictions must set up adequate safeguards against moral hazard by credit institutions due to the exponential increase of explicit DGSs and the possibility of bank crises.[52]

A study in 1989 revealed that, during the U.S. Savings and Loan crisis, regulatory activity encouraged protected thrift institutions to take excessive risk. Furthermore, the study exposed principles which reduce moral hazard and increase market discipline. In addition, it was highlighted that privately managed DGSs reduce moral hazard as stakeholders have sound incentives to oversee management actions.[53]

According to a 2002 study in the European Economic Review, financial institutions' levels of risk-taking are affected by competition, concluding that risk resulting from increased competition can be moderated through risk-based premiums and information sharing with depositors. A DGS should be explicitly established in the law so that depositors are cognizant of the rules that govern the scheme to reduce moral hazard. However, some economists argue that risk-based premiums are insufficient in mitigating moral hazard, suggesting that alternative principles should be assessed.[54]

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[52] Maria Fenech Imbroll, 'An Evaluation of Deposit Guarantee Schemes in the EU' (MBA thesis, University of Malta 2012).

[53] Asli Demirguc-Kunt and Edward J Kane, 'Deposit Insurance Around the Globe: Does It Work?' (2001) WP 8493 National Bureau of Economic Research, Cambridge MA <https://www.nber.org/papers/w8493> accessed 12 January 2023.

[54] Cariboni and others (n 29).

Some critics disagree, arguing that the drawbacks of excessive moral hazard and lower market discipline outweigh the advantages of an explicit protection scheme. An increase in moral hazard and poor behaviour problems can be solved more successfully by efficient resolution of insolvent banks, rather than by co-insurance or risk-based contributions.[55]

In a study conducted in 2007, the author emphasised the importance of countries choosing explicit deposit insurance to be aware of other principles for a successful performance deposit insurance, including a strong legal framework, suitable deposit insurance design and safeguards to prevent risk, efficient monitoring by regulators, sound and strong credit institutions, and good corporate governance. Explicit deposit insurance may safeguard depositors, while reducing moral hazards if all of these measures are in place.[56]

Studies have shown that DGSs must be accompanied by an improved prudential and supervisory framework, which attempts to reduce moral hazard. The rationale is to try to counterbalance the negative incentives for bank officials and management to increase their risks that are integral to DGSs. If deposit insurance can be strengthened with suitable supporting measures in prudential regulation, it would fulfil its goal of strengthening system stability, and may even have a positive influence on economic growth.[57]

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[55] George Kaufman, 'Using efficient bank insolvency resolution to solve the deposit insurance problem' (2006) 8 JBR <https://doi.org/10.1057/palgrave.jbr.2350035> accessed 12 January 2023.
[56] McCoy (n 41).
[57] Bernet and Walter (n 36) 10.

An effective safety net might succeed in countries where informational and proper integrity is inadequate; thus, DGS structure and design policies must be established, taking into consideration accountability between regulators and taxpayers. Furthermore, the study highlighted that transparency is achieved when credit institutions provide accurate information about a bank's financial situation, which is a key component in ensuring a decrease in moral hazard. Consequently, such information provides additional protection by enabling supervisors and depositors to identify the financial implications and changes in the bank's financial circumstances.[58]

The EU framework was strengthened after the financial crisis, particularly the level of coverage, cross-border funding arrangements, and encouraging regulatory arbitrage. Meanwhile, in 2019, the EU further developed the Recast Directive to include the calculation of risk-based contributions.

2.5 Systemic Risk

A significant feature of the creation of a DGS is the guarantee it provides to depositors ensuring that they can swiftly retrieve their funds in case of insolvency, thus minimising bank runs and preserving strong depositor confidence in the financial system. In the event of a 'bank run', the banks' capacity to invest in long-term assets to generate liquid deposits that may be utilised in transactions suffers. In addition, retail depositors may

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[58] Edward J. Kane, 'Designing Financial Safety Nets to Fit Country Circumstances' (2000) World Bank Policy Research Working Paper WPS2453 <https://documents1.worldbank.org/curated/en/423381468764432839/pdf/multi-page.pdf> accessed 12 January 2023.

demand their deposits instantly for various reasons, which could undermine banks' liquidity reserves.

Typically, as depositors request withdrawals, payments are made on a first-come, first-served basis, and thus, it is rational for depositors to withdraw their funds if asset values fall precipitously. Naturally, depositors at the forefront may receive all of their funds, while the remaining depositors may not receive anything if the bank exhausts its capital and is obliged to limit withdrawals.[59]

The failure of one bank can cause systemic risk, which might affect other industries besides the financial industry thereby possibly generating negative externalities, resulting in additional impediments. Bank runs may manifest either due to negative irregular returns or to increased volatility in the stock returns of the banks concerned.[60] In fact, in the GFC, depositors ran to withdraw their funds from Northern Rock, fearing the bank would fail, and the government was forced to act by guaranteeing their funds to halt the panic.[61]

[59] Anginer and Demirguc-Kunt (n 37).

[60] Commission, 'Review of the Deposit Guarantee Schemes Directive' (2005) Commission Services Consultative Working Paper on Deposit Guarantee Schemes DGS 001/2005 <www.ft.dk/samling/20051/almdel/eru/bilag/67/216758.pdf> accessed 15 January 2023.

[61] Simon Lambert, 'Fears Mount That the Eurozone Debt Crisis 'Jog' Could Turn into a Run on Banks Unless Savers Get Better Protection Pot' (London 8 June 2012) This is Money <www.thisismoney.co.uk/money/news/article-2155449/Fears-mount-euro-debt-crisis-bank-jog-turn-run.html> accessed 15 January 2023.

According to the ECB, depositors recently rushed to withdraw funds from Sberbank Europe AG, causing the bank's liquidity position to deteriorate due to its position as FOLTF.[62]

Bank runs can occur during times of crisis; however, the creation of DGSs can significantly lower the frequency of bank insolvencies. The notion of bank insolvencies presents severe negative consequences for the economy since they can have an impact on the entire banking system by eroding public trust and damaging other financial institutions. Consequently, the failure of a single bank might result in systemic danger.[63]

Although deposit insurance has the tendency to aggravate moral hazard and increase the vulnerability of financial systems to crises in periods of economic growth, it can also enhance depositor confidence and reduce the likelihood of contagion bank runs in times of financial difficulty. The effect of deposit insurance vis-a-vis the risks on banks and the stability of the financial system is determined by whether the safeguards of DGSs prevail over its costs.

The moral hazard impact prevails if the implementation of deposit insurance is more closely connected with bankruptcy than it is with panic runs. The study demonstrates that the costs associated with moral hazard exceed the stability advantages of deposit insurance that separates liquidity issues brought on by irrational outflows of deposits

[62] ECB, ‘ECB Assesses that Sberbank Europe AG and Its Subsidiaries in Croatia and Slovenia Are Failing or Likely to Fail’ (2022) <www.bankingsupervision.europa.eu/press/pr/date/2022/html/ssm.pr220228~3121b6aec1.en.html> accessed 15 January 2023.

[63] Douglas Diamond and Philip Dybvig, ‘Bank Runs, Deposit Insurance, and Liquidity’ (1983) 91 Journal of Political Economy 401 <www.bu.edu/econ/files/2012/01/DD83jpe.pdf> accessed 16 January 2023.

from issues caused by insolvency. In addition, other studies have also analysed the impact of deposit insurance, prior to and post-GFC, in relation to banks and systemic risk.[64]

Furthermore, DGSs encourage more risks on banks, and minimise systemic stability in normal times. The study revealed that, during the GFC, jurisdictions with more significant coverage levels have lower bank risk and higher systemic stability. In addition, non-fully financed DGSs must be reputable in terms of ex-ante funding in order to prevent systemic bank runs.[65]

The government's capacity to provide deposit insurance is crucial for its credibility, as evidenced by the experiences in Cyprus and Iceland. A study conducted in 2020 analysed the Portuguese depositors' actions following the disclosure that protected depositors in Cyprus would be required to contribute to their banks' losses. It was revealed that Portuguese depositors decreased their deposits in small, less-known banks, despite having deposits that were guaranteed.[66]

The significance of DGS design structure and features cannot be underestimated, determining how poorly designed DGSs can raise the possibility of a banking crisis in a nation. DGSs must include features that assist banks in internalising risk-taking. A system with supervisors who are able to take immediate remedial action and deposit insurance that is supplemented by stricter capital rules tends to perform more effectively in

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[64] Harold Ngalawa and others, 'Banking Instability and Deposit Insurance: The Role of Moral Hazard' (19th edn 2016) Journal of Applied Economics.
[65] Anginer and others (n 38).
[66] Diana Bonfim and Joao Santos, 'The Importance of Deposit Insurance Credibility' (2020) <https://ssrn.com/abstract=3674147> accessed 15 January 2023.

practice than one without these additional design elements. The overall impact of deposit insurance can be uncertain. Depending on how well it is established and managed, it may assist or harm a jurisdiction.[67]

2.6 The Banking Union

2.6.1 The Creation of the Banking Union

The establishment of the BU was proposed at the 2012 EU Summit in the wake of the GFC. The rationale for such proposal was to '*affirm that it is imperative to break the vicious circle between banks and sovereigns'*.[68]

The creation of the BU should establish an EU safety net for credit institutions, and is comprised of three pillars: the first pillar comprises a Single Supervisory Mechanism (hereinafter referred to as the 'SSM') solely for the banking sector and for banks in the Eurozone regarding micro-prudential supervision. Meanwhile, the second pillar comprises the Single Resolution Mechanism (hereinafter referred to as the 'SRM') for non-viable banks, and a Single Resolution Fund (hereinafter referred to as the 'SRF') to cover any subsequent funding gaps, and the third pillar comprises the European Deposit Insurance Scheme (hereinafter referred to as the 'EDIS'). The institutional and legislative measures to build the first and second pillars of the BU emerged in 2013 and 2014. In addition, in 2015, the EU Commission proposed a third pillar to establish the EDIS;

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[67] Anginer and Demirguc-Kunt (n 37).
[68] EU Summit, 'Euro Area Summit Statement' (2012) Brussels <www.consilium.europa.eu/media/21400/20120629-euro-area-summit-statement-en.pdf> accessed 16 January 2023.

however, the process of implementing the legislative framework has been halted. Furthermore, these three pillars are incorporated in a 'single rulebook' comprising specific provisions to banks and DGSs in relation to prudential regulation and supervision.[69]

2.6.2 The First Pillar: The SSM

The SSM was established in 2014 by virtue of the Single Supervisory Mechanism Regulation (hereinafter referred to as the 'SSMR'),[70] and is relevant to all EU MS both in terms of the euro currency and MS with a derogation.[71]

The SSMR is developed on four fundamental factors that illustrate the agreement established between EU institutions and MS during its development. The first factor comprises the delegation to the ECB of 'specific tasks' for micro-prudential supervision pertaining to specific types of financial institutions from NCAs, which are implemented in the SSM. The second factor comprises of the identification of financial institutions to which the ECB has been delegated these specific obligations. In this regard, the SSMR implemented a 'two-tier system' for the separation of powers within the SSM, differentiating between SIs, LSIs and other supervised entities.[72] Nonetheless, the

[69] Christos Gortsos, 'European Banking Union within the System of European Banking and Monetary Law: Semantic Scholar' (2019) The Palgrave Handbook of European Banking Union Law <www.semanticscholar.org/paper/European-Banking-Union-Within-the-System-of-Banking-Gortsos/54d656f1cab0ea033f7cd0374f3c5a2af664c766> accessed 16 January 2023.
[70] Directive (EU) 1024/2013 of the Council Regulation of 15 October 2013 conferring specific tasks on the ECB concerning policies relating to prudential supervision of credit institutions [2013] OJ L287/63 (the 'SSMR').
[71] ibid art 2 (1).
[72] ibid art 6.

authorisation and withdrawal of licence for all banks is exclusively within the ECB's capacity.[73]

The third factor of the SSMR is the integration of the SSM into the 'European System of Financial Supervision' (hereinafter referred to as the 'ESFS') without interfering with the duties of the EBA and the other duties of the ESFS.[74] The fourth factor is the establishment of 'Chinese walls' within the ECB to facilitate the efficient segregation of monetary policy and other obligations from regulatory duties.[75]

2.6.3 The Second Pillar: The SRM and SRF

The SRM and SRF were established in 2014 by virtue of the Single Resolution Mechanism Regulation[76] (hereinafter referred to as the 'SRMR') and the SRF Agreement.[77] The SRMR was enforced in 2016, and its purpose is to establish consistent guidelines and harmonisation for the orderly resolution of banks established in EU MS.[78] The standard procedures must be followed by the Single Resolution Board (hereinafter referred to as the 'SRB'), which was implemented in pursuance of Article 42 of the SRMR, in co-operation with the Council, the Commission, and the national resolution authorities, within the framework of the SRM pursuant by the Regulation. Its

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[73] ibid arts 4, 14-15.
[74] ibid art 3.
[75] ibid art 25.
[76] Directive (EU) 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 [2014] OJ L225/1 (the 'SRMR').
[77] Council, 'Intergovernmental Agreement No 8457/14 on the transfer and mutualisation of contributions of the SRF' (2014) <https://data.consilium.europa.eu/doc/document/ST-8457-2014-INIT/en/pdf> accessed 16 January 2023.
[78] SRMR (n 77) art 1.

implementation was an essential supplement to the SSMR since it would be a contradiction for the ECB to supervise banks at an EU level, while decision-making in instances requiring resolution is conducted at national level.[79]

2.6.4 The Third Pillar: The Proposal for an EDIS

Another essential risk-sharing instrument for the BU is the establishment of an EDIS, which comprises the third pillar. This would ensure that deposits are adequately safeguarded throughout the BU, and hence, eligible deposits are protected throughout the Monetary Union. EDIS, like the SRF, requires funding from credit institutions. Backstop measures would also be required in times of severe systemic crisis. The amalgamation of the second and third pillars, the SRM and EDIS, would result in an EU analogue of the successful FDIC framework in the US.[80]

In 2015, the EU Commission proposed an amendment in the SRMR to create an EDIS to supplement present national deposit insurance funds.[81] In addition, every DGS which is formally recognised in an EU MS, as well as all member bank participants in such schemes, will be covered by such proposal. The proposed legislation develops on the DGSD, and will be backed by a Deposit Insurance Fund (hereinafter referred to as the 'DIF'). The SRB, which will be broadened to operate the EDIS in collaboration with DGSs, and specified authorities will be incorporated into what is known as the Single

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[79] Gortsos (n 70) 25-26.
[80] ibid 150-151.
[81] Commission, 'Proposal for a Regulation of the EU Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish an EDIS' COM (2015) 586 final <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015PC0586&from=EN> accessed 16 January 2023.

Resolution and Deposit Insurance Board that will supervise DGSs on a national level, and will only release funding if certain requirements are met.[82]

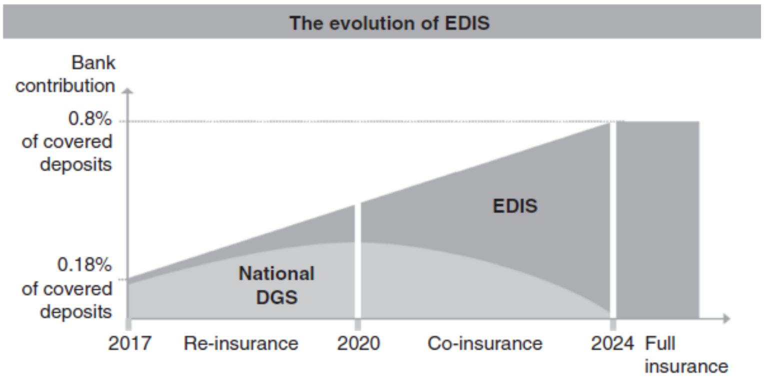

Figure 2: EDIS Evolution[83]

The Commission's proposal is three-fold, where the process comprises the 're-insurance stage', the 'co-insurance stage', and 'full insurance', as shown in *Figure 2*.

During the 're-insurance stage', which would span three years from 2017-2020, a DGS could only obtain financing from EDIS after they have utilised all of their funds. Once EDIS provides the necessary liquidity coverage to the DGS, naturally, the latter must reimburse the funds obtained from EDIS. EDIS funding would supplement a national strategy, albeit with a specific limit, and solely account for a fraction of the DGS's incurred losses. Furthermore, there will be mechanisms in place to guarantee that

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[82] ibid 75, 396-398.

[83] John Sammut and Jessica Friggieri, 'The European Deposit Insurance Scheme: A Myth or a Fact?' (2018) <www.emerald.com/insight/content/doi/10.1108/S1569-375920180000099010/full/html> accessed 16 January 2023.

justified DGSs can only access the EDIS and address the potential moral hazard. In addition, EDIS funding would be accessible only if the applicable regulations in the DGSD were properly implemented by the respective MS, and any expenditure of EDIS funding would be properly scrutinised. During the 'co-insurance stage', between 2020-2024, the EDIS develops further into a mutualised system, albeit still governed by restrictions and precautions against exploitation. At this stage, the national DGS would not be expected to consume its own finances before obtaining funding from EDIS. Furthermore, EDIS would be prepared to compensate a portion of the expenses incurred as soon as eligible depositors are required to be compensated.[84]

Through EDIS, this creates a higher degree of risk allocation among DGSs. EDIS's contribution will begin at a low level of circa twenty per cent, and will increase gradually over a period of four years. Finally, from 2024 onwards, DGSs would be entirely insured by EDIS. Therefore, when the respective DGS becomes fully insured, it denotes that it is fully insured from liquidity needs and losses arising from claims.[85]

Therefore, in 2024, the SRF will have been fully formed, and the participation rate in the EDIS will reach 100%. By 2024, the DIF should account for 0.8% of all eligible deposits held by banks within the BU. Based on statistics from 2011 pertaining to bank balance sheets, the fund should be approximately €43 billion in total. If the banking industry develops, the fund would naturally increase and it would take eight years to gradually increase the DIF.[86]

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[84] Sammut and Friggieri (n 84) 218-219.
[85] ibid.
[86] ibid 217.

Although the proposal for an EDIS sought to protect and harmonise depositors across the EU, improved credibility and easier pay-out mechanisms, EDIS also has its own challenges. Firstly, the establishment of cross-border DGS is impossible, unless a global supervisory institution and legislation are implemented. Furthermore, political intervention may preclude the establishment of the EDIS, and lastly, there might be additional administrative and operational complexities to administering such a project.[87]

Other arguments were also raised by experts for the adoption of an EDIS. The principal concern of its opponents is that the establishment of a single pan-EU DGS raises the possibility that poor banking sectors would be subsidised by stronger EU credit institutions since they do not give considerable weight to risk-based contributions. The argument was debated on two issues: NPLs and prudential treatment of banks' disclosure to country risk. With regards to the former, NPLs have been one of the ECB's main aims in banking supervision since the SSM's inception.[88]

A report published by the EU Commission in 2018 demonstrates that the Q3 figures of the previous year proved the EU's NPL ratio significant decline. With regards to the latter, the primary goal of EU authorities in terms of risk reduction is to decrease the correlation between banks and their 'home nation'.[89]

[87] ibid 218.
[88] Concetta Brescia Morra, 'The Third Pillar of the Banking Union and Its Troubled Implementation' (2019) <https://link.springer.com/chapter/10.1007/978-3-030-13475-4_17> accessed 16 January 2023.
[89] Commission, 'Second Progress Report on the Reduction of Non-Performing Loans in Europe' COM (2018) 133 final <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0133&rid=9> accessed 16 January 2023.

During credit crunch, extensive holdings of national government bonds held in banks had a significant impact on crisis management and exacerbated public debt restructuring expenditure. Another issue is the absence of harmonisation of various state laws, for instance, insolvency laws, that have an impact on the administration during a crisis. In addition, other reservations in terms of the EDIS proposal in relation to the governance of the EDIS are raised in the EU Commission's recommendations. The issue is under intense political review since some MS believe that the DGS and resolution authorities should work together to govern the EDIS, while others suggest giving these responsibilities to national central banks.[90]

In 2017, the Commission published amendments to the original proposed plan since there were debates on the three-stage EDIS model. Additionally, the report recommended several changes and measures to solve the problem of NPLs and to facilitate the process for banks to diversify their sovereign portfolios, which would undermine the bank, particularly the sovereign nexus. Consequently, the Committee recommended implementing the EDIS model more gradually, along with the progress made in mitigating risk, commencing with a constrained stage of re-insurance, and progressively transitioning to co-insurance.[91]

In 2018, the EU Council issued a '*progress report'* which aimed to determine that broad support was encouraged for the continuation of the EDIS proposal, subject to the

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[90] Sammut and Friggieri (n 84) 225.

[91] Commission, 'Communication to the EU Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions on completing the Banking Union' COM (2017) 592 final <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017DC0592&rid=1> accessed 16 January 2023.

involvement in the discussion of possible alternatives to the EDIS initially proposed model would not be construed as support from MS, and that the technical work should not take precedence over any potential political negotiations. Furthermore, the Council has also shown little support for the technical working group's recommendations due to the intense political dispute. Despite the Commission's strong desire to support the establishment of the EDIS, it is highly probable that the initial proposal will deteriorate due to the political consensus, leading to the establishment of a system that is too ineffective to guarantee the standardised coverage of EU depositors within an adequate period of time.[92]

Evidently, there are various 'winding paths' to be explored before the EDIS is properly implemented. Legislators and regulators are still debating whether it would be more advantageous to focus primarily on lowering banking risks before concentrating on developing an EDIS. In addition, accepting the restriction of state involvement from supporting the EDIS in order to preserve a uniform system continues to be the major hurdle in all EDIS discussions.[93]

In December 2022, the EU Parliament published a draft report on the Banking Union, stressing that the third pillar remains incomplete due to the lack of an EDIS. Furthermore, it acknowledges that such proposal would enhance protection for EU depositors, and believes that it would offer further safeguards to host MS, which may

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[92] Council, 'Presidency report on work in the AHWP on strengthening the Banking Union' (2018) 9819/18 <https://data.consilium.europa.eu/doc/document/ST-9819-2018-INIT/en/pdf> accessed 16 January 2023.

[93] Sammut and Friggieri (n 84).

result in resolving home-host issues. According to the DCS Annual Report (2021), EDIS is still being debated, and the Scheme, in collaboration with the Maltese government and other stakeholders, is providing the required guidance and support.[94]

2.7 National Legislation

2.7.1 The Depositor Compensation Scheme Regulations

The Depositor Compensation Schemes Regulations (hereinafter referred to as the 'Regulations') are implemented to protect the interests of depositors of failed banks which are authorised and licensed by the MFSA.[95] Pursuant to the Regulations, compensation must be provided by the DCS in the event that a bank fails to fulfil its commitments to its depositors or has deferred payment.[96]

In addition, the purpose of these Regulations is to enforce and reflect the relevant provisions of the Recast Directive.[97] Pursuant to the Regulations, '*depositors*' are defined as both natural and legal persons who have entrusted their deposits to a credit institution. In the case of joint accounts, each holder is a depositor, whereas, in the case of deceased depositors, each holder is the successor of the deceased depositor.[98]

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[94] Parliament, 'Draft report on the Banking Union – Annual report 2022) (2022) Committee on Economic and Monetary Affairs 2022/2061 (INI) <www.europarl.europa.eu/doceo/document/ECON-PR-739749_EN.docx> accessed 16 January 2023.
[95] Depositor Compensation Scheme Regulations (n 19).
[96] ibid Regulation 3.
[97] DGSD (n 4).
[98] Depositor Compensation Scheme Regulations, Regulation 2.

In addition, the term '*eligible deposits*'[99] is defined as deposits which are not excluded from coverage,[100] and include deposits held in a beneficiary account, and are 'absolutely entitled', on condition that the person is identified before the pay-out period.[101]

Furthermore, all Maltese licensed credit institutions are protected up to a maximum of EUR 100,000. The DCS covers all eligible deposit accounts, including savings, current, and fixed deposit accounts, as well as any accounts in credit at the time of the bankruptcy, such as, credit card accounts and overdrafts.[102] Under this legislation, the Regulations stipulate exclusions in terms of eligible deposits.[103]

2.7.2 The Establishment of the Maltese Depositor Compensation Scheme

Pursuant to the Regulations, Legal Notice 369 of 2003, as amended by Legal Notices 132 of 2017, 43 of 2019, and 193 and 262 of 2022, the Depositor Compensations Scheme (hereinafter referred to as the 'Scheme') was established on 23 November 2003 to carry out functions by virtue of these Regulations. In addition, the Scheme is a rescue fund for depositors of insolvent banks licensed by the MFSA. In addition, the Scheme maintains an independent legal structure and resides within the MFSA. Furthermore, the Scheme is managed by a separate Management Committee, who is appointed by the MFSA, and is composed of a chairperson and six members from the Central Bank of Malta (hereinafter referred to as the 'CBM'), MFSA, licensed credit institutions, financial

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[99] ibid.
[100] ibid Regulation 9(2).
[101] ibid Regulation 12(5).
[102] Depositor Compensation Scheme, FAQ (2017) <www.compensationschemes.org.mt/Home/ViewContent/17> accessed 17 January 2023.
[103] ibid (n 101).

institutions, licensed investment firms, and consumers having the competence and experience in financial services, administration, or any other professional legal or commercial knowledge and expertise in view of the MFSA.[104] Furthermore, the judicial representation of the Scheme is vested in the Chairman. The Management Committee is accountable for pursuing and implementing the Scheme's objectives and functions.[105] The Management Committee has further appointed the CBM to invest and administer funds pertaining to the Scheme.[106]

The Scheme is designed to promote confidence, not only in licensed institutions, but also in the whole economy. The Scheme is funded by licensed credit institutions, which implies that consumers would not be required to contribute to the Scheme, and thus, the latter is also in charge of handling claims from depositors that are reimbursed from the contributions of credit institutions. The Scheme was established as an additional layer of protection within a sound regulatory and legal framework. In addition, every member bank is obliged to provide the 'Depositor Information Sheet' to its current and potential clients pursuant to Legal Notice 132 of 2017.[107] The Depositor Information Sheet was intended to ensure that depositors remain knowledgeable regarding the key aspects of their protection with the Scheme. Banks provide the standardised

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[104] Investor Compensation Scheme Regulations, S.L. 370.09, Regulation 5 <https://legislation.mt/eli/sl/370.9/eng/pdf> accessed 18 January 2023.

[105] Depositor Compensation Scheme Regulations, Regulation 4.

[106] Compensation Schemes Management Committee (2019) <www.compensationschemes.org.mt/Home/ViewContent/14> accessed 18 January 2023.

[107] Depositor Compensation Scheme Regulations, Schedule.

information sheet to their consumers, either by post or by electronic means, at least once a year.[108]

Furthermore, banks are also obliged to provide a single customer view file (hereinafter referred to as the 'SCV') and a deferred file (hereinafter referred to as the 'DEF') to each depositor holding eligible deposits to the Scheme, either within twenty-four hours when the deposits become unavailable, by a request from the Scheme within twenty-four hours, within three months of receiving deposits, or within three months due to significant changes in the member's SCV system. In addition, SCV and DEF data should be in line with the Scheme's technical requirements pursuant to the notice issued by the Scheme from time to time on its website.[109]

Pursuant to Regulation 3 of the Regulations, the main objectives and functions of the Scheme are to establish a fund for the settlement of claims for compensation by depositors, and to place contributions to the fund, or for the purpose of investments. Other functions involve implementing arrangements for the processing of compensation claims to depositors after consulting with the MFSA. There is also the obligation to process claims in a timely manner and without any undue delay. The fund may be used to fund the resolution of members, to employ its available financial means for backstop measures, and to advise the MFSA on matters related to the Scheme. Furthermore, pursuant to Regulation 15 of the Regulations, all claims are paid in the euro currency denomination, and where the currency is denominated in a foreign

[108] ibid Regulation 19.
[109] ibid Regulation 20.

currency, the applicable EU foreign exchange rate by the ECB on the compensation payment date is used to carry out compensation.

Pursuant to Regulation 10, the maximum compensation of EUR 100,000 is awarded to depositors for eligible deposits. Any interest earned on the account is protected until the bank is declared insolvent.

The Scheme is triggered when, in view of the MFSA, a member bank is unable to achieve its obligations arising from demands of depositors for reasons related to its financial conditions, or when the Law Courts resolve to liquidate the bank. In terms of Regulation 8 of the Regulations, when the MFSA determines that the deposits of the failed credit institution have been made unavailable, the Scheme publishes a notice on its website, newspapers, and also DGSs concerned which may have been impacted by such determination, and provides the necessary information to the host MS. In the event of a pay-out, the Scheme pays compensation within ten working days, until the end of December 2023, and within seven working days from 1 January 2024 in case of SCV payments.[110]

Meanwhile, the compensation pay-out period for DEF payments involves a three-month period from the date of determination. It is thus crucial for member banks to ensure that their data on their clients is up-to-date, and that their information systems are in place to facilitate the smooth process of the pay-out.[111]

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[110] Depositor Compensation Scheme Regulations, Regulation 2.
[111] ibid Regulation 14.

The Annual Report for the year ending 31 December 2021 indicates that the total assets amount to EUR 83,498,132.[112] Under the Banking Act, the Scheme is exempt from the payment of taxation.[113]

Member Banks Protected by the Depositor Compensation Scheme

The Scheme covers eligible deposits which are made with any of the following credit institutions licensed under the Banking Act which are incorporated in Malta, including their branches in the European Economic Area (hereinafter referred to as the 'EEA').

In addition, for depositors of branches registered in another MS set up by the Maltese head office, the host DGS pays compensation on behalf of the Scheme, on condition that the Scheme provides the necessary funding and information to the depositors accordingly and the host DGS does not bear any liability. Similarly, depositors of branches registered in Malta set up by a home MS are repaid by the Scheme on behalf of the MS, on condition that the Scheme does not bear any liability, and has the necessary funding and information to provide compensation provided by the home MS.[114]

In the case where a branch is registered in Malta, and the parent credit institution is located outside the EU, the Scheme ensures that it has the same protection and coverage level as provided in the Regulations. Furthermore, each branch registered in Malta which has its parent credit institution outside the EU, and is not a participant of

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[112] DCS, 'DCS Annual Report and Financial Statements YoA 2021, Statement of Financial Position' (2022) <www.compensationschemes.org.mt/Home/ViewContent/33> accessed 18 January 2023.
[113] Banking Act, Chapter 371 of the Laws of Malta, Article 28A.
[114] Depositor Compensation Scheme Regulations, Regulation 35.

the Scheme, provides to existing and potential depositors at the Maltese branch all the necessary information about guarantee arrangements for deposits held in the Maltese branch.[115] Pursuant to the Regulations, every licensed credit institution is obliged to accept deposits and become a member of and contribute to the Scheme. As at 31 December 2021, eighteen banks were registered with the Scheme.[116]

Maintenance of the Fund

Pursuant to Regulation 23 of the Regulations, the Available Financial Means of the Scheme (hereinafter referred to as the 'AFM') amount to 1.3% of eligible deposits of its participant banks, and the target level is sustained. Meanwhile, as at 31 December 2021, the AFM of the Scheme amounted to EUR 150,137,365; however, the target level required as at the end of 2021 was EUR 184,747,862. The gap in the fund was attributed to the compensation paid out to depositors in 2017 following a determination by the MFSA of an insolvent credit institution. Therefore, the Management Committee is taking all the necessary steps to reach the target level of the AFM. The MFSA appointed a Controller in August 2021 in order to recover the gap in the fund.[117]

Pursuant to Regulation 24 of the Regulations, the Management Committee may, at any time, require participant banks to pay a Compensation Contribution and a Management Expenses contribution.

[115] ibid Regulation 37.
[116] DCS Annual Report (n 113) Participants with the Scheme.
[117] ibid Maintenance of the Fund.

i. *Compensation Contribution*

In accordance with Regulation 25 of the Regulations, the Compensation Contribution is the total amount of covered deposits, excluding temporary high balances, of each participant bank and the level of risk acquired by the member bank. Compensation Contributions are calculated annually, and are determined by the Scheme for each participant bank, in line with the Compensation Contribution method.

As at 31 December 2021, the Compensation Contribution was based on 1.3% of covered deposits of participant banks, the eligible deposits made by each participant bank at the end of the year prior to the relevant fiscal year, along with the degree of risk incurred by every member bank.[118]

During the year, the EU Commission notified the Scheme of a non-conformity issue in relation to the apportionment of the compensation contribution in terms of cash and pledges. The Scheme took prompt action, and liaised with the relative Ministries, and a formal reply was presented to the EU Commission, stipulating an action plan in terms of the revised transposition.[119]

As at 31 December 2021, the required compensation contribution amounted to EUR 184,747,862.

[118] ibid.

[119] Commission, 'DGS: Commission urges Croatia, Malta and Hungary to amend their transposition of the DGSD' (2021) <https://ec.europa.eu/commission/presscorner/detail/EN/INF_21_4681> accessed 18 January 2023.

ii. *Management Expenses Contribution*

As aforementioned, the Scheme may also request participant banks to contribute to a Management Expenses Contribution if it has reasonable grounds to believe that the accessible funds are, or will be, inadequate. During the year, the Management Committee did not require participant banks to contribute to Management Expenses. [120]

Alternative Funding Arrangements

As at 31 December 2021, the Management Committee embarked on a project to explore ways to adopt backstop measures, and discussed with member banks in order to establish a credit line to the Scheme to act as an AFA. The credit line is triggered when the available funds are insufficient to meet its obligations towards depositors of failed banks in accordance with Regulation 33 of the Regulations. Pursuant to the non-conformity issued by the EU Commission, the Scheme focused on the establishment of a state guarantee in favour of the Scheme. At the time of this study, discussions are currently ongoing with the Maltese government to finalise the legislative procedure.[121]

2.7.3 Amendments to the DCS Regulations

Pursuant to the Regulations, Legal Notice 369 of 2003 has been amended several times to reflect better the requirements of the Recast Directive.

[120] DCS Annual Report (n 113).
[121] ibid Alternative Funding Arrangements.

On 4 December 2015, Legal Notice 383 of 2015[122] was issued in the Government Gazette in lieu of Legal Notice 369 of 2003, which transposed the Recast Directive. The salient features include the under-mentioned:

i. Deposits in any currency are protected up to EUR 100,000 per depositor for each credit institution;
ii. The provision for natural and legal persons was implemented for deposit protection. Nevertheless, relatively few depositors were excluded from compensation; and
iii. The time limits for a pay-out were established, and were gradually implemented accordingly:
    a. Payment within twenty working days until 31 December 2018;
    b. Payment within fifteen working days from 1 January 2019;
    c. Payment within ten working days from 1 January 2021 until 31 December 2023; and
    d. Payment within seven working days from 1 January 2024.

On 2 May 2017, Legal Notice 383 of 2015 was amended by Legal Notice 132 of 2017[123] to better reflect the requirements of the Recast Directive. The salient features of the amendments include:

i. Regulation 4 of the Regulations was amended to include that the establishment of the DCS does not prevent the merger with a DGS of a different MS or cross-

[122] L.N. 383/2015, Depositor Compensation Scheme Regulations (2015).
[123] L.N. 132/2017, Depositor Compensation Scheme (Amendment) Regulations (2017).

border DGS, on condition that approval has been granted from the MFSA or the NCA where the relative MS is established.

ii. Regulation 10 of the Regulations was amended to include that the Arbiter for Financial Services may adjudicate any decision or award up to a maximum of EUR 20,000 for the payment of compensation.

On 8 March 2019, Legal Notice 43 of 2019[124] was published to better reflect the requirements of the Recast Directive. The salient features of the amendments include:

i. Regulation 9 of the Regulations stipulated an additional exclusion for electronic money, and thus, it is not considered as an eligible deposit.

ii. Regulation 23 of the Regulations stipulated an amendment on the available financial means of the Scheme. If the available financial means are lowered to more than two-thirds of the target level, the annual contribution is determined at a level that allows the target level to be met within four years.

On 24 June 2022, the Regulations were amended by virtue of Legal Notice 193 of 2022.[125] The salient features of the new amendments include the following:

i. Regulation 23 of the Regulations stipulated an amendment on the total percentage of payment commitments, not exceeding 30% of the accumulated amount of available financial means.

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[124] L.N. 43/2019, Depositor Compensation Scheme (Amendment) Regulations (2019).
[125] L.N. 193/2022, Depositor Compensation Scheme (Amendment) Regulations (2022).

ii. Regulation 25 of the Regulations stipulated an amendment wherein the Scheme may allow a percentage of a Compensation Contribution to be contributed to the Scheme through a payment commitment.

On 21 June 2022, the Regulations were amended by virtue of Legal Notice 262 of 2022.[126] The amendment was triggered by the infringement action which was published by the EU Commission in 2021 to be in line with the Recast Directive.[127] Therefore, the Scheme adjusted Regulation 23 (2) in terms of the target level for the Scheme's funding, as mentioned hereunder:

The available funding of the Scheme is required to achieve a target level of covered deposits of its participant banks gradually as stipulated below, or such higher target level in accordance with the banking rules by virtue of regulation 42 of the Regulations:

a) 1.1% from 1 January 2022 till 31 December 2022;

b) 1.2% from 1 January 2023 till 31 December 2023; and

c) 1.3% from 1 January 2024 till 31 December 2024.

2.8 EU Legislation

2.8.1 The Deposit Guarantee Scheme Directive

The 1994 Directive on deposit guarantee schemes was implemented in the EU for explicit deposit insurance. Directive 94/19/EC ensures every EU MS establishes a safety net which protects depositors of failed banks. The EU issued this Directive with effect

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[126] L.N. 262/2022, Depositor Compensation Scheme (Amendment No. 2) Regulations (2022).
[127] Commission (n 120).

from 1 July 1995.[128] Furthermore, this Directive stipulated that deposit insurance would be required for all banks across EU MS.[129]

The 1994 Directive sought to standardise the systems in existence in several MS, but it also allowed them to develop their individual systems of protection based on national circumstances. The objective of the Directive was to establish a level of protection based on predetermined minimum requirements, rather than to establish a single model to be achieved by all EU MS. The Directive mandated all financial institutions to join a DGS, and to establish a minimum level of protection of EUR 20,000 for each depositor. Meanwhile, it provided no guidelines on whether deposit insurance should be administered by a public or private agency, and did not impose a limit on the contributions.[130]

The 1994 EU Directive established minimal uniformity for DGSs, with only a few requirements to be met by EU MS. EU DGSs differed significantly among countries, disrupting financial stability and the smooth running of the internal market. Consequently, the EU proposed a change to the 1994 Directive in order to set a level playing field across EU MS and simplify the Directive in order to assert the required level of deposit coverage, compensate depositors more quickly, and ensure that DGSs are

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[128] Directive 94/19/EC (n 31).

[129] Neil Murphy, 'European Union Financial Developments: The Single Market, the Single Currency, and Banking' (1999) FDIC Banking Review, 1-18 <www.semanticscholar.org/paper/European-Union-Financial-Developments-%3A-The-Single-Murphy/6d46fa431e1882e5643a4066fe061475b46e9666> accessed 11 January 2023.

[130] Harry Huizinga and Gaetan Nicodeme, 'Deposit Insurance and International Bank Deposits' (2002) European Economy. Economic Papers 164 <https://ec.europa.eu/economy_finance/publications/pages/publication1940_ee.pdf> accessed 19 January 2023.

adequately funded. Such amendments, particularly the new financing obligations, aimed to strengthen and restore depositor trust, while also ensuring long-term financial stability.[131]

2.8.2 The Recast Directive

In 2010, the EU Commission presented a comprehensive recast of the Directive to strengthen depositor protection and confidence in the banking sector. It was intended to improve uniformity and facilitate coverage of deposits by encouraging prompt compensation payment in the event of insolvency. It recommended that, if possible, eligibility standards need to be harmonised across all EU MS. This suggestion was proposed by the EU Commission in an attempt to establish a more stable and secure financial system, mitigate further crises, and improve market confidence.[132]

According to the Press Release published by the EU Commission, the salient features proposed were the following:[133]

i. <u>*Increase in Coverage*</u>

The capping for deposit protection was established to be increased after the GFC. In addition, the capping had to grow from EUR 20,000 to at least EUR 50,000 by mid-2010, and to a maximum fixed coverage level of EUR 100,000 per depositor at the end of the year.

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[131] Commission, 'Deposit Guarantee Schemes – Frequently Asked Questions' (2010) Memo/10/318 <https://ec.europa.eu/commission/presscorner/detail/de/MEMO_10_318> accessed 19 January 2023.
[132] Mariosa Vella Cardona, 'More Protection for Bank Deposits' *Times of Malta* (Malta 12 August 2010) <https://timesofmalta.com/articles/view/more-protection-for-bank-deposits.322123> accessed 19 January 2023.
[133] Commission (n 132).

ii. *Faster Access to Compensation Payments*

In contrast to the 1994 Directive, where depositors had to wait significantly longer to receive their money back, compensation payments to depositors are now to be made within seven working days as from 1 January 2024.

iii. *Less Bureaucracy*

A more streamlined and unbureaucratic strategy is proposed in the Recast Directive. Consequently, the DGS will automatically compensate depositors in the event of a bank failure. Meanwhile, depositors will not be required to submit applications for a smoother process.

iv. *Enhanced Information*

Enhanced information will be useful for depositors in terms of the coverage and main functions of DGSs, enabling them to understand their rights and protection, in line with the Directive. Therefore, after depositors sign their contract with their bank, a 'depositor information sheet' is provided immediately to them to ensure that depositors are well informed of their protection with the Scheme.

v. *Sounder Funding*

In order to promote market discipline, the Recast Directive ensured that participant banks would not only contribute after the event of a bank failure (*ex-post*), but would have to contribute to the DGS on a regular basis (*ex-ante*). In addition, riskier banks are to contribute greater premiums through a risk-based method approach. In addition, the minimum target level for *ex-ante* financing is 0.8% of their covered deposits, to be achieved within ten years. In addition, the Recast Directive also implemented alternative funding arrangements for DGSs in case the target level is not reached, such as, a credit line from governments or private financial institutions.

On 11 February 2020, the EBA published further proposals in relation to three opinions to improve the existing DGSD legislative framework, as follows:[134]

i. *<u>The First Opinion</u>*

The recommendations by the EBA in the First Opinion in relation to Deposit Eligibility, Coverage Level, and DGS Co-Operation included, *inter alia*, amendments to the present regime to guarantee that depositors having funds placed in branches within an EU MS by a bank situated in a third country to cover deposits as defined by the Directive, on condition that they are licensed by the EU NCA, to join a DGS of the MS concerned. If protection is not similar, MS must require such branches to join a DGS operating within their borders. This amendment was proposed particularly in light of the UK's departure from the EU. It also provided recommendations on how to effectively communicate with depositors regarding their protection and proposed to broaden the list of eligible deposits for coverage, including deposits made by governments and by financial institutions acting as nominees.

[134] EBA, 'EBA puts forward concrete proposals to improve the current DGSD legal framework' (2020) <www.eba.europa.eu/eba-puts-forward-concrete-proposals-improve-current-dgsd-legal-framework> accessed 19 January 2023.

ii. *<u>The Second Opinion</u>*

The recommendations by the EBA in the Second Opinion in relation to DGS pay-outs advocated amendments to ensure that depositors are not left unfairly without entitlement to their deposits when the NCA has not yet decided to make a determination. In such a case, the Opinion suggests that depositors are entitled to a sufficient daily amount of their deposits. In addition, the EBA highlighted the significance of increasing the protection of depositors and explicitly informing depositors regarding protection, both in normal times and during a crisis.

iii. *<u>The Third Opinion</u>*

The recommendations by the EBA in the Third Opinion are based on the first and second opinions. The EBA evaluated 115 matters, and proposed 81 amendments to the current law regime with the aim of improving the depositor protection framework and depositor information, while strengthening DGSs' operational efficiency, creating a level playing field across EU MS, ascertaining the stability of the financial system, and ultimately, ensuring the protection of depositors.

2.9 DGS Design and Structure

2.9.1 Principles of Design

The principles and structure of DGS are always determined by the statutory, legal, social, and economic conditions of the relative jurisdiction. In 2001, the FSF published guidelines for the establishment and adoption of a deposit insurance scheme. Over the years, several papers have been published which complemented and expanded these guidelines.[135]

In 2009, the IADI and the BCBS published several core principles in order to be used as guidelines for the establishment and development of a more sophisticated deposit insurance scheme.[136] Apart from highlighting the key findings of a wide conceptual and practical debate in previous years, these guidelines contain previous DGS experiences from the GFC.

2.9.2 Types of Funding

The guidelines discuss three financing options that DGSs may adopt, namely, ex-ante financing, ex-post financing, and a hybrid approach that syndicates both ex-ante and ex-post financing. Conversely to ex-post funding, ex-ante funding can prevent future delays which can be potentially costly. Ex-ante financing is more adequate since insolvent banks contribute to DGSs before a bank fails, in contrast to collecting funds from taxpayers. Risk-based contributions may be easily used to prevent risky behaviour in ex-ante financing, unlike in ex-post financing. Conversely, ex-ante financing comes at the expense of banks with a lack of capital which could have been used elsewhere. As opposed to ex-post funding, it enforces additional administrative costs to manage the fund that would be non-existent if it were acquired through ex-post financing, resulting in potential moral hazard concerns for credit institutions and fund managers. Furthermore, IADI argues that the advantages of ex-ante financing prevail over the

[135] Bernet and Walter (n 36) 25.
[136] IADI (n 35).

disadvantages, and that ex-ante financing is preferable to ex-post financing, particularly for newly established DGSs. Contributions from participant banks are the primary source of ex-ante funding. These can be collected either as a flat rate, differential rate (risk-based), or a combination of both. A flat rate system charges the same premium rate to all participant banks. Furthermore, it is simple to administer, and could be a foundation for a newly-incorporated DGS. However, it would require further developments once the DGS and banks have acquired some practice in collecting contributions and evaluating the necessary risks. To fully understand its resulting effects, a risk-based approach must be risk-aware enough to recognise developing risks at a preliminary phase. Although financial safety-net members can control moral hazard in many forms, a risk-based approach of a DGS can be one mechanism to limit the effect of moral hazard.[137]

In July 2022, the EBA opened a public consultation on its proposed guidelines on DGS contributions.[138] The proposed guidelines seek to improve the correlation between a bank's risk and its contributions to DGSs, including the under-mentioned:

i. Establish the minimum benchmarks for the greater part of core risk indicators, and adjust their minimum weights to improve the performance of risk indicators in calculating risk to DGSs;

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[137] Jan Nolte and Isfandyar Khan, 'Deposit Insurance Systems: Addressing Emerging Challenges in Funding, Investment, Risk-Based Contributions and Stress Testing' (2017) <https://openknowledge.worldbank.org/bitstream/handle/10986/28949/121708-WP-P143745-PUBLIC-FinSAC-Deposit-Insurance-Systems-Guidance-Papers-Nov-2017.pdf?sequence=6> accessed 21 January 2023.

[138] EBA, 'EBA consults on revised Guidelines on methods for calculating contributions to deposit guarantee schemes' (2022) <www.eba.europa.eu/eba-consults-revised-guidelines-methods-calculating-contributions-deposit-guarantee-schemes> accessed 21 January 2023.

ii. Implement an enhanced formula for calculating each participant bank's risk adjustment factor that guarantees a continuous correlation between the risk level of institutions and their DGS contributions; and

iii. Indicate how to account for deposits where the DGS coverage is based on uncertainty to ensure that a bank's eligible deposits and contributions are more closely aligned.

2.9.3 The Mandate for DGSs

The mandate for DGSs when developing a risk-based approach varies between four types, namely:

i. A 'pay box' mandate, where the DGS is solely obligated to compensate eligible deposits. In the event of a pay-out, the DGS receives a mandate from the NCA, and guarantees that all claims are settled in a timely manner;

ii. A 'pay box plus' mandate, where the DGS is responsible for additional functions, such as, financial support for resolution functions;

iii. A 'loss minimiser' mandate, where the DGS directly participates in a series of least-cost resolution systems; and

iv. A 'risk minimiser' mandate, where the DGS is responsible for overall risk reduction duties, such as, risk evaluation, early intervention and resolution powers, and, in certain situations, prudential monitoring.[139]

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[139] Nolte and Khan (n 138).

2.9.4 Legal Structure

The adopted legal structure, which is determined by local legal conditions, is a function of the desired target and the level of independence required for DGSs. Theoretical literature proposes that DGSs should be independent of credit institutions, regulators, supervisors, central banks, governments, and other participants in the financial safety net. For that purpose, it necessarily involves a legal structure wherein, while the administration and the Board are appointed by the relevant authority, they are independent to take their own decisions.[140]

2.9.5 Membership

With regards to membership, there is a broad consensus that all financial institutions that fulfil the requirements must be required to join a DGS. In fact, pursuant to Article 4 of the Directive, it imposes obligatory membership for EU MS to have one or more DGSs in their jurisdiction. Conversely, voluntary membership may lead to adverse selection or an increase in moral hazard. Furthermore, the coverage level correlates closely with the integrity of DGSs. Therefore, the more comprehensive the maximum cover is, the more credible the DGS is seen in the financial safety net.[141]

2.9.6 Governance and Responsibilities

The GFC proved that it is merely the government that has the capacity to restore and preserve public trust in the stability of the financial system. The primary objective of

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[140] Bernet and Walter (n 36) 29.
[141] ibid 30.

DGSs is to support the stability of the financial system as one of the safety net participants. In terms of DGS governance, the DGS board members and management should have the autonomy to take their own decisions in the best interests of the DGS and depositors, and to act in accordance with the legislative framework. Furthermore, important decisions should be taken by the board, even operational decisions, for instance, the decision to make a pay-out in the case of claims arising from an insolvent bank. In addition, the board should also take decisions in terms of their investment policies and the monitoring of risks for the benefit of the DIF.[142]

According to the DCS Annual Report (2021), the Management Committee appointed the CBM to manage the DCS investments since 2003, whose responsibility is to offer financial, accounting, and reporting services, with the aim of safety and liquidity. In addition, the DGS management serves as the administrative role for the board's decisions. It oversees how decisions are put into action, co-ordinates with other participants in the financial safety net and makes sure that the administration and capital management of the DIF are operationally carried out. One of the guiding principles in the governance of the DGS is transparency with regard to the assets of the fund, its financing structure, and its earnings. In order to achieve this, it should release a comprehensive annual report to the public that is also understandable to the common citizen. Along with information about the financial statements, the DGS is required to regularly disclose information about its objectives with regard to investment policy, its choices and actions concerning the application of those choices, and the disclosure of

[142] ibid 36.

risk, or the evaluation of both present and potential risk. Members may still be chosen by the government, parliament, or other government institutions, notwithstanding the independence obligation. Additionally, members ought to be chosen for a fixed period in order to minimise unnecessary political influence.

2.9.7 Administration

Cost-effectiveness is one of the management's objectives for DGS operations. The earnings on the DIF are reduced by administrative expenses. In addition, participant banks would make contributions to the DGS in order to cover these assets. Therefore, the administration of the fund, as well as its protection and performance of its functions, should be undertaken with the least operating expenses. The DGS autonomy is a crucial consideration when it comes to DGS governance. Pursuant to Article 4 of the Directive, it is up to the relative MS to decide the element of DGS independence, being either a public or private entity, taking into consideration the social, economic, and political circumstances of the jurisdiction concerned. With regards to the former, particularly during a crisis, the DGS ensures an efficient distribution of eligible deposits. Consequently, the DGS might be simply assigned to or placed under the management of one of the organisations that supervise the financial services sector. Cross-functional co-ordination, faster implementation of decisions made by regulators, and improved financial liaison with the CB or government are some benefits of a public entity. Conversely, by virtue of the very existence and design of the DGS, it conveys to the depositor the protection of those funds. The credibility of deposit insurance is its main selling point. Therefore, its structurally verified independence from undue political interference serves as justification for this. Conflicts of interest may arise from organisational subordination to other financial institutions, which could jeopardise DGS credibility.[143]

2.9.8 Pay-Out Mechanism

The DGS is responsible for the prompt and effective reimbursement of eligible deposits in the event of insolvency in accordance with legal requirements.[144]

According to the DCS Annual Report (2021), the Scheme conducts a pay-out promptly, and takes all reasonable steps to guarantee that compensation is provided without undue delay. The Data Exchange and Payment Solution (hereinafter referred to as the 'DEPS') system has been created and implemented for this purpose. The SCV data file, the DEF data file, and supplementary data files must all be received, imported, and verified by the Scheme in order for the Regulations to be implemented. Within the time constraints specified by the Scheme, both kinds of files must be electronically received directly from the banks via a secure communication method. The DEPS system was established in January 2019.

2.9.9 Co-Operation and Co-Ordination

The GFC demonstrates that financial market oversight, deposit insurance, and the CB can only instil trust in market participants necessary for crisis management by co-ordinating and adopting valid joint decisions. Co-operation and co-ordination with other

[143] Bernet and Walter (n 36) 35.
[144] ibid 65.

aspects of a financial safety net are critical for efficient deposit insurance, including, *inter alia*, financial services regulators, CB, government, and bank resolution authorities.[145]

2.10 Conclusion

The development of DGSs across Europe reflects the fundamentally diverse and intricate economic and financial systems of the EU MS. DGSs are established in order to ensure a robust system to prevent a crisis in order to protect taxpayers' monies in the event of bankruptcy. Naturally, apart from a robust financial safety net, DGSs must ensure that their structure and design are suitable, not only in terms of the economic, social, and political conditions of the jurisdiction concerned, but should also be robust enough to prevent a systemic crisis.

[145] ibid 70.

CHAPTER 3: METHODOLOGY

'Research is to see what everybody else has seen, and to think what nobody else has thought.'

Albert Szent-Gyorgyi, 1937

3.1 Introduction

Following an evaluation of EU and national legislation, together with the existing literature on the principles of DGS structure and design, including, *inter alia*, the establishment of DGSs within a global context, the importance of financial stability, the implications of moral hazard, and systemic risk hindering the financial services sector are all factors which complement the architecture of DGSs.

This chapter explains the research methodology adopted in this study. This practical research aimed to obtain a better understanding of the various structures and designs of EU DGSs, as well as several opinions about the actual value and significance to the financial services sector. In addition, the chapter explains the methods used for data collection, and discusses why the data achieved is relevant and significant, while highlighting the limitations of this study.

3.2 Primary and Secondary Research

Primary research is designed to meet the demands of the researcher, and usually involves, *inter alia*, interviews, focus groups, and surveys. In this study, the author first carried out secondary research to set the basis before moving on to primary research to cover the research gaps.

In order to better understand the subject under consideration, the author resorted to secondary research. This required gathering data from a variety of sources, including the relevant laws and legislation which govern DGSs, guidelines published by international organisations, and other scholarly literature. Literature was mainly obtained from various databases and other reliable sources obtained from the internet. The author also spent a considerable amount of time evaluating the data primary sources by assessing the various types of structures of EU DGSs, including various opinions thereto. On the other hand, primary data was collected by way of online surveys and semi-structured interviews with several professionals working within the financial services sector. The respondents also comprised experts from many jurisdictions, with years of experience in the provision of financial services.

3.3 Search Synopsis

In conducting the research for this study, the author carried out a comprehensive review of the literature consulted for this study. In view of this, the PRISMA (Preferred Reporting Items for Systematic Reviews and Meta-Analyses) approach was utilised, including a flow diagram outlined in Appendix 2, illustrating the search outcomes and the filtering process employed to identify relevant academic resources. The author conducted a search across four databases, specifically HyDi, Google Scholar, Research Gate, and Springer Link, yielding a total of 65,172 articles, including duplicates which were excluded accordingly.

Subsequently, the author filtered the articles manually limited to the English language and those articles published between 1990–2023. The relevance of these articles was also determined by their connection to the research field and literature that could provide valuable insights on the research questions. Furthermore, the author ensured that the selected literature review was directly related to EU legislation, the history of deposit insurance, the establishment and significance of DGSs, the benefits and challenges of the structure of DGSs within the EU, and academic studies on potential improvements to DGS structures. The information gathered from numerous sources encompassed the research objectives and the appropriate research methods required to achieve such objectives.

3.4 Data Collection

The purpose of mixed-methods research, which combines both qualitative and quantitative research methods, is to broaden and enhance the findings of a study thereby further contributing to the secondary literature. In addition, the mixed-methods approach assisted in providing answers to the research questions.[146]

The author believes that the mixed-method approach was the best research strategy for this study since it provided more leeway in terms of the available strategies for gathering primary data. In addition, the author acknowledges that every research approach has its own advantages and disadvantages. Nevertheless, the various approaches used to collect primary data should support one another in order to increase the relevance and significance of this study.

3.4.1 Quantitative Data

Throughout this study, the author opted for online survey data collection, which is an efficient instrument for all types of quantitative data. Even though other observational

[146] Judith Schoonenboom and R. Burke Johnson, 'How to Construct a Mixed Methods Research Design' (2017) <www.researchgate.net/publication/318228078_How_to_Construct_a_Mixed_Methods_Research_Design> accessed 25 January 2023.

techniques are more challenging to quantify, this research strategy is effective in providing further information about opinions.[147]

The author sought to analyse different perceptions and opinions from several EU DGSs on the benefits and challenges they experience in line with their current DGS structure and design. By conducting surveys, the author sought to answer several questions, collect information, categorise and assess such data to primarily understand the participants' current DGS structure and design, obtain several perceptions, and ultimately, determine whether there is a relationship between various viewpoints.

3.4.2 Qualitative Data

Conversely, qualitative research seeks to comprehend the problems of the study from several perspectives by creating a complex and comprehensive picture. Furthermore, qualitative data is particularly helpful to determine the significance of the events, circumstances, and behaviours of the respondents being studied.[148] The author decided to pursue this form of data collection through interviews in order to further evaluate the different perceptions of MFSA and DCS representatives of the structure and design of the DCS.

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[147] Lisa McIntyre, 'The practical skeptic: Core concepts in sociology' (1999) <www.proquest.com/docview/223511991 > accessed 25 January 2023.

[148] Joseph Alex Maxwell, 'Designing a Qualitative Study' (2008) <www.researchgate.net/publication/255579877_Designing_a_Qualitative_Study> accessed 26 January 2023.

3.5 Survey and Interview Questions

In accordance with Section 2.9 outlined in the previous chapter, the author sought additional perceptions from EU DGSs by means of an online survey, focusing on the factors which affect the adoption and design of the DGS within the jurisdiction concerned.

Moreover, based on the literature examined in the previous chapter, the author sought further insight into the benefits and challenges of public and private administered DGSs, including consumer protection, moral hazard, resources, co-operation and exchange of information, and alternative funding arrangements.

In addition, considering the various arguments outlined by numerous authors concerning moral hazard in deposit insurance, the author also pursued additional insights from EU DGSs on how consumer protection and financial stability could be maintained, while reducing the risk of moral hazard.

In conclusion, the author sought additional insights from respondents on the efficiency of the existing DGS governance structure within the particular jurisdiction, including justifications, to ascertain whether there is the need for further improvement to the structure.

In addition, the author obtained opinions in the form of semi-structured interviews with two financial services industry professionals, one senior official from the DCS and another senior official from the MFSA, allowing them to share their knowledge and voice their diverse opinions. Since the respondents were familiar with the subject and could contribute positively to this study, the author used semi-structured interviews as a qualitative method.

The researcher continuously evaluated the calibre of the responses received, leading to the development of an understanding of the research questions to assess the efficacy of the DCS design and structure, the benefits and challenges of the structure, moral hazard in deposit insurance within the local context, the premises of the DCS within the MFSA, and further improvements to the structure of the DCS, while assessing whether there were any potential discrepancies between the different viewpoints of both officials.

3.6 Survey and Interview Procedure

In terms of quantitative data, the author determined the target audience, concluding that the survey questions should target EU DGS experts in deposit insurance since they would be familiar with the implementation, design, and structure of the DGS in the respective jurisdiction. Conversely, the semi-structured interviews, in terms of qualitative data, should target DCS and MFSA. Therefore, the author chose to interview senior management officials from the DCS and MFSA in order to gain various perspectives from the DCS and the MFSA since the former is housed within the MFSA premises.

With reference to selecting survey respondents, the author adopted non-probability sampling in order to evaluate further the research questions. Given that this study was quite a technical subject, the author pursued 'purposive sampling' which involves choosing respondents for the sample based on their expertise.

In addition, the author formulated the online survey through an online software known as ‘Google Forms’, and circulated it via electronic mail to representatives of EU DGSs through the author’s personal contacts, together with an information letter and consent form, found in Appendix 3, in line with the Ethics Code of Practice. According to a reliable sample size calculator, setting the population size at 49, confidence level at 95%, and margin of error at 5%, the sample amounted to 44 responses. However, the author managed to obtain 35 responses, given that the target population was limited to EU DGSs, while the survey was voluntary to complete. In this regard, limitation mitigation strategies were carried out, as stated in Section 3.8 below.

With regards to semi-structured interviews, the author contacted two officers, from the MFSA and DCS, due to the limitation outlined in Section 3.8 below, and asked them whether they were willing to participate in this study. Additionally, the author forwarded through electronic mail the interview questions, together with an information letter and consent form, found in Appendix 4, in line with the Ethics Code of Practice. A copy of the coded transcribed interviews can be accessed in Appendix 5 of this dissertation.

3.7 Analysis of Results

In terms of the survey results, the author evaluated the closed-ended questions through statistical measures in order to interpret the survey results. In addition, the author interpreted the statistical results through SPSS using the Fisher’s Exact Test method by evaluating the statistical analysis and revealing correlations between the variables. Therefore, this method was utilised since it is more accurate on small samples and it measures how well-observed distribution of data suits with the distribution that is expected if the variables are not dependent.

In addition, the author adopted thematic analysis for the open-ended survey questions and interviews in order to extrapolate themes. Thematic analysis is an effective method for conducting research when the researcher intends to analyse respondents' viewpoints, opinions, and experiences.[149]

3.8 Research Limitations

During the data collection and analysis stage, the author encountered several constraints that became evident. Primarily, an underlying restriction that also emerged from this research is the level of involvement by participants in the survey. According to the sample size calculator, 44 respondents were required to participate in the survey, at 95% confidence level. Therefore, the author circulated the survey to 49 potential respondents, albeit receiving 35 responses, hence a margin of error of 8.77%. Given that the respondents were foreigners, the survey had to be circulated through electronic means. Furthermore, the non-physical element with respondents made it increasingly challenging for the author to interact with potential respondents and achieve a significant response rate.

As regards the questionnaires, the author encountered a limitation, and resorted to online distribution of questionnaires due to the impossibility of physically meeting respondents since the study required EU jurisdictions to participate in the survey. In

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[149] Jack Caulfield, 'How to do Thematic Analysis' (2019) <https://www.scribbr.com/methodology/thematic-analysis/> accessed 26 January 2023.

addition, non-face-to-face data collection has the benefit of being more logistically practical and less likely to introduce the author's biases into the responses provided by the respondents because the author is not present while the data is collected.

In terms of semi-structured interviews as a research tool, the limitation is their subjectivity, as well as the time necessary for their interpretation. In addition, the DCS is quite a technical and specific subject, and is relatively small in size, compared to the MFSA. Therefore, to gain greater insight and balance perspectives, the author conducted an interview with a representative of the MFSA with expertise in the DCS. Additionally, the author interviewed a representative of the DCS who is an expert in the subject, while having expertise in the management and administration of the DCS operations. These experts provided valuable information about the DCS by understanding the structure of the DCS and its relationship with the MFSA.

Furthermore, the notion of practitioner bias might have been present since the author is an officer of the DCS. Meanwhile, the interviewees may not have made a distinction between the author, as a student, and the profession, and thus, the respondents may not have replied objectively. In this regard, the author mitigated such bias by employing surveys and interviews as research methods which were circulated to different participants thereby enabling the author to triangulate the research findings and enhance the validity of this study. Furthermore, the author expressly declared that all the responses would be kept anonymous, and used only for the purposes of this study, as indicated in Appendix 4.

3.9 Research Ethics

In accordance with the Ethics Code of Practice procedure, the author took several ethical measures to ensure that the data was collected, maintained, and assessed properly, while also protecting the identity of the participants who assisted the author throughout this research study.

In terms of the online survey, the author circulated through electronic mail an information letter, as outlined in Appendix 3, and ensured that the participants were not personally identified through the data collected and that replies remained anonymous due to the sensitive nature of the subject. Meanwhile, the collected data is to be destroyed within four months following the publication of the results.

For the semi-structured interviews, the author also circulated through electronic mail an information letter and consent form to MFSA and DCS officials, as outlined in Appendix 4. In addition, the participants were informed that, while their opinions would be referenced in the dissertation, their identities would be anonymised, and their responses would be properly secured by the author and destroyed within four months following the publication of the results.

3.10 Conclusion

This chapter provided a brief overview of the research methodology utilised for this study. The mixed-method approach is a diverse research strategy that allowed the author to acquire a thorough grasp of the perceptions, issues, and further improvements towards the design and implementation of the Maltese DGS. It must be acknowledged that this is a very complex topic; however, through this research methodology, significant conclusions and the appropriate use of surveys and interviews are considered as valid and reliable instruments for this study. Unfortunately, research limitations were encountered throughout this study, which were outlined in this chapter. The following chapter presents the research findings, as indicated by a statistical and thematic evaluation of the primary data obtained.

CHAPTER 4: ANALYSIS AND RESULTS

‘A deposit insurance system is like a nuclear power plant. If you build it without safety precautions, you know it's going to blow you off the face of the earth. And even if you do, you can't be sure it won't’.

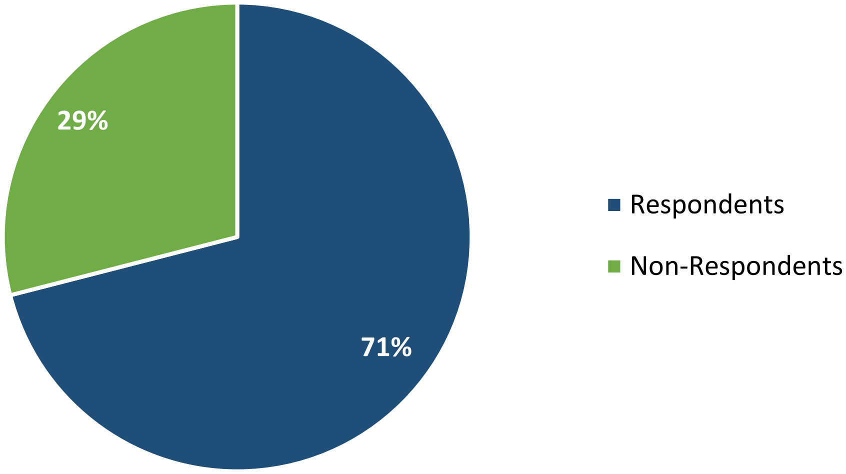
L. William Seidman, 1999

4.1 Introduction

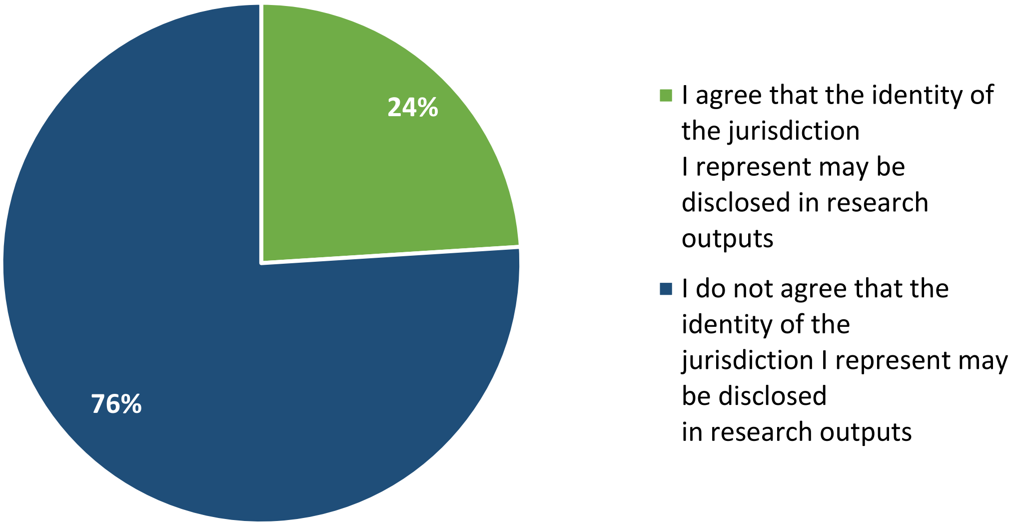
This chapter highlights the findings obtained from the questionnaires compiled by representatives of various EU DGSs and the interviews conducted with representatives of the Maltese DGS and the CA, the MFSA. This primary data was collected in order to evaluate the different structures of EU DGSs, and to obtain different perspectives on the advantages and disadvantages of the current structure of the DGS in every MS. The author further obtained feedback, on a national level, to evaluate whether there are different viewpoints on the structure of the Maltese DGS from the CA and the Maltese DGS itself.

4.2 Questionnaires - Respondents' Consent and Demographics

Despite that the questionnaire was a voluntary one, it is worth noting that 35 (71%) jurisdictions across the EU responded and shared relevant information, perceptions, and recommendations. On the other hand, 14 (29%) jurisdictions did not contribute to the study.

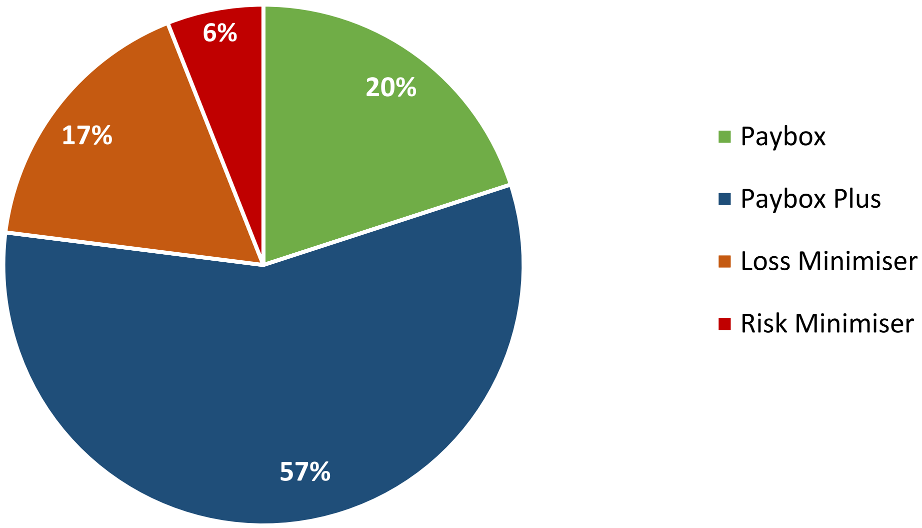


The author obtained 35 responses, with 26 (76%) respondents opting for anonymity, and 9 (24%) respondents agreeing to reveal the identity of the jurisdiction. This result indicates that the majority of the respondents are in favour of maintaining anonymity, and thus, the study does not disclose the identity of the EU jurisdictions involved in the questionnaire. To ensure the confidentiality of those involved, all data collected has been anonymised and stored securely, as defined in Chapter 3. Furthermore, the author adhered to the highest ethical standards, and the gathered information was not used in any way that could compromise the privacy of those who participated in the questionnaire.



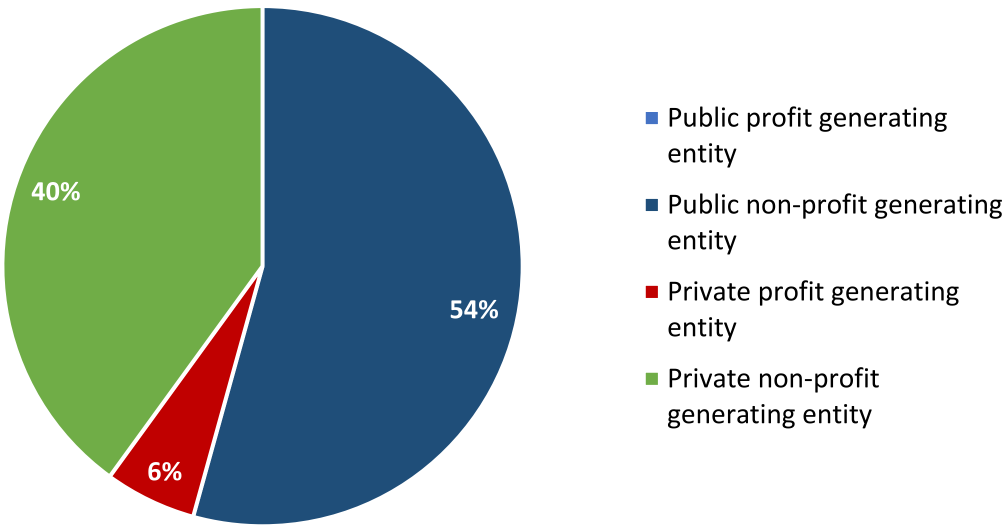
4.3 DGS Structure

4.3.1 DGS Mandate



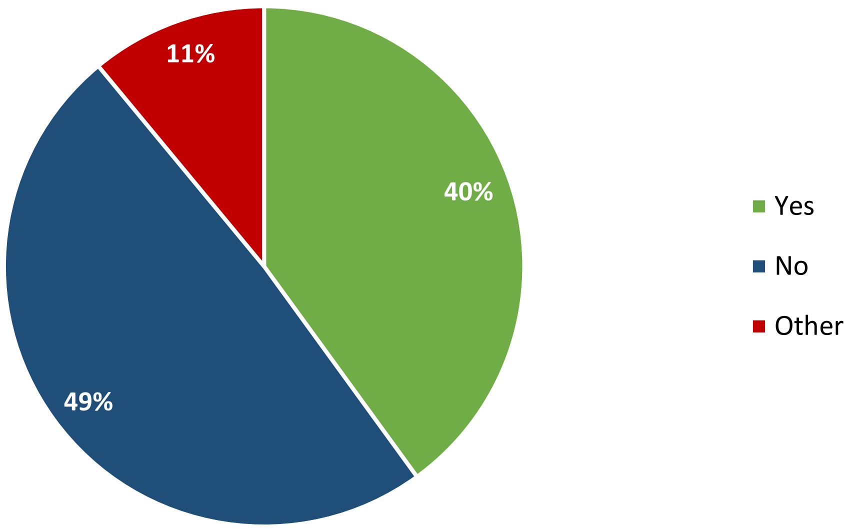
The majority of the EU DGSs (20 - 57%) have a mandate of a Paybox Plus. Therefore, the DGS has additional responsibilities regarding resolution functions, such as, providing financial support. Moreover, 7 (20%) respondents clarified that their mandate is a Paybox, which is solely responsible for the compensation of eligible deposits. Another 6 (17%) respondents highlighted that their mandate is a Loss Minimiser, focusing on least-cost resolution strategies. Lastly, 2 (6%) DGSs have a Risk Minimiser mandate, which entails a range of risk management tasks, such as risk assessment and management, a full range of early intervention and resolution powers, and, in certain cases, prudential supervisory duties.

4.3.2 Profit or Non-Profit DGSs



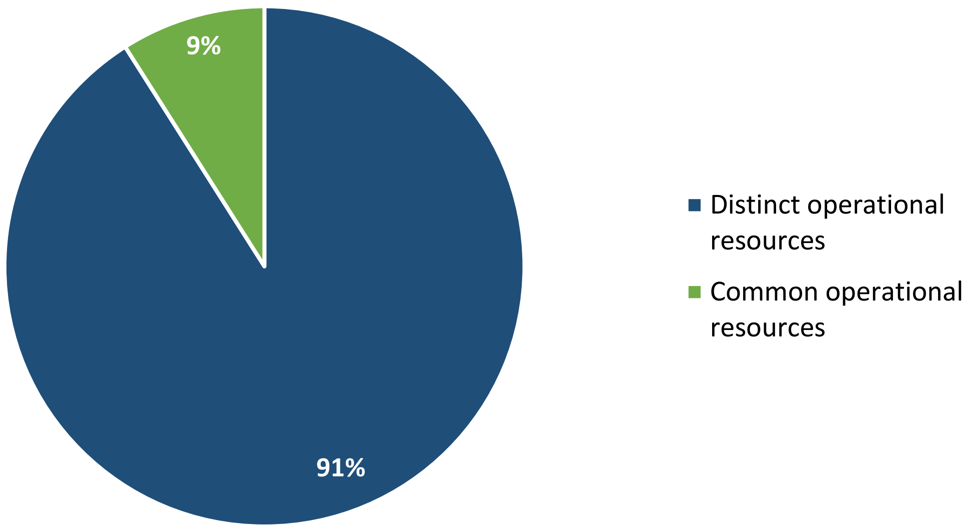
The survey results indicate that most EU DGSs (19 - 54%) are public non-profit entities, while 14 (40%) are private non-profit entities, and 2 (6%) are private profit-generating entities. Interestingly, there were no public profit-generating entities among the surveyed DGSs.

4.3.3 Resolution Tasks



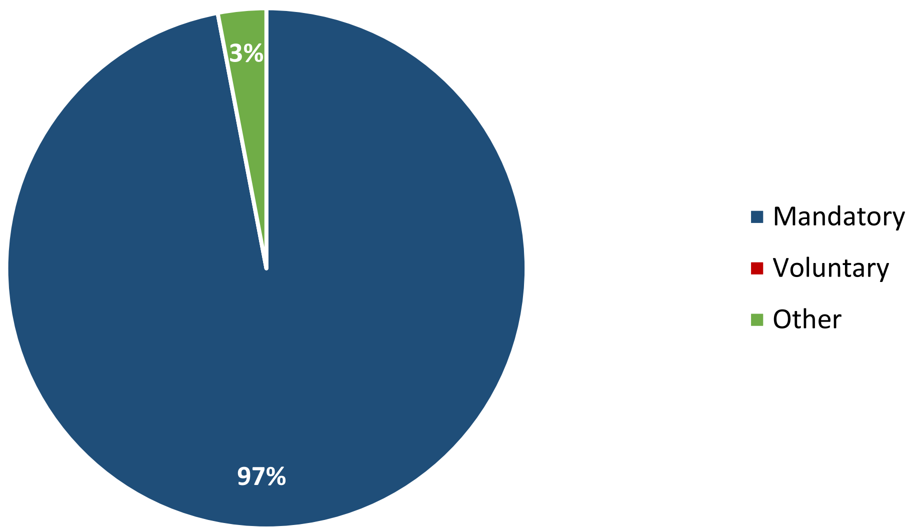
Several EU DGSs (17 - 49%) highlighted that employees do not carry out work related to resolution beyond deposit insurance. On the other hand, 14 (40%) EU DGSs highlighted that DGS employees carry out resolution duties apart from deposit insurance. Furthermore, the remaining 4 (11%) DGSs stated that, since their DGS is a pay-box plus, employees carry out work related to financing for resolution initiatives for third-country branches. Moreover, other DGSs are the administrators of the Resolution fund.

4.3.4 Resources and Administration



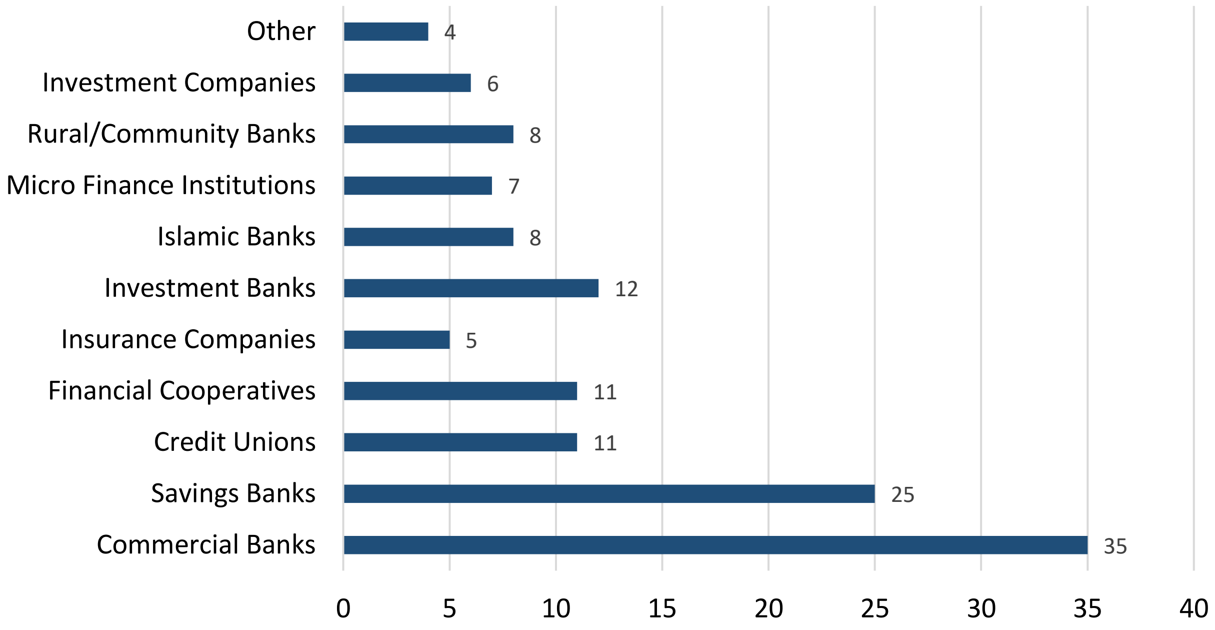
In terms of resources and administration, the majority of the DGSs have distinct operational resources, while the remaining are integrated within another authority. Therefore, 32 (91%) respondents reported that their DGS has separate functions, such as Human Resources, Finance and Procurement functions, while 3 (9%) respondents noted that their DGS functions are not operated independently.

4.3.5 Membership of Participant Banks



It transpired that 34 (97%) respondents disclosed this fact, with only 1 (3%) participant stating that local banks are required to be members, while foreign branches can top up voluntarily. Therefore, it can be inferred that no respondents cited voluntary membership of banks as an option.

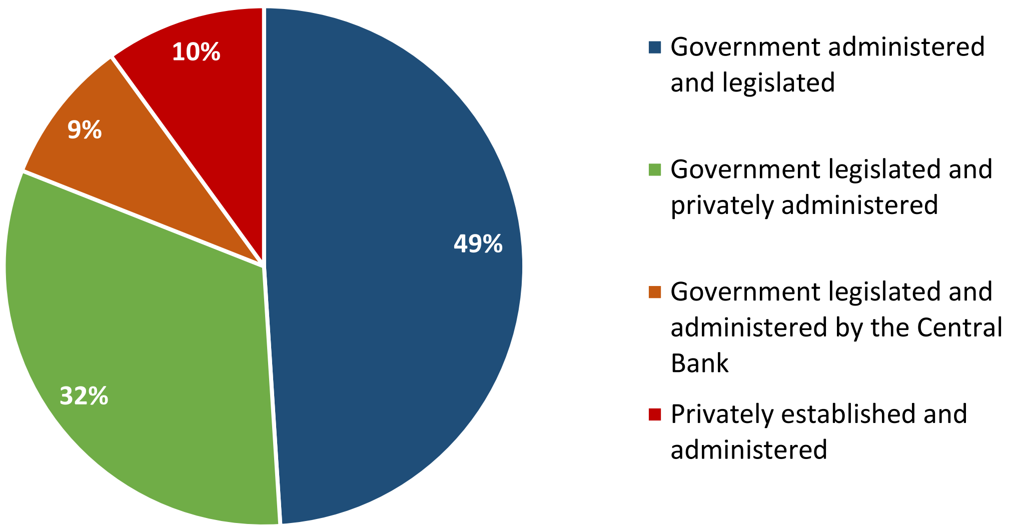
4.3.6 Types of Member Banks



The respondents had the option to choose various types of member banks which are covered by their DGS. It transpired that all 35 (100%) respondents were unanimous that commercial banks are covered by their DGS. Additionally, savings banks (25 - 71%), investment banks (12 - 34%), financial cooperatives and credit unions (11 - 31%), and Islamic banks and rural/community banks (8 - 22%) are covered by their DGS. Moreover, micro-finance institutions (7 - 20%), investment companies (6 - 17%), and insurance companies (5 - 14%) are also protected by their DGS. Other DGSs commented that they also protect securities dealers with deposit accounts, life insurance, home finance, and debt management.

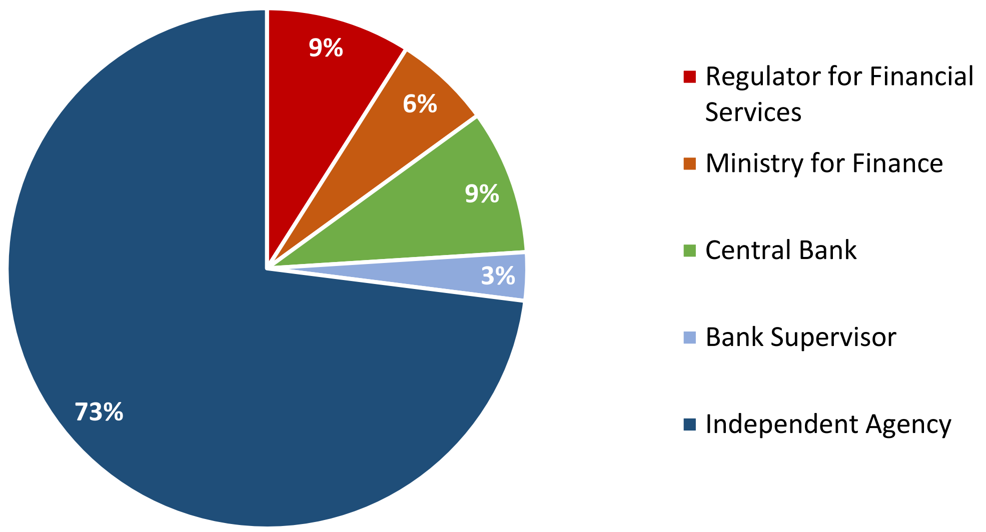
4.4 Legal Structure

4.4.1 Type of DGS



Several respondents (17 - 49%) reported that their DGS is publicly legislated and administered. Another 11 (32%) respondents highlighted that their DGS is publicly legislated and privately administered. Meanwhile, 4 (10%) participants stated that their DGS is privately established and administered, and another 3 (9%) reported that their DGS is publicly legislated and administered by the Central Bank.

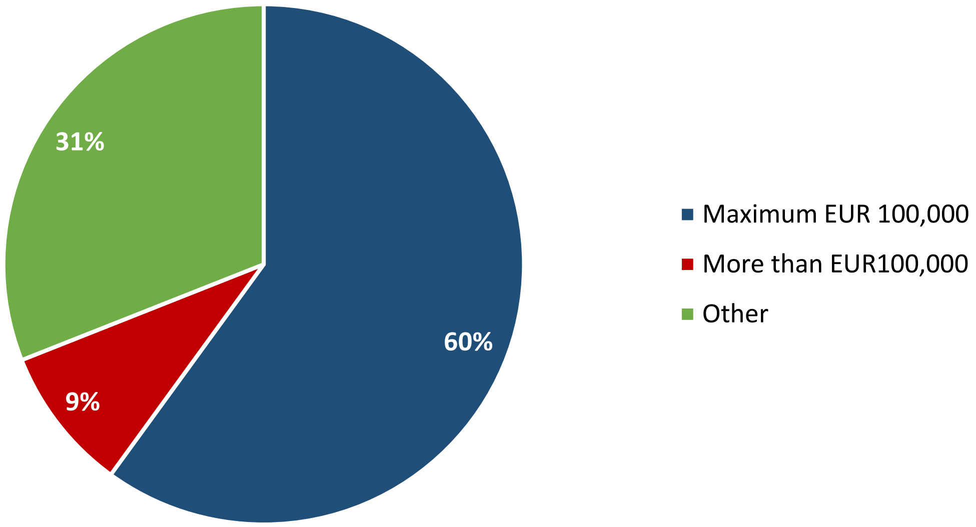
4.4.2 DGS Autonomy or Dependence



The survey results suggest that the majority of the DGSs operate as independent agencies, as stated by 26 (73%) respondents. Additionally, 3 (9%) respondents said their DGSs are administered under the supervision of the regulator for Financial Services and Central Bank, respectively. Meanwhile, 2 (6%) are supervised by the Ministry of Finance, and 1 (3%) under the bank supervisor. This indicates that, although the majority of the DGSs are publicly legislated and administered, as shown in Question 4.4.1 above, most DGSs have their own legal status, and operate independently.

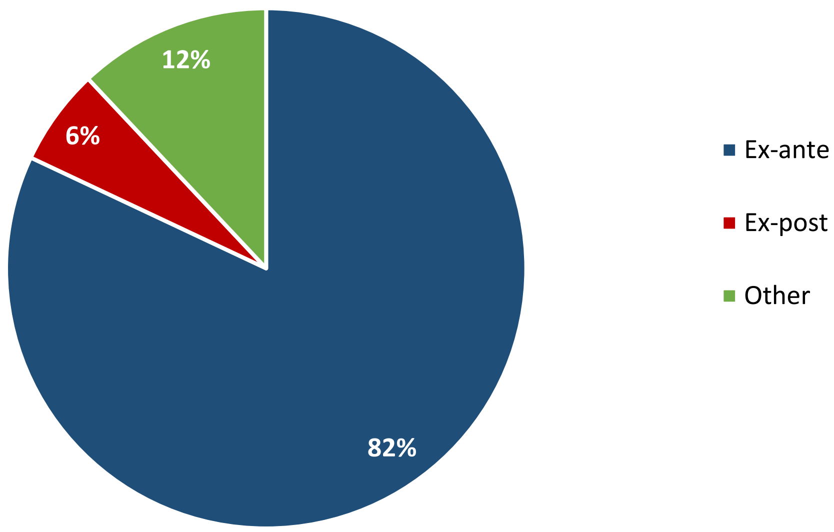
4.5 DGS Funding

4.5.1 Level of Coverage



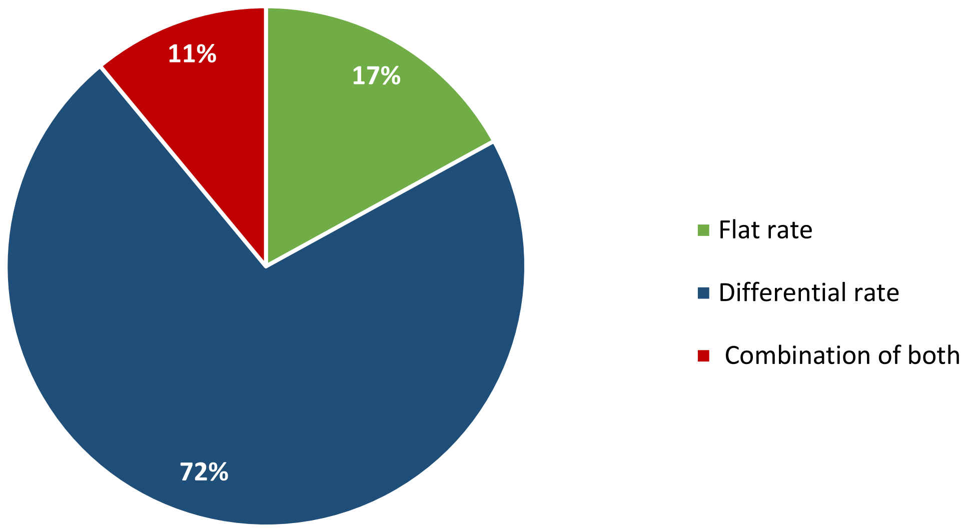
The respondents were asked to indicate their level of coverage in terms of eligible deposits. Specifically, 21 out of the total 35 respondents indicated that their DGS covers up to a maximum of EUR100,000. This is almost 60% of the total respondents, which indicates that this is the preferred coverage level considered necessary for DGSs by most countries. Interestingly, 11 (31%) respondents stated that their DGS only covers up to an amount lower than EUR100,000, and only 3 (9%) respondents reported that their DGS covers more than the maximum of EUR100,000.

4.5.2 Type of Funding



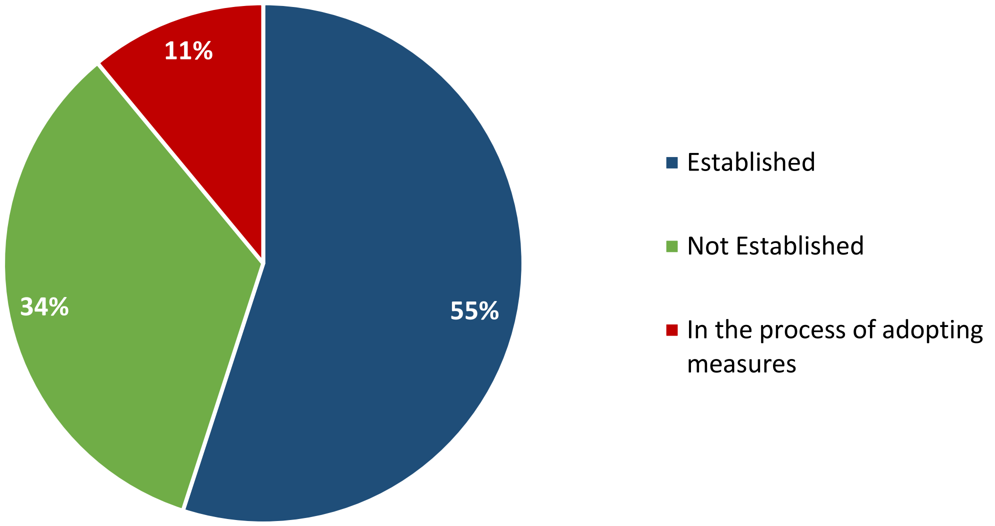
Most EU DGSs (29 - 82%) focus on collecting ex-ante contributions. Furthermore, 4 (12%) respondents stated that contributions are collected by a combination of ex-ante and ex-post contributions to reach the target level. Additionally, 2 (6%) participants highlighted that contributions are collected ex-post.

4.5.3 Method for Assessing Contributions



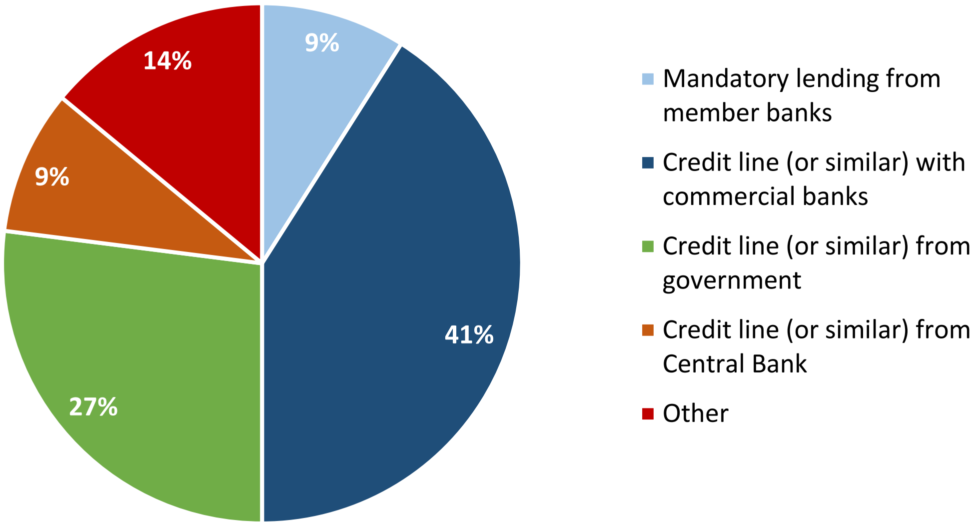
From the survey results, it is evident that DGSs consider the risk exposure of banks, as the majority of the respondents (25 - 72%) stated that a differential rate is used for assessing contributions. In addition, 6 (17%) respondents indicated that a flat rate contribution is utilised, whereas another 4 (11%) respondents highlighted that a combination of both flat rate and differential rate is utilised when calculating contributions. The author considers this as a beneficial approach as it allows banks to evaluate their risks, and take appropriate decisions accordingly.

4.5.4 The Establishment of Alternative Funding Arrangements



The survey results demonstrate that the majority of the respondents 19 (55%) have established alternative funding arrangements within their DGS. Furthermore, adequate alternative funding arrangements are required in order to obtain short-term funding to meet necessary claims. Additionally, 12 (34%) respondents stated that alternative funding arrangements are not in place, and 4 (11%) participants reported that these arrangements are in the process of being established.

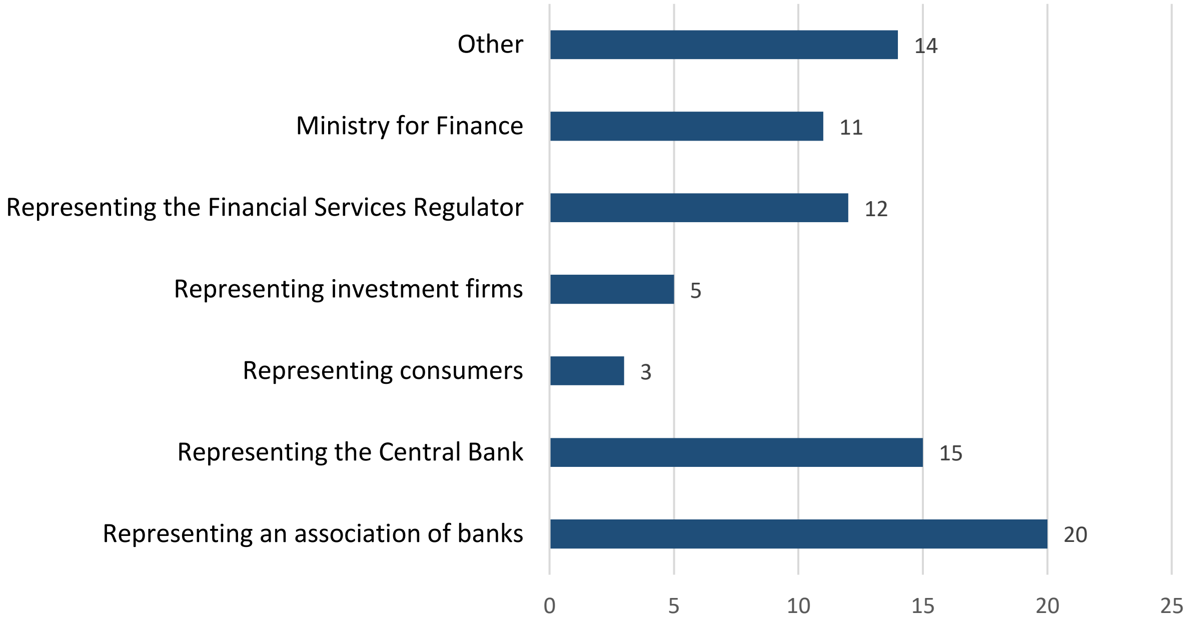
4.5.5 The Method for Alternative Funding Arrangements



Several respondents (8 - 41%) indicated that a credit line (or similar) from commercial banks was established for alternative funding arrangements. Meanwhile, another 4 (27%) highlighted that their alternative funding arrangements were made through a credit line from the government. An additional 3 (14%) participants noted that they have a stand-by arrangement with a development bank and institutional investors. Moreover, according to 2 (9%) respondents, such measures are in place through arrangements with the Central Bank, while the other 2 (9%) respondents disclosed that such measures are undertaken through mandatory lending from member banks. This demonstrates that alternative funding arrangements have been implemented in a variety of ways across different jurisdictions.

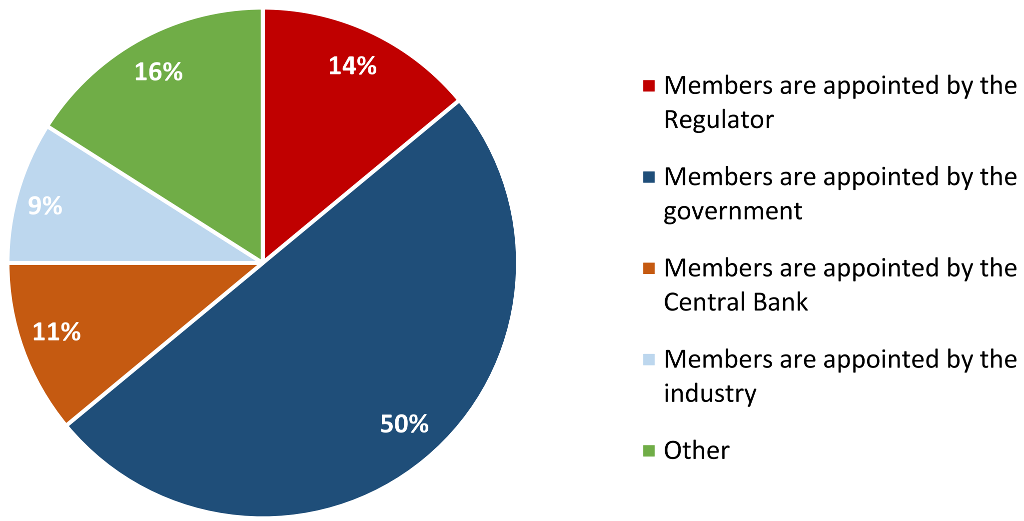
4.6 Governance

4.6.1 Composition of the Board



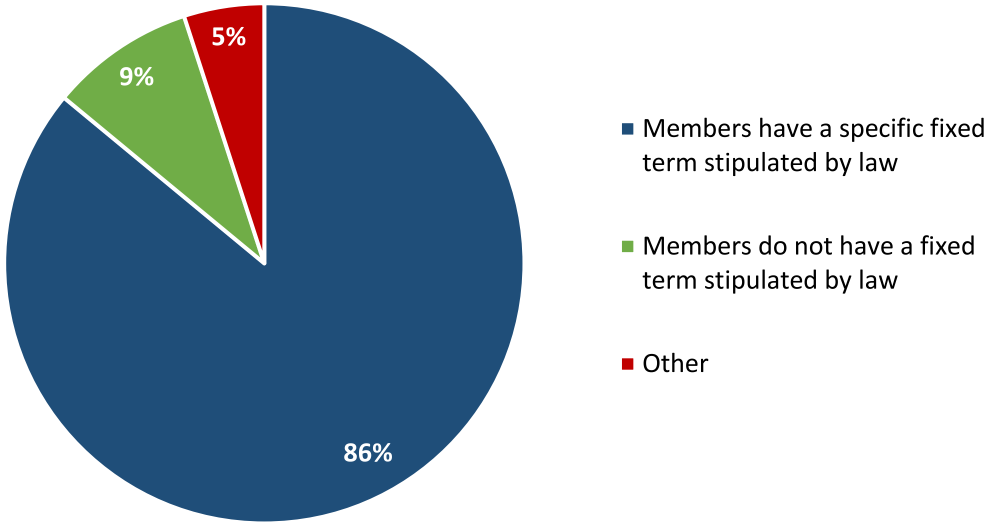
The survey results demonstrate that 20 (57%) respondents indicated that a member or members of their Board represented an association of banks. Furthermore, 15 (42%) participants selected a member or members represented the Central Bank, while 14 (40%) respondents selected the option members represented other entities, such as, credit unions, deposit insurance experts, auditors, lawyers, accountants, and financial market specialists. Additionally, 12 (34%) respondents reported that a member or members represented the Financial Services Regulator, while 11 (31%) specified that the Board had members from the Ministry for Finance, 5 (14%) respondents indicated that members represented investment firms, and 3 (9%) noted that members represented consumer protection. Such results indicate that most of the EU DGS board members represent an association of banks.

4.6.2 Appointment of the Board



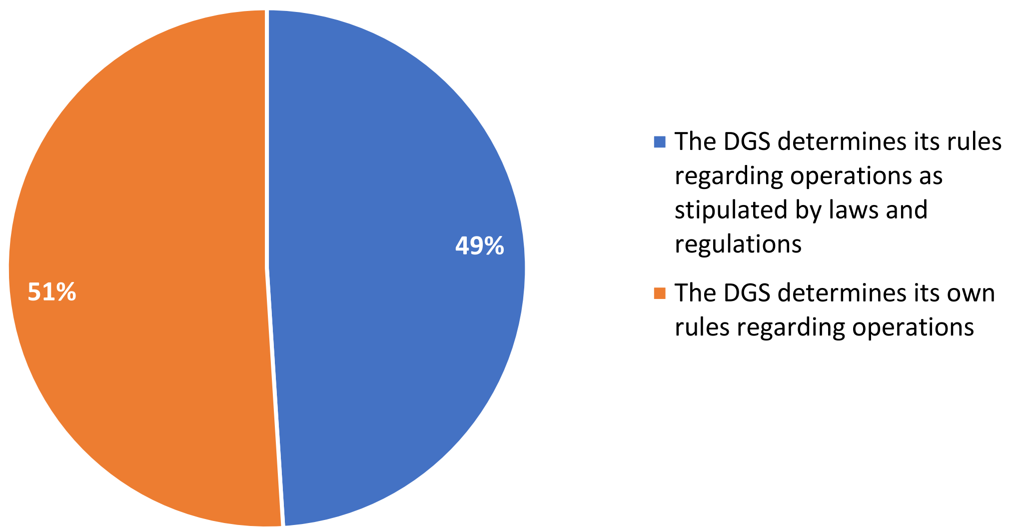
The respondents were asked, through a multiple-choice question, to indicate how DGS board members are appointed. Half of the participants (18 - 50%) noted that members are appointed by the government, particularly the Ministry for Finance. In addition, 6 (16%) respondents stated that a board is not established. Furthermore, other jurisdictions reported that the appointment is a combination of different entities, including the Chamber of Economy. Furthermore, 5 (14%) participants disclosed that members are appointed by the Regulator, 4 (11%) indicated that members are appointed by the Central Bank, and 2 (9%) respondents reported that members are appointed by the industry. Therefore, this result indicates a range of different appointments which may influence how DGS board members operate. From this survey, one can note various approaches to appointing DGS board members, which could result in an array of experiences and expertise within the DGS board for that particular jurisdiction.

4.6.3 Term of the Board



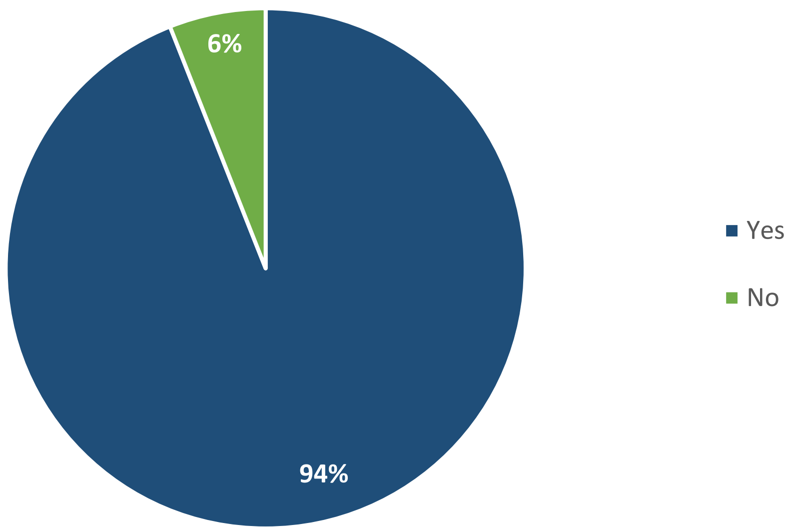
In light of the DCS Annual Report outlined in Section 2.9.6 of the literature review, the author requested further insights on whether the Board is appointed on a fixed term basis. According to most respondents (30 - 86%), the appointment of the DGS board in the jurisdiction concerned has a specific fixed term period stipulated by law. This suggests that board members are bound to a certain term, and would need to be re-elected in order to stay on the board. On the other hand, 3 (9%) participants divulged that board members do not have a specific fixed term stipulated by law. In addition, 2 (5%) respondents indicated that members have a specific fixed term, albeit not stipulated in their national legislation. Meanwhile, another jurisdiction reported that there is no establishment of a board in their DGS structure, and decisions are only taken by a Chief Executive Officer.

4.6.4 DGS Operations



The survey findings suggest that there is no single approach to DGS operations and rules. While the majority of the respondents (18 - 51%) indicated that the DGS in their jurisdiction determines its own rules according to their needs, the remaining 17 (49%) respondents commented that national legislation determines its rules for such operations. This result indicates the considerable variation between different jurisdictions in how DGS operations are administered.

4.6.5 Shift in the DGS Model



The absolute majority of the respondents (33 - 94%) confirmed that the establishment of their DGS has not undergone any shift in its structure. This indicates that, while operations, legislation, and jurisdiction may adapt to changing circumstances over time, the overall structure and administration of the DGS remain consistent. On the other hand, 2 (6%) respondents reported some modification in the structure model of their DGS over the years.

One of the DGSs was initially implemented in the 1920s as a voluntary scheme for savings banks; however, in 2004, it was expanded to commercial banks, introducing protection for both. In 2019, the DGS underwent a major shift when the Directive was transposed into national legislation in order to ensure that the operations of the DGS better reflect the requirements of the Directive. This also involved a shift in the structure of the DGS, transforming it from a private administration model to a public administered DGS. Another DGS stated that such change occurred in 2014 when the responsibility for the DGS shifted entirely to the public sector. The DGS added that, prior to 2014, the operations of the DGS were solely under private administration.

In light of the discussions outlined in the literature review, the author assessed the benefits and challenges of both public and private DGSs in line with the research objectives of this study. In addition, the respondents were given the option to choose between Strongly Agree, Agree, Neutral, Disagree, and Strongly Disagree throughout Sections 4.7 and 4.8.

4.7 Benefits and Challenges of a Public Administered DGS

Perceptions may have a significant impact on the success of public DGSs; thus, understanding and addressing concerns and misconceptions are crucial to ensure their effectiveness. This section analyses questions wherein the author provided the respondents with a list of benefits and challenges to assess their perceptions. In view of this, this section of the survey was only applicable to respondents representing publicly administered DGSs. Therefore, 20 of the 35 respondents completed this section. They were further encouraged to add additional feedback or practical examples to support their answers; however, it was emphasised that confidential data on the case should not be included.

Benefits of Public Administered DGSs

4.7.1 Public Administered DGSs Grant More Protection to Public Interest

Following the GFC, consumer protection has become an essential requirement as an element of the financial safety net. In view of this, the author sought to pursue further insights on whether the type of DGS grants more consumer protection. It transpired that

11 (55%) respondents agreed that public DGSs tend to grant more protection to public interest, while 7 (35%) others strongly agreed with this statement. On the other hand, 1 (5%) respondent was neutral towards this statement, while 1 (5%) other disagreed with this statement.

4.7.2 Public Administered DGSs Have Wider Access to Resources for Their Day-to-Day Operations

The majority of the public DGSs shared positive opinions about this statement. In view of this, 10 (50%) respondents agreed that public DGSs tend to have wider access to resources for their day-to-day operations, while 6 (30%) were neutral towards this statement. In addition, 2 (10%) respondents strongly agreed with this statement, while 2 (10%) others disagreed.

4.7.3 Public Administered DGSs Reduce Moral Hazards in the Banking Sector

In view of the notion of moral hazard in deposit insurance, the author sought to gain further insights on whether a public DGS reduces moral hazard. In fact, the majority of the public DGSs had positive opinions about this statement. It transpired that 11 (55%) respondents agreed that public DGSs tend to reduce moral hazard in the banking sector, while 8 (40%) respondents were neutral towards this statement. On the other hand, 1 (4%) respondent disagreed with this benefit.

4.7.4 Public Administered DGSs Find It Easier to Communicate and/or Obtain Information from the Relevant Authorities

As highlighted by Bernet and Walter, exchange of information and co-operation are amongst the key objectives to secure and improve the stability of the financial system.

In light of this, 11 (55%) respondents agreed that public DGSs tend to find it easier to communicate and/or obtain information from the relevant authorities, while 8 (40%) others strongly agreed with this statement, and only 1 (5%) respondent was neutral towards this statement.

4.7.5 Public Administered DGSs Have a Greater Opportunity to Achieve Alternative Financing Arrangements

In light of Article 10 of the Directive, EU DGSs should have in place adequate alternative funding arrangements. In view of this, the author explored whether public DGSs are more prone to achieve such measures than private DGSs. The results demonstrate that 9 (45%) respondents agreed that public DGSs tend to have a significant opportunity to achieve alternative financing arrangements, while 5 (25%) others strongly agreed with this statement. On the other hand, 3 (15%) respondents were neutral towards this statement, while 3 (15%) disagreed.

Challenges of Public Administered DGSs

4.7.6 A Public Law Framework Reduces the Flexibility of Public Administered DGSs

Given that the Directive provides flexibility to EU MS in terms of the structure of DGSs, the author assessed the legislative framework of public DGSs. In view of this, 11 (55%) respondents agreed that a public law framework minimises the flexibility of public DGSs. On the other hand, 7 (35%) respondents disagreed with this statement, while 2 (10%) were neutral.

4.7.7 Public Administered DGSs May Experience Constant Pressure from the Government

As discussed in Section 2.9.7, undue political interference may arise from their dependence. With regards to this statement, 9 (45%) respondents agreed that public DGSs might experience constant pressure from the government. On the other hand, 7 (35%) respondents disagreed with this statement, while 3 (15%) others were neutral, and 1 (5%) strongly disagreed.

4.7.8 Public Administered DGSs May Experience More Bureaucracy for Approval of Budgets/Other Funding Expenditures

The majority of the public DGSs demonstrated positive opinions about this statement. In view of this, 11 (55%) respondents agreed that a public DGS might experience more bureaucracy for approval of budgets and any other funding expenditures. On the other hand, 6 (30%) respondents disagreed with this statement, while 2 (10%) others were neutral, and 1 (5%) strongly disagreed.

4.7.9 Public Administered DGSs Are More Prone to Political Interference

With regards to this statement, 9 (45%) respondents agreed that a public DGS is more prone to political interference. On the other hand, 8 (40%) participants disagreed with this statement, while 2 (10%) were neutral, and 1 (5%) strongly disagreed.

4.7.10 Additional Comments

Pursuant to the additional feedback received from the respondents, it was noted that the type of DGS administration might impact its operations. For instance, a public administered DGS may have limitations due to its adherence to laws and regulations. Meanwhile, a private administered DGS may have more flexibility to deal with exceptional circumstances. In addition, another participant pointed out that public administered DGSs also have their advantages, such as, having more access to public resources, as opposed to a private administered DGS. Therefore, when it comes to DGSs, both public and private administration have pros and cons, and it ultimately depends on the situation on a case-by-case basis.

4.8 Benefits and Challenges of a Private Administered DGS

Throughout this section, the participants were given a list of benefits and challenges to assess the perceptions of the remaining 15 respondents representing private DGSs. The respondents were also encouraged to add any additional feedback or practical examples to support their answers; however, it was emphasised that confidential data on the case should not be included.

Benefits of Private Administered DGSs

4.8.1 A Private Law Framework Assists in the Flexibility of Private Administered DGSs

With regards to this statement, 8 (53%) respondents agreed that a private law framework assists in the flexibility of a private DGS. On the other hand, 4 (27%) participants disagreed with this statement, while 2 (13%) were neutral, and 1 (7%) strongly disagreed. Given their operational independence, it has been proved that private DGSs are given more flexibility in their governance framework, as opposed to public DGSs.

4.8.2 Private Administered DGSs Are Less Likely to Endure Bureaucracy for the Approval of Budgets or Other Expenditures

The majority of the private DGSs had positive opinions about this statement. In view of this, 2 (13%) respondents strongly agreed, and 11 (73%) others agreed that a private DGS is less likely to experience a bureaucratic process for approval of budgets and any other funding expenditures. On the other hand, 1 (7%) respondent disagreed with this statement, while another (7%) was neutral.

4.8.3 Private Administered DGSs Reduce the Consequence of Moral Hazard in the Industry

With regards to this statement, the majority of the private DGSs (8 - 53%) were neutral towards this statement. Furthermore, 5 (33%) others agreed that a private DGS reduces the consequence of moral hazard in the industry, while the remaining respondents did not agree with such statement. In view of this, 1 (7%) respondent disagreed, and another (7%) strongly disagreed with this statement.

4.8.4 Private Administered DGSs Are Less Likely to Endure Political Interference

As highlighted by Bernet and Walter, private DGSs are less likely to endure political interference. In fact, 12 (80%) respondents agreed that private DGSs are less likely to endure political interference, while another respondent (7%) strongly agreed with such statement. On the other hand, 2 (13%) participants highlighted their disagreement with this statement.

4.8.5 Private Administered DGSs Are Less Likely to Endure Government Pressure

Most private DGSs demonstrated their agreement with this benefit. In fact, 1 (6%) respondent strongly agreed, and 7 (47%) others agreed that a private DGS is less likely to endure government pressure. Meanwhile, 4 (27%) respondents were neutral towards this statement, while 3 (20%) others expressed their disagreement with this statement as a benefit.

Challenges of Private DGSs

4.8.6 Private Administered DGSs Endure Issues in Communicating and/or Obtaining Information from the Relevant Authorities

In view of this, 3 (20%) respondents strongly agreed, and 8 (53%) others agreed that private DGSs experience issues in communicating and/or obtaining information from the relevant authorities. On the other hand, 1 (7%) private DGS expressed its disagreement, and 3 (20%) others were neutral towards this statement.

4.8.7 Private Administered DGSs May Be Negatively Exposed to Inappropriate Actions Carried Out by the Sector

Overall, most private DGSs demonstrated different views on this statement. In fact, 6 (40%) respondents agreed with this statement, while another 5 (33%) disagreed that a private DGS might be negatively exposed to inappropriate actions carried out by the industry. Meanwhile, 4 (27%) private DGSs were impartial towards this statement.

4.8.8 Private Administered DGSs May Experience the Slow Implementation of Resources to Meet Their Operational Needs

With reference to the above statement, 9 (60%) private DGSs disagreed that they had experienced the slow implementation of resources in order to meet their operational needs. Meanwhile, 4 (27%) participants agreed, and 2 (13%) others were neutral towards this statement. Overall, the majority of the private DGSs demonstrated their disagreement with the above-mentioned challenge.

4.8.9 Private Administered DGSs May Mitigate Public Confidence

In general, the majority of the private DGSs had mixed perceptions of this statement. In fact, 5 (34%) respondents agreed that a private DGS might mitigate public confidence, while 5 (33%) disagreed with this statement, and another 5 (33%) demonstrated neutrality towards this statement.

4.8.10 Additional Comments

Pursuant to the additional feedback from the respondents, the majority of the private DGSs highlighted that, in their opinion, private DGSs have more flexibility than public DGSs. As observed by the participants, the establishment of an MoU between authorities would standardise the exchange of information thereby enhancing the effectiveness of the DGS.

Moreover, according to the respondents, the reputation of a private DGS is key to determining public confidence in its operations. It is essential that this reputation is assessed through various official channels to promote more awareness of the scope of the DGS. Moreover, the evaluation of the previous handling of claims throughout the year is another factor to be determined which can provide insights on how well-equipped a DGS is in managing claims during unforeseen circumstances.

4.9 Final Remarks

In the final section of the survey, the author sought various perceptions of factors which influence the adoption and design of EU DGSs, the organisation of the DGS structure in order to achieve financial stability and consumer protection, and whether the respondents agreed with the current structure of the DGS in the jurisdiction concerned, including any recommendations thereto to achieve the research objectives.

4.9.1 In your jurisdiction, are there other benefits and/or challenges within the DGS's existing governance structure?

Several respondents provided various opinions, where most highlighted that private DGSs provide more flexibility, and thus, decisions are taken in a less bureaucratic manner. Furthermore, other opinions were that a benefit to public DGSs is the governing body since it would include the highest officials from the country's financial system. Furthermore, resourcing, both from a funding perspective and recruiting technical expertise, comprises a benefit to public DGSs. On the other hand, conflicts of interest may arise when the DGS is based in a small jurisdiction. The respondents also emphasised effective co-operation and communication with regulators and supervisors in order to enhance consumer protection.

4.9.2 What other factors and circumstances influence the current adoption and design of the DGS in your jurisdiction?

Several respondents had different views on the factors and circumstances which influence the adoption and design of the DGS in their jurisdiction. Most explained that the Directive is one of the significant factors contributing to the structure of their DGS as it creates effective harmonisation for all EU MS. Furthermore, one respondent suggested that some provisions of the legal framework should be regulated more flexibly, taking into consideration the element of harmonisation, for instance, investment of DGS funds, cross-border pay-outs, temporary high balances, exclusions, and the role of DGS in anti-money laundering issues. In addition, it also takes into account guidance from international standard setters on deposit insurance, such as, the FSB and IADI. The participants particularly emphasised pressures for DGSs to be compliant with the EU Financial Market regulation and with the IADI Core Principles, which are influencing the design of DGSs on a global level.

Furthermore, the participants emphasised that the history of DGS pay-outs is one of the considerations influencing the current adoption and design. In addition, one respondent commented that the change in structure from private to public administration prevented conflict of interest with the industry, proving more beneficial to the jurisdiction concerned. Other respondents highlighted that the DGS being part of a financial safety net is a significant factor of the structure in their jurisdiction. Meanwhile, another participant disclosed that deposit insurance had traditionally been under the roof of the association of banks prior to the legal obligation to establish an officially recognised DGS in each jurisdiction, and upon the introduction of the Directive, the system was designed in a way that could exploit the existing know-how. The respondents further explained that the financial crisis caused a significant impact wherein such effects have been a guide in determining the jurisdiction's financial safety net which examined the duties, functions, and responsibilities executed as a DGS.

4.9.3 Are there any other recommendations on how the DGS design and implementation system can be organised in your jurisdiction for financial stability and consumer protection to be achieved, while minimising the risk of moral hazard?

According to the majority of the respondents, effective co-operation between the authorities and DGSs is fundamental in order to achieve financial stability and consumer protection, while minimising the risk of moral hazard. They further highlighted that they assist public authorities by providing expert support in legislative projects and issues pertaining to deposit insurance. Furthermore, constant supervision, compliance, and enforcement are key to minimising the risk of moral hazard by implementing an appropriate system of risk-based contributions in order to avoid credit institutions from engaging in excessive risk.

4.9.4 In your opinion, do you think that the current DGS model of your jurisdiction should retain its governance structure model?

All the respondents demonstrated a positive opinion about their current governance structure model. In view of this, they disclosed that the current model in their jurisdiction has proven to be efficient, notwithstanding the challenges they experience. Several respondents explained that their current model proved to be efficient due to the successful history of pay-outs which has increased public confidence. Furthermore, other respondents divulged that their current model is less bureaucratic, and its operations have proved to be successful throughout the years.

4.10 Interviews

As a concluding area for analysis, the author conducted interviews (transcriptions found in Appendix 5) in order to obtain various perceptions of the structure of the Maltese DGS and its relationship with the CA. In view of this, the author extrapolated the following perceptions.

4.10.1 Efficacy of the DCS Design and Structure

The interviewees unanimously expressed positive and similar perceptions of the DCS design and structure.

During an interview with a representative of the DCS, the importance of maintaining its separate legal entity from the CA was emphasised. The interviewee highlighted that, having a separate MC is crucial as it allows for administering funds independently of the CA, especially in cases of insolvency. This approach ensures that depositor funds are safeguarded, and are not mixed with other public funds. It operates under the oversight of the CA, but its autonomy is crucial to ensure its effectiveness. On the other hand, the interviewee highlighted that the composition of the board should be shifted to avoid unnecessary market influence. Additionally, with the developments in the CMDI, it is imperative for the Committee to have further expertise in funds and investments as such developments can create an additional burden on the fund, which can be mitigated with better knowledge and practice. Therefore, the DCS should prioritise strengthening the fund, rather than focusing on target levels.

Meanwhile, the MFSA representative expressed similar views, adding that the CA and MC have distinct powers under the existing DCS structure, which is efficient. In addition, the interviewee explained that the DCS is managed by a separate committee which manages the fund and pay-outs for insolvent banks, while the CA is responsible for issuing and revoking licences. The interviewee also agreed that the CA appoints the members of the MC. Therefore, the interviewee concluded that it is rational to maintain the DCS within the MFSA property, given its small size.

4.10.2 Benefits of the DCS's Current Structure

The interviewees unanimously expressed positive benefits of the DCS's current structure and design in terms of its independency from the CA.

The interviewee representing the DCS expressed that the DCS as a separate legal entity has a separate raison d'etre, adding that, while the DCS is responsible for ensuring consumer protection, the CA is responsible for its own supervisory duties. Therefore, a separate Board is essential for managing the DCS. The interviewee further expressed that the DCS may concentrate more on its goals, expertise, laws, and the fund to safeguard deposits, adding that it is the third pillar of the Banking Union due to its independency. In the event of a pay-out, the DCS may concentrate on funding and how to pay out depositors without having to shoulder the additional duty of oversight.

For their part, the MFSA representative outlined that the DCS structure reduces bureaucracy due to its separate MC, enabling easier decision-making and schedule meetings with MFSA representatives, hence facilitating continuous communication between the two entities. Furthermore, the interviewee highlighted that certain information could be achieved easier since the DCS is within MFSA premises, allowing the former to be prepared for potential pay-outs, hence fostering synergies between the MFSA and the DCS.

4.10.3 Challenges of the DCS's Current Structure

Both interviewees disclosed various challenges of the DCS's current structure and design in terms of its independency from the CA.

The DCS representative explained that the DCS relies heavily on the MFSA to provide the DCS with facilities. Furthermore, the supervisory side also has its challenges, particularly due to certain disagreements by MFSA in decisions taken by the MC. Other issues the interviewee encountered included lack of information exchange between authorities, and inappropriate industry behaviour, particularly when a pay-out is initiated, which increases the burden on the remaining banks to compensate for the deficit in the DCS fund, as well as the requirement for more public awareness of the functions and objectives of the DCS.

Meanwhile, the MFSA representative expressed that the CA sometimes overlooks the DCS, causing issues, particularly when management changes and new officials prioritise different aspects. The interviewee suggested that an agreement between the two entities in terms of facilities could resolve this matter. The interviewee further highlighted that the DCS faces challenges due to structural changes from the previous year as the former Secretary, also an MFSA executive, had negotiating powers for the benefit of the DCS. However, a shift in the role of the Secretary led to a loss in negotiations for the DCS.

4.10.4 DCS Premises

The interviewees unanimously expressed positive and similar perceptions of the current premises of the DCS.

According to the DCS representative, the DCS should maintain its independence and location within the MFSA. The respondent also emphasised that, even while there are challenges with the information-exchange element, there are advantages to accessing some information, such as, the flexibility of organising meetings with supervisors since DCS officials are familiar with MFSA officials. The DCS representative further outlined that, if it were to be housed independently of the MFSA, the DCS would incur high administration costs and resources.

Meanwhile, the MFSA representative shared similar views, observing that the DCS should maintain its premises within the MFSA. Furthermore, the interviewee explained that, initially, the DCS had only one part-time employee, making independent housing impractical. Furthermore, due to synergies between both DCS and Resolution, discussions initiated, and the Head of Resolution also became the Secretary of the Compensation Schemes. The interviewee concluded that, housing the small-sized DCS independently would increase administrative costs.

4.10.5 Factors and Circumstances which Influence the DCS's Design and Structure

The DCS representative outlined that the scope of the DCS is to strengthen financial stability. Meanwhile, the interviewee emphasised several factors that could impact the DCS's structure, for instance, the management of the DCS fund and its independence, which are an essential component of DCS independence from the government to focus on consumer protection. Another factor is the Directive that is transposed into national legislation to harmonise the structure in line with other EU DGSs and the administration of previous pay-outs which proved to be successful and effective.

For their part, the MFSA representative explained that the small-sized DCS's design and structure were meant to be situated within the MFSA. Upon establishing Resolution and DCS, consumer protection, which was a former MFSA department, became independent as the Arbiter for Financial Services. The Head of Resolution also served as the Compensation Schemes' Secretary. Furthermore, previous pay-outs impacted the DCS design, which required MFSA employee assistance due to the small nature of the DCS. The interviewee highlighted that, if the DCS were to be independent, it would need to outsource personnel, resulting in higher administration costs.

4.10.6 Moral Hazard in Deposit Insurance

The DCS representative observed that the primary objective of the DCS is to ensure financial stability. The interviewee further stressed that the CA should be in charge of maintaining oversight on banks' risk-taking as, ultimately, the DCS does not possess the necessary powers, expertise, and resources needed to guarantee that banks are not taking any unnecessary risks, which could potentially lead to moral hazard.

On the other hand, the MFSA representative disagreed, explaining that banks do not solely benefit from higher risk-taking due to the need to cover deficits on the DCS fund when a bank fails. The interviewee further highlighted that, while banks cannot market themselves as DCS participants, they must contribute to other contributions, such as, SRB, MFSA, and ECB regulatory contributions. The interviewee concluded that, although banks are protected by DCS, they do not gain a significant advantage from the increased investment risk tied to deposit insurance.

4.10.7 The Efficacy of the DCS Design to Achieve Financial Stability and Consumer Protection, while Minimising the Risk of Moral Hazard

According to the DCS representative, financial stability and consumer protection can be achieved by improving exchange of information among the relevant authorities. In addition, the interviewee suggested that the structure of the MC should be amended to minimise market influence thereby enabling the DCS to focus on identifying its functions and objectives.

Meanwhile, the MFSA representative outlined those authorities in the financial safety net, such as, the CBM’s aim to minimise the use of the DCS, as this could impact other banks, which may cause a domino effect. Furthermore, the interviewee highlighted that, since banks are discouraged from promoting the Scheme, it reduces moral hazard and competition. The interviewee further emphasised that effective supervision by the CA is essential to identify any potential issues, adding that the public should be better informed about consumer protection, with the Arbiter handling complaints and the MFSA ensuring protection. Therefore, the interviewee recommended that the DCS can publish information about the CA's website to raise awareness of consumer protection measures.

4.10.8 Further Recommendations on the DCS Structure

The DCS representative maintained that there is lack of clarity on the exchange of information pursuant to the DCS regulations, which do not encompass all relevant authorities, including CBM. The interviewee further emphasised that, in times of crisis, it is imperative to grant adequate powers in national legislation to both the DCS and relevant authorities in terms of exchange of information and cooperation to enhance financial stability. To reinforce the exchange of information, the interviewee suggested to establish a detailed MoU among the relevant authorities to ensure its legal enforcement. In addition, to improve the MC's structure, it is recommended to amend provisions in national legislation. While preserving diversity and expertise, the interviewee suggested that it is essential to eliminate market representatives to avoid undue influences. The interviewee further suggested the inclusion of Resolution experts who would provide valuable insight into bank risk, and investment experts who would provide valuable insights on market trends, particularly to strengthen the DCS fund.

The MFSA representative shared similar views in terms of recommendations, suggesting that the current DCS structure should be retained. However, a comprehensive agreement with MFSA should be established in terms of operations. A standardised contract among all parties was recommended by the interviewee to ensure DCS continuity, despite management changes.

4.11 Hypothesis Testing

This hypothesis involves the Fisher's Exact Test, through which the author analysed the correlation between the type of DGS and any issues in communication and exchange of information with relevant authorities, with a 95% level of significance *(p)*. In addition, the author utilised the Fisher's Exact Test due to the small counts of less than 5, and thus, this test uses an exact hypergeometric dispersion. With reference to the findings obtained in both the online survey and the interviews, the author's rationale was to discover whether the academic literature and findings prove that there is a correlation between public or private DGSs and issues in communication and exchange of information.

Chi-Square Tests

	Value	df	Asymptotic Significance (2-sided)	Exact Sig. (2-sided)
Pearson Chi-Square	28.058[a]	2	<.001	<.001
Likelihood Ratio	35.364	2	<.001	<.001
Fisher-Freeman-Halton Exact Test	30.952			<.001
N of Valid Cases	35			

a. 3 cells (50.0%) have expected count less than 5. The minimum expected count is 1.71.

Table 1 - Testing Fisher's Exact Test Correlation between Type of DGS and Issues in Communication and Exchange of Information with Relevant Authorities

Table 1 indicates that the value of the Fisher-Freeman-Halton Exact Test is 30.952, hence yielding a p value of 0.001, indicating that it is smaller than the 0.05 level of significance. Therefore, it may be concluded that the type of DGS affects issues in communication and exchange of information since the null hypothesis is rejected.

4.12 Empirical Observations

Several factors could have influenced the study's results, including consent and demographic details of the respondents, such as, sensitive questions, limited resources, challenges in contacting participants, or lack of incentive. To address this issue, the author circulated the survey to EFDI Secretariat channels in order to engage a broader audience.

In terms of the DGS mandates, the author aimed to determine whether a diversity existed within the mandates for DGSs, subsequently confirming the concept of distinct mandates, as highlighted in the literature review.[150] Furthermore, the author assessed whether the DGSs were profit-oriented or non-profit-based on the type of DGS. As a practitioner researcher, the author's initial presumptions align with the consensus among various colleagues as the majority of the DGSs operate on a non-profit basis.

In addition, the findings on Resolution indicate that the majority of the DGSs do not engage in activities related to resolution, which aligns with the author's initial assumptions as the DCS does not undertake tasks associated with resolution.

Regarding resources and administration, the author sought to investigate the self-governance independence of administrative functions, such as Human Resources and Finance within the framework of DCS, specifically as the DCS operates within the MFSA. Studies indicate that DGSs housed within a larger structure are capable of preserving operational and managerial autonomy, thus corroborating this hypothesis.

In accordance with Article 4 of the DGSD, the majority of EU DGSs have implemented mandatory participation for banks within their respective national legislations. Although Article 6 details coverage exclusions, the Directive does not explicitly define the

[150] Nolte and Khan (n 138).

categories of member banks. The researcher examined DGS coverage across a range of participating banks, corroborating the findings on membership in the literature review.

In a thorough analysis of EU DGS legal frameworks, the author analysed EU DGS legal structures based on the literature review, and discovered that the findings correlate with Article 6 of the Directive concerning funding. While the majority of EU DGSs maintain a consistent maximum coverage limit, there are variations in some jurisdictions to accommodate their jurisdiction's requirements. Furthermore, the author analysed various funding types, with the predominant consensus supporting the Recast Directive's encouragement of more robust funding through ex-ante contributions.

Furthermore, the literature review highlights alternative funding arrangements in line with Article 10 of the Directive. The author’s findings indicate that most EU DGSs have implemented adequate alternative funding measures, ensuring adherence to the requirements of the Directive.

Meanwhile, the survey findings on board composition and appointment, as well as fixed-term periods, support the governance and responsibilities outlined in the 2021 DCS Annual Report, aiming to reduce undue political influence.

In the capacity of a practitioner researcher, the author identified benefits and challenges of public and private DGSs through preliminary assumptions, while also engaging in discussions with various colleagues. The viewpoints of the DCS and MFSA representatives were collected through interviews, indicating their agreement on the current DCS structure's benefits, while voicing their concerns over its board composition and facilities. Meanwhile, the survey results indicated impartial views on whether private DGSs decrease moral hazard, which contrasts the concept emphasised in the academic literature.[151] Conversely, the interviewees' viewpoints aligned with the academic literature.

Furthermore, the literature review[152] emphasises that co-operation and communication are crucial elements for efficient deposit insurance. In light of the survey and interview results, a clear distinction was identified between public and private DGSs, with the latter encountering such issues. Consequently, the author analysed the data by utilising the Fisher’s Exact Test theory, which proved that the nature of the DGS influences the efficiency of communication and exchange of information.

In addition, the author assessed EU and local participants' views on factors impacting DGS adoption and design, with economic and political aspects being influential, as highlighted in the literature review. The survey results revealed a range of viewpoints differing from the literature review, while the interview results were consistent with such theoretical framework.[153]

The author further evaluated EU and local participants' perspectives on the DGS design's effectiveness in ensuring financial stability and consumer protection, while reducing moral hazard. Both representatives re-iterated the importance of effective cooperation between relevant authorities in accordance with the discussions presented in the literature review.

[151] Demirguc-Kunt and Kane (n 54).
[152] Bernet and Walter (n 36).
[153] Arda and Dobler (n 39).

In terms of the current structure of the DGSs, all representatives expressed their agreement to retain their current DGS structure from both an EU and local perspective. Therefore, the findings indicate that economic conditions and policy structures of a jurisdiction may affect the design of DGSs, which may impact financial stability, as highlighted in the literature review.[154]

4.13 Conclusion

This chapter provided a comparison of the structure and design of various EU DGSs and the various perceptions thereto, including perceptions of the efficiency and challenges of the current DCS structure from the CA and DCS viewpoints.

The author concludes this study, in the following chapter, by summarising the salient findings and discussing the significance of conducting further research in the area. In addition, the author provides recommendations on how the DCS structure can be improved, based on the theoretical literature and the main findings obtained.

[154] ibid.

CHAPTER 5: CONCLUSIONS AND RECOMMENDATIONS

'Financial stability is a joint responsibility. The financial system safety net as a whole – not just its components – must be sound and resilient.'

Stefan Ingves, 2017

5.1 Introduction

This study explored the intricacies through a comprehensive analysis of the structure of EU DGSs in terms of governance, legal structure, mandate, funding, membership, and administration. In addition, the author evaluated various benefits and challenges of public and private administered DGSs through various perceptions to obtain an understanding and address any concerns which may have a significant impact on the DGS structure of the jurisdiction concerned. On a national level, the author further explored prevailing perceptions of the DCS structure through the viewpoints of the CA and the DCS. The notion of consumer protection and moral hazard within deposit insurance were further thoroughly examined. In addition, the author conducted hypothesis testing by evaluating statistical analysis, and revealing correlations between the types of variables.

This chapter discusses some further limitations encountered during this study, as well as recommendations and suggestions for further research in this area. The research presented in this dissertation aims to serve as a foundation for future policy discussions and regulatory changes concerning DGS structures.

5.2 Salient Findings

The author evaluated the perceptions of various benefits and challenges of public and private DGS structures within the EU.

The findings gathered throughout this research indicate that most respondents have a positive perception of the benefits of public DGSs that are designed in a way to protect depositors and contribute to financial stability. The primary benefits of the structure of public-administered DGSs include greater protection of public interest, wider access to resources, decreased moral hazard, easier communication and information sharing with relevant authorities, and easier to achieve alternative financing arrangements.

Aside from the benefits derived from a public-administered DGS structure, several challenges were identified, with the majority of the respondents agreeing that they had experienced the challenges mentioned hereunder.

i. *Legality under public law*

Most participants (55%) agreed that a public-administered DGS might have its limitations due to its adherence to laws and regulations, while a private-administered DGS might have more flexibility to address situations on a case-by-case basis. In terms of private law, actions are legal, unless explicitly prohibited, as opposed to public law, where actions can only be performed if specifically authorised by legislation. This distinction indicates that an organisation operating under private law is more flexible in its operations, and can respond quickly to unanticipated events in the financial sector.

ii. *Political interference and pressure from the government*

It transpired that several respondents (45%) agreed that public DGSs experience pressure and political interference from the government. Political agendas may have an impact on public DGSs, reducing their effectiveness in preserving financial stability and depositor protection. In order to ensure efficient operations, neutrality, and transparency, while avoiding political interference and preserving the trust of depositors and financial institutions, it is essential to establish a clear distinction between the DGS and political authorities.

iii. *Government funding*

According to the majority of the respondents (55%), public-administered DGSs experience a bureaucratic process for the approval of budgets and other related expenditures due to the involvement of the government and the need for transparency and accountability. This may lead to slower decision-making, which may hinder the allocation of funds. In order to ensure that public DGSs have the required financing to function efficiently and safeguard the financial stability of the jurisdiction concerned, it is crucial to analyse the budget and policies of each entity.

With regard to the benefits of private DGSs, the findings gathered throughout this research indicate that most respondents have positive perceptions of the structure of private-administered DGSs. The primary benefits of the private-administered DGS structure involve more flexibility in the legality of private law, less prone to experience a bureaucratic process for the approval of budgets, decreased moral hazard, and less likely to experience government pressure and political interference.

On the other hand, several challenges were identified in the structure of private-administered DGSs, with most respondents divulging that they had experienced the challenges mentioned hereunder.

i. *<u>Issues in communication and exchange of information</u>*

The majority of the respondents (73%) had experienced issues in communication and the exchange of information from the relevant authorities. In this case, banking supervisors might be, in principle, more confident in sharing information with other public authorities. Therefore, this indicates a lack of trust as the relevant authorities' willingness to co-operate and exchange information may be hindered by several uncertainties about the efficacy, accountability, and transparency of private DGSs. It is thus recommended that private DGSs should develop strong relationships with the relevant authorities, and demonstrate their commitment to transparency, while maintaining good governance in order to overcome this challenge.

ii. *<u>Undue influence by the industry</u>*

Despite the participants' different opinions, several (40%) agreed that a private DGS might be adversely affected by inappropriate industry actions. Since private DGSs are funded by membership banks, conflicts of interest may emerge when decisions are made on bank insolvency or pay-outs to depositors. In addition, this could create a perception that the DGS is biased, which could undermine public confidence in the system. Therefore, private DGSs should establish a robust governance framework, maintain operational transparency, and cooperate closely with regulators and supervisors in order to reduce such risk.

iii. *Public confidence*

The majority of the private DGSs have mixed perceptions of the decrease in public confidence. It is of utmost importance that private DGSs should be well-managed, transparent, and adequately funded to increase public confidence. Therefore, a private DGS, in collaboration with supervisory authorities, may encourage banks to adopt responsible risk management measures thereby promoting market discipline. Since participant banks often fund private DGSs through contributions, such banks have a direct interest in reducing the risk of insolvency.

Furthermore, most participants highlighted that the Directive is one of the significant factors influencing the current adoption of the DGS structure in the jurisdiction concerned. They further added that the successful administration of previous pay-outs was another additional factor which contributed to the current structure. Meanwhile, the majority of the respondents recommended that effective co-operation between relevant authorities, ongoing supervision, compliance, and enforcement are significant contributors to achieving financial stability and consumer protection, while minimising the risk of moral hazard. Furthermore, all the respondents were unanimous that the current DGS model in their jurisdiction has proven to be efficient, despite the challenges encountered.

Lastly, the author obtained further insights from professionals on a national level which have significantly contributed to the understanding of the benefits and challenges of the DCS structure, as an independent entity, within the premises of the CA. In view of this, engaging with experts from both sectors has not only enriched the scope of this analysis, but also provided valuable recommendations for enhancing the existing DCS structure.

Consequently, senior management officials from the DCS and CA also shed light on ways to improve the existing DCS structure. In this respect, given the complexity of the subject, it was ensured that both representatives were experts in the area. Ultimately, the author thoroughly examined both the benefits and challenges associated with the establishment of the DCS within the premises of the CA in order to contribute to the promotion of protection to depositors, while maintaining a stable and resilient system. By way of reconciling the salient findings obtained from the interviews, it appears that each representative shared similar views on the benefits and challenges of the DCS structure, and provided similar recommendations to the existing DCS structure thereto. Furthermore, it is crucial for the DCS, in collaboration with the CA, to revise and strengthen the DCS structure continually as this would ensure that it remains well-adapted to emerging trends and risks within the financial sector.

Communication and exchange of information in public and private DGSs were also highlighted in the online survey and interviews, respectively. From the salient findings obtained, it transpired that most respondents (55%) expressed their agreement that public-administered DGSs find it easier to communicate and/or obtain information from the relevant authorities. Meanwhile, most respondents (73%) had agreed in terms of experiencing issues in communication and/or exchanging information from the relevant authorities with a private DGS structure. In addition, the interviewees expressed their concern about the structure of the DCS in terms of communication and exchange of information. In this respect, the author further evaluated such perceptions through statistical analysis. Consequently, the Fisher's Exact Test proved that the type of DGS affects issues in communication and/or exchange of information with the relevant authorities.

5.3 Research Limitations and Further Research

Apart from the limitations outlined in Chapter 3, further limitations were encountered that may have affected the accuracy of the study.

One of the shortcomings was that, during the hypothesis testing, the author experienced a low count of five due to the limited number of respondents in the sample. Consequently, the Fisher's Exact Test had to be utilised in lieu of the Chi-Squared Pearson Test in order to validate the hypothesis testing using exact hypergeometric dispersion.

Furthermore, the author focused solely on DGSs within the EU thereby narrowing the potential overview of the findings. In view of this, the sample respondents did not involve representatives of international jurisdictions outside the EU. To this effect, further study could be conducted to encompass an extensive sample size from international DGSs, enabling a more comprehensive comparison of DGS structures and varying perspectives.

The author encountered another limitation involving the number of interviewees. Due to the dissertation's word count limitation, the author had to limit the number of semi-structured interviews to two officials representing the DCS and CA who were knowledgeable in the area of study. Further study could be conducted by investigating different perspectives from additional pertinent authorities, such as, the CBM and MFE.

Lastly, as discussed in the theoretical literature, during financial turmoil, the role of the 'common individual' is crucial as they possess the ability to decide when to withdraw from a bank, or when to maintain confidence in the system. Nonetheless, the intricate nature of human actions makes it difficult to foresee how each person would utilise, inter alia, their distinct biases and past experiences. This indeed presents an interesting area for further research to examine and integrate into a framework an analysis involving financial stability, human conduct, and deposit protection.

5.4 Recommendations

Throughout this research, the author explored various EU perceptions, while also gathering invaluable insights from local industry practitioners of the DCS and CA, respectively.

In order to improve the DCS structure, it is essential to include clear guidelines for exchange of information between the relevant authorities. Pursuant to Regulations 35 and 36 of the DCS Regulations, the provisions stipulate that information should only be exchanged with the CA and other EU DGSs, which indicates a lack of clarity about the involvement of other relevant authorities, such as the CBM, thus highlighting the need for adequate powers to be granted in national legislation. Moreover, it is recommended that the legislation is amended to reflect the exchange of information and cooperation with other entities, hence strengthening the DCS structure. It is additionally recommended that a detailed agreement is established with the relevant authorities to ensure its legal enforcement, subject to confidentiality clauses.

In accordance with the salient findings of this research, it has transpired that the DCS structure should be retained within the CA. Therefore, it is also recommended that both the DCS and the CA establish a detailed agreement in terms of operations to ensure the smooth functioning of the DCS. Consequently, an MoU between the two entities could prevent any discrepancies, and guarantee the continuity of services, even if there are changes in management. In this case, an MoU can provide a framework for efficient and effective coordination between DCS and CA. Such agreement is thus another significant step towards establishing a robust DCS structure.

By virtue of the ICS Regulations,[155] the author recommends that the composition of the MC should be amended in national legislation to improve the structure of the MC. While preserving diversity and expertise, it is recommended that the inclusion of Resolution and investment experts in the Committee would also provide valuable insights on bank risk and market trends, respectively, while ensuring that decisions are made in the best interests of depositors. The proposed recommendation would further strengthen the DCS fund, and provide more significant protection to depositors.

The concept of moral hazard in relation to deposit insurance was extensively examined in the theoretical literature and in the salient findings. Additionally, effective governance, risk management for participating banks, enhancing industry discipline under the guidance of the CA, and adherence to regulatory and supervisory frameworks by DGS participant banks are crucial aspects of reducing moral hazard within deposit insurance. Meanwhile, the author recommends that the DCS collaborates with

[155] Investor Compensation Scheme Regulations, S.L. 370.09, Regulations 3 and 5.

representatives of the relevant authorities and international DGSs to address moral hazard through a dedicated task force to share best practices and strengthen industry discipline.

In furtherance of the salient findings of this research, it is recommended that, to increase credibility in the financial system, DGSs should be well-administered, transparent, and sufficiently funded. Furthermore, it is essential that DGSs maintain a high level of transparency, on-going communication, and cooperation with both the relevant authorities and depositors. With regard to the Maltese DCS, given its small size, depositors may lack awareness of the Scheme's functions and objectives. Therefore, to address this issue, it is recommended that the DCS works closely with the CA, with the former taking control of all public awareness material to promote information about the Scheme on the CA's social media platforms. Ongoing surveys on public awareness should be conducted to evaluate the efficacy of the public awareness-raising strategies employed. This collaboration would assist in reaching a wider audience, ultimately enabling the Scheme to increase depositor awareness and contribute to a more secure and stable financial system in Malta.

5.5 Conclusion

Deposit insurance involves several benefits for the stability of the financial system, hence explaining why most jurisdictions establish a DGS. Despite the challenges associated with the establishment of a scheme, for instance, the potential increase in moral hazard, such issues could be resolved through a suitable DGS design and structure.

In light of the significance of having an explicit and adequately funded DGS as part of the financial safety net, DGSs should implement their suitable design in line with the economic circumstances of the jurisdiction concerned and in line with the requirements of the Directive and guidelines provided by international organisations on deposit insurance. Naturally, DGSs should be designed in a way that does not provide a burden on the banking system, interfere with competition in the banking industry, or cause moral hazard to the extent that it may cause a threat to financial stability. In light of the salient findings, despite the various structures of various jurisdictions and challenges, it has, so far, been proved that each design has been effective. In terms of the Maltese DCS, the author believes that it is essential for both the DCS and the MFSA to enhance their collaborative efforts in order to ensure that the identified challenges and potential areas for growth highlighted in this study are effectively addressed and achieved.

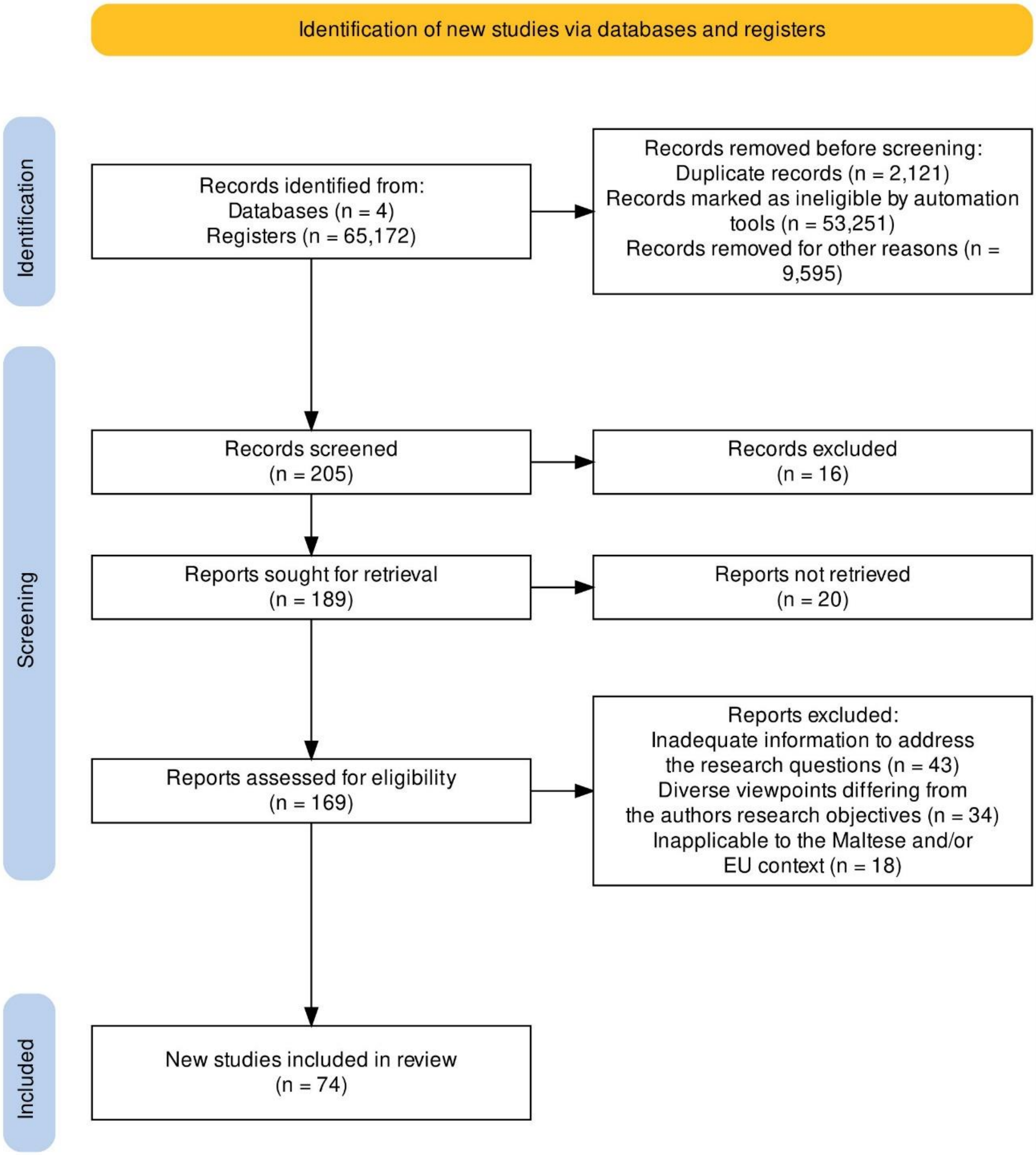
Appendix 1 – List of Participants in EFDI

Albania – Albanian Deposits Insurance Agency (ADIA)
Armenia – Armenian Deposit Guarantee Fund
Austria – Einlagensicherung Austria
Azerbaijan – Deposit Insurance Fund
Belgium – Deposit and Financial Instrument Protection Fund
Bosnia and Herzegovina – Deposit Insurance Agency
Bulgaria – Bulgarian Deposit Insurance Fund (BDIF)
Croatia – Croatian Agency for Deposit Insurance
Cyprus – Deposit Guarantee Scheme
Czech Republic – Deposit Insurance Fund
Denmark – The Danish Guarantee Fund for Depositors and Investors
Estonia – Guarantee Fund
Finland – Finnish Financial Stability Authority
France – Deposit Guarantee and Resolution Fund
Germany – Deposit Guarantee Scheme for German Private Banks GmbH
Germany – Protection Scheme of the German Savings Banks Association
Germany – German Saving Banks Association
Germany – Protection Scheme of the Cooperative Banks GmbH
Gibraltar – Financial Services Commission
Greece – Hellenic Deposit and Investment Guarantee Fund (HDIGF)
Guernsey – Banking Deposit Compensation Scheme
Hungary – National Deposit Insurance Fund of Hungary (NDIF)
Iceland – Icelandic Depositors and Investor Guarantee Fund
Ireland – Central Bank of Ireland **–** Irish Deposit Guarantee Scheme
Italy – Deposit Protection Fund for Co-Operative Banks
Italy – Interbank Deposit Protection Fund
Isle of Man – Isle of Man Financial Services Authority
Jersey – Jersey Bank Depositors Compensation Board
Kosovo – Deposit Insurance Fund of Kosovo
Latvia – Financial and Capital Market Commission of Latvia
Liechtenstein – Deposit Guarantee and Investor Protection Foundation
Lithuania – Deposit and Investment Insurance
Luxembourg – Luxembourg's Bankers Association
Luxembourg – Deposit Guarantee Fund Luxembourg
Macedonia – Deposit Insurance Fund
Malta – Depositor and Investor Compensation Schemes
Montenegro – Deposit Protection Fund
Netherlands – De Nederlandsche Bank
Norway – Norwegian Banks Guarantee Fund
Poland – Bank Guarantee Fund
Portugal – Deposit Guarantee Fund
Romania – Bank Deposit Guarantee Fund
Russia – Deposit Insurance Agency

San Marino – Central Bank of San Marino
Serbia – Deposit Insurance Agency
Slovakia – Deposit Protection Fund
Slovenia – Deposit Guarantee Scheme
Spain – Deposit Guarantee Fund of Credit Institutions
Sweden – Swedish National Debt Office
Switzerland – Esisuisse **–** Swiss Deposit Insurance
Turkey – Savings Deposit Insurance Fund
Ukraine – Deposit Guarantee Fund
United Kingdom – Financial Services Compensation Scheme (FSCS)

Source: European Forum of Deposit Insurers (2022). Available at: https://www.efdi.eu/page/full-members

Appendix 2 – Preferred Reporting Items for Systematic Reviews and Meta-Analysis (‘PRISMA’)



Appendix 3 – Survey Information Letter and Questions

Information Letter

Dear participant,

My name is Francesca Mangion and I am currently in my final year at the University of Malta, presently reading for a Master of Arts in Financial Services. I am currently conducting a research study for my postgraduate dissertation titled "*An Evaluation of Depositor Guarantee Schemes Designated Authorities: An EU Perspective and Extrapolation of the Maltese DGS Governance*". The aim of this study is to analyse the structure and implementation of the DGS Designated Authorities in the EU in comparison with the structure of the Maltese DGS.

Your participation in this study would contribute significantly towards this research as it would help the researcher better understand the DGS structure in your jurisdiction and what factors and circumstances influence such adoption and design. Furthermore, the researcher recommends supporting replies with specific examples and highlighting additional advantages and challenges of its current structure, where applicable. Such answers would provide valuable insight into this study's research and contribute to the necessary recommendations and/or improvements for the structure of DGSs. The participant declares that any case studies and/or practical examples used to support your answer shall not include confidential data.

Any data collected from this research will be used solely for the purpose of this study. The survey will take around 20 minutes to complete and includes no financial incentives or any risks on the participants. Taking part in this research is entirely a voluntary process and the responses will be anonymized. Data collected will be treated confidentially and such data is solely accessible to the researcher and the supervisor. All responses obtained in this survey will be deleted within four months following publication of results.

Please also note that, as a participant, you have the right under the General Data Protection Regulation (GDPR) and national legislation to access, rectify and where applicable ask for the data concerning your jurisdiction to be erased.

Thank you for your time and consideration. Should you have any questions or concerns, please do not hesitate to contact me by e-mail francesca.mangion.20@um.edu.mt. Alternatively, you may also contact my supervisor by email: simon.grima@um.edu.mt.

I am aware that, by marking the first tick-box below, I am giving my consent of the identity of the jurisdiction I represent to be revealed in publications arising from this research and responses I provide may be quoted directly or indirectly.

- ☐ I agree that the identity of the jurisdiction I represent may be disclosed in research outputs.
- ☐ I do not agree that the identity of the jurisdiction I represent may be disclosed in research outputs.

Kind regards

Francesca Mangion

Survey Questions

Section A: Information on the DGS

1. Name of DGS

Open-ended question

2. Jurisdiction

Open-ended question

3. Mandate of the DGS

Closed-ended question: Paybox; Paybox Plus; Loss Minimiser; Risk Minimiser; Other

4. The DGS is a profit or non-profit generating entity:

Closed-ended question: The DGS is a public profit generating entity; The DGS is a public non-profit generating entity; The DGS is a private profit generating entity; The DGS is a private non-profit generating entity; Other

5. In your jurisdiction, do employees carry out work related to Resolution apart from deposit insurance?

Closed-ended question: Yes; No; Other

6. Resources and Administration

Closed-ended question: Distinct operational resources (Human Resources, Finance, Procurement etc); Does not have distinct operational resources; Other

7. Membership of participant banks

Closed-ended question: Mandatory; Voluntary; Other

8. Types of Member banks

Multiple-choice question: Commercial Banks; Savings Banks; Credit Unions; Financial Cooperatives; Insurance Companies; Investment Banks; Islamic Banks; Micro Finance Institutions; Rural/Community Banks; Investment Companies; Other

Legal Structure

1. Type of DGS

Closed-ended question: Government administered and legislated; Government legislated and privately administered; Government legislated and administered by the Central Bank; Privately established and administered

2. DGS Autonomy or Dependence

Closed-ended question: Regulator for Financial Services; Ministry for Finance; Central Bank; Bank Supervisor; Independent Agency; Other

DGS Funding

1. Level of Coverage

Closed-ended question: Maximum EUR100,000; More than EUR100,000; Other

2. Type of Funding

Closed-ended question: Ex-ante; Ex-post; Other

3. The method for assessing/levying contributions

Closed-ended question: Flat rate; Differential rate (risk-based); Combination of both; Other

4. Are the Alternative Funding Arrangements (AFA) in place?

Closed-ended question: Yes; No; In the process of adopting AFA measures; Other

If yes, kindly select the method for AFA

Multiple-choice question: Mandatory lending from member banks; Credit line (or similar) with commercial banks; Credit line (or similar) from government; Credit line (or similar) from Central Bank; Other

Governance

1. The Board is composed of members

Multiple-choice question: Representing an association of banks/credit institutions; Representing the Central Bank; Representing consumers; Representing investment firms; Representing the Financial Services Regulator; Other

2. Appointment of the Board

Multiple-choice question: Members are appointed by the Regulator; Members are appointed by the government; Members are appointed by the Central Bank; Members are appointed by the industry; Other

3. Term of the Board

Closed-ended question: Members have a specific fixed term stipulated by law; Members do not have a fixed term stipulated by law; Other

4. DGS Operations

Closed-ended question: The DGS determines its rules regarding operations as stipulated by laws and regulations; The DGS determines its own rules regarding operations; Other

5. Shift in the DGS model

Was there a shift in the DGS governance structure model within the years? (i.e., from public to private or vice versa)

Closed-ended question: Yes; No; Other

If yes, kindly indicate the year below

Open-ended question

Section B: Benefits and Challenges of a Public Administered DGS

This section is only applicable to publicly administered DGSs. If the DGS in your jurisdiction is privately administered, **please select not applicable (N/A) and kindly proceed to Section C.**

The researcher would like to know whether you consider that a publicly administered DGS bring the following benefits listed below. It is encouraged to make use of case studies and/or practical examples to support your answer. ***It is strongly advised not to include confidential data relating to the case.***

Benefits of a public administered DGS

1. Public administered DGSs grant more protection for public interest

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

2. Public administered DGS have wider access to resources for their day-to-day operations

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

3. Public administered DGSs reduce moral hazards in the banking sector

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

4. The public administered DGS finds it easier to communicate and/or obtain information from the relevant authorities

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

5. The public administered DGS has a greater opportunity to achieve alternative financing arrangements

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

Please enhance your answer by providing an explanation/s on the above

Open-ended question

Section B: Challenges faced by Public Administered DGSs

This section is only applicable to publicly administered DGSs. If the DGS in your jurisdiction is privately administered, ***please select not applicable (N/A) and kindly proceed to Section C.***

The researcher would like to know whether you consider that a publicly administered DGS bring the following challenges listed below. If you can explain or mention other challenges in your jurisdiction, kindly do so, as it will further enhance this academic study. ***It is strongly advised not to include confidential data relating to the case.***

6. A public law framework reduces the public administered DGS to be more flexible

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

7. A public administered DGS may experience constant pressure from the government

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

8. A public administered DGS may experience a more bureaucratic process for approval of budgets/other funding expenditure

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

9. A public administered DGS is more inclined to political interference

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

Please enhance your answer by providing an explanation

Open-ended question

Section C: Benefits and Challenges of a Private Administered DGS

This section is only applicable to private administered DGSs. If the DGS in your jurisdiction is publicly administered, **please select not applicable (N/A) and kindly proceed to the last Section (Section D).**

The researcher would like to know whether you consider that a private administered DGS bring the following benefits. If you can provide an explanation or mention other benefits in your jurisdiction, kindly do so, as it will further enhance this academic study. **It is strongly advised not to include confidential data relating to the case.**

Benefits of a private administered DGS

1.A private law framework assists the private administered DGS in being more flexible

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

2. A private administered DGS is less likely to endure a bureaucratic process for the approval of budgets or other expenditure

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

3. A private administered DGS reduces the consequence of moral hazard in the industry

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

4. A private administered DGS is less likely to endure political interference

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

5. A private administered DGS is less likely to endure government pressure

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

Please enhance your answer by providing an explanation

Open-ended question

Challenges faced by Private Administered DGSs

This section is only applicable to private administered DGSs. If the DGS in your jurisdiction is publicly administered, **please select not applicable (N/A).**

The researcher would like to know whether you consider that a private administered DGS bring the following challenges listed below. If you can explain or mention other challenges in your jurisdiction, kindly do so, as it will further enhance this academic study. **It is strongly advised not to include confidential data relating to the case.**

6. The private administered DGS endures issues in communicating and/or obtaining information from relevant authorities

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

7. A private administered DGS may be negatively exposed to inappropriate actions carried out by the sector

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

8. A private administered DGS may experience the slow implementation of resources to meet their operational needs

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

9. A private administered DGS may mitigate public confidence

Linear scale: Strongly Agree; Agree; Neutral; Disagree; Strongly Disagree; N/A

Section D: Final Remarks

1. *In your jurisdiction, are there other benefits and/or challenges within the DGS's existing governance structure?* Open-ended question

2. *What other factors and circumstances influence the current adoption and design of the DGS in your jurisdiction?* Open-ended question

3. *Are there any other recommendations on how the DGS design and implementation system can be organised in your jurisdiction, so that financial stability and consumer protection are achieved while minimising the risk of moral hazard?* Open-ended question

4. *In your opinion, do you think that the current DGS model of your jurisdiction should retain its governance structure model?*
   Closed-ended question: Yes; No; Other

   Please state the reason for your answer: Open-ended question

Appendix 4 - Interview Information Letter, Confidentiality Form and Questions

Information letter

Dear Sir/Madam,

My name is Francesca Mangion and I am a student at the University of Malta, presently reading for a Master of Arts in Financial Services. I am currently conducting a research study for my dissertation titled *"An Evaluation of Depositor Guarantee Schemes Designated Authorities: An EU Perspective and Extrapolation of the Maltese DGS Governance"*; this is being supervised by Prof Simon Grima. This letter is an invitation to participate in this study. Below you will find information about the research and about what your involvement would entail, should you decide to take part.

My study aims to analyse the structure and implementation of the DGS Designated Authorities in the EU in comparison with the structure of the Maltese DGS.

Your participation in this study would help the researcher better understand your perception as a representative of the financial services industry to express your opinion/s on whether the Maltese Depositor Compensation Scheme (DCS) should retain its separate legal entity or integrate with the public sector.

Any data collected from this research will be used solely for the purposes of this study.

Should you choose to participate, you will be asked to take part in an interview to provide your views on the subject from an economic and financial perspective and the data collected shall be anonymised. Data collected will be treated confidentially and such data is solely accessible to the researcher and the supervisor.

Participation in this study is entirely voluntary; in other words, you are free to accept or refuse to participate, without needing to give a reason. You are also free to withdraw from the study at any time, without needing to provide any explanation and without any negative repercussions for you. Furthermore, your participation does not entail any known or anticipated risks.

Please also note that, as a participant, you have the right under the General Data Protection Regulation (GDPR) and national legislation to access, rectify and where applicable ask for the data concerning your jurisdiction to be erased. All data collected will be erased following the publication of the results.

A copy of this information sheet is being provided for you to keep and for future reference.

Thank you for your time and consideration. Should you have any questions or concerns, please do not hesitate to contact me by e-mail francesca.mangion.20@um.edu.mt; you can also contact my supervisor by email: simon.grima@um.edu.mt.

Sincerely,

Francesca Mangion

Consent Form

"An Evaluation of Depositor Guarantee Schemes Designated Authorities: An EU Perspective and Extrapolation of the Maltese DGS Governance"

I, the undersigned, give my consent to take part in the study conducted by Francesca Mangion. This consent form specifies the terms of my participation in this research study.

1. I have been given written and/or verbal information about the purpose of the study; I have had the opportunity to ask questions and any questions that I had were answered fully and to my satisfaction.
2. I also understand that I am free to accept to participate, or to refuse or stop participation at any time without giving any reason and without any penalty. Should I choose to participate, I may choose to decline to answer any questions asked. In the event that I choose to withdraw from the study, any data collected from me will be erased as long as this is technically possible (for example, before it is anonymised or published), unless erasure of data would render impossible or seriously impair achievement of the research objectives, in which case it shall be retained in an anonymised form.
3. I understand that I have been invited to participate in an interview for the researcher to evaluate different perceptions whether the Maltese DGS should retain itself as a separate legal entity or otherwise amalgamates with the national competent authority from a local perspective. I am aware that the interview will take approximately not more than forty-five (45) minutes. I understand that the interview is to be conducted in a place and at a time that is convenient for me.
4. I understand that whether undertaken online or in-person, the presence of third parties, at any time during an interview, is prohibited.
5. I understand that my participation does not entail any known or anticipated risks.
6. I understand that, under the General Data Protection Regulation (GDPR) and national legislation, I have the right to access, rectify, and where applicable, ask for the data concerning me to be erased.
7. I understand that within 4 months following publication of results all data collected shall be erased and destroyed.
8. I have been provided with a copy of the information letter and understand that I will also be given a copy of this consent form.
9. I understand that the collected data shall be anonymised.

10. I am aware that, by marking the first-tick box below, I am giving my consent for this interview to be audio recorded and converted to text as it has been recorded (transcribed).

    - ☐ I agree to this interview being audio recorded.
    - ☐ I do not agree to this interview being audio recorded.

11. I am aware that, by marking the first tick-box below, I am giving my consent for the identity of the organisation I represent to be revealed in publications, reports or presentations arising from this research, and responses I provide may be quoted directly or indirectly.
    - ☐ I agree that the identity of the organisation I represent may be disclosed in research outputs.
    - ☐ I do not agree that the identity of the organisation I represent may be disclosed in research outputs.

12. I have read and understood the above statements and agree to participate in this study.

Name of participant: ____

Signature: ____

Date: ____

Francesca Mangion | Prof Simon Grima

francesca.mangion.20@um.edu.mt | simon.grima@um.edu.mt

Interview Questions

1. The Maltese Depositor Compensation Scheme is currently a separate legal entity however housed within the Malta Financial Services Authority (MFSA);

a) In your opinion, do you agree with the current system and structure of the Depositor Compensation Scheme?

b) Can you mention some benefits of the current structure and administration of the Depositor Compensation Scheme, particularly due to its operational autonomy from the MFSA?

c) Can you mention any disadvantages that the Depositor Compensation Scheme may encounter, particularly due to its operational autonomy from the MFSA?

d) In your opinion, do you think that the Depositor Compensation Scheme should be housed independently from the MFSA?

2. In your opinion, what factors and circumstances influence the design of the Depositor Compensation Scheme?

3. The establishment of deposit insurance may lead to moral hazard. What are your views on this?

4. In your opinion, how can the Depositor Compensation Scheme's design and implementation system be organized so that financial stability and consumer protection are achieved while minimizing the risk of moral hazard?

5. Do you have any other recommendations which may benefit the structure of the Depositor Compensation Scheme?

Appendix 5 - Interview Transcripts

Interview 1

Interviewer: The Maltese Depositor Compensation Scheme is currently a separate legal entity however, housed within the Malta Financial Services Authority (MFSA);

In your opinion, do you agree with the current system and structure of the Depositor Compensation Scheme?

Interviewee: Agreed. The DCS should be independent of the MFSA. It is crucial for the DCS to have a separate Management Committee because it allows funds to be administered independently from the CA, especially in cases of insolvency. However, the composition of the board members should be rejuggled to avoid market influence. In my experience, market influence took over in certain instances. In the sense that certain proposals may have been controlled by market influence, which has potentially lost sight of the DCS primary objective.

Therefore, I believe that the DCS should retain its independency, however the Management Committee should also involve experts in investments of the fund to make it invest more wisely as there will be more demand, particularly with the developments of the CMDI framework, which puts additional pressure on the DCS fund. In fact, Mr Dominique Laboureix, Chairman of the SRB, gave a speech to the EU Parliament and emphasized on the developments of the CMDI framework and the development of the DCS fund within Resolution. Therefore, rather than focusing on the target level, the DCS should focus on strengthening the fund.

Interviewer: Can you mention some benefits of the current structure and administration of the Depositor Compensation Scheme, particularly due to its operational autonomy from the MFSA?

Interviewee: The current structure of the DCS involves its own benefits as it has a separate raison d'etre. The CA has its own responsibilities of supervision whilst the DCS has its own responsibilities of safeguarding consumer protection. Thus, a separate Board is crucial for the members to administer the DCS.

The DCS as a separate legal entity, in my opinion, can focus more on their objectives, competence, legislation, the fund to safeguard deposits and is the third pillar of the Banking Union. In case of a pay-out, the DCS can focus on funding and how to pay-out depositors and not involve the additional responsibility of supervision. Thus, it is crucial, in my opinion, that the DCS retains its separate legal personality from the CA. Other benefits of the DCS in being independent is that the scope of the DCS is to increase financial stability, provides more flexibility in operations, makes its own procedures on the operation of a pay-out in line with national legislation, reduces moral hazard and reduces government interference.

Interviewer: Can you mention any disadvantages that the Depositor Compensation Scheme may encounter, particularly due to its operational autonomy from the MFSA?

Interviewee: Naturally, disadvantages may arise, particularly the DCS relying on MFSA to provide us with facilities. Apart from experiencing challenges from the administration side, the supervisory side also has its challenges, particularly with the disagreements in decisions taken by the Management Committee. Other challenges which I have experienced is the lack of exchange of information. Drafting provisions in the legislation or in an agreement would be beneficial to the DCS to enforce the element of exchanging information and minimise uncertainty to obtain information. Another challenge is inappropriate actions by the industry especially when a pay-out occurs which puts additional pressure on the remaining banks as they would need to fork out the shortfalls on the DCS fund. Furthermore, although the DCS is ultimately working on its primary objective, there is not enough awareness on the DCS which may mitigate public confidence.

Interviewer: In your opinion, do you think that the Depositor Compensation Scheme should be housed independently from the MFSA?

Interviewee: In my opinion, the DCS should retain its current structure. Therefore, it should be housed within the MFSA however retains its independency. Although the element of exchange of information can be challenging, there is the benefit of accessing certain information or the accessibility to schedule meetings with supervisors, given that the DCS is familiar with MFSA officials. If the DCS were to be housed independently from the MFSA, the DCS would incur high administration costs and resources. Given the nature and the size of the DCS, it should retain itself with the MFSA rather than being housed independently or elsewhere. For instance, if it were to be housed within the MFE, the DCS fund will be reserved and taken into budget which would be a disadvantage for the DCS.

Interviewer: In your opinion, what factors and circumstances (e.g., political and economic factors) influence the design of the Depositor Compensation Scheme?

Interviewee: The scope of the DCS is to provide financial stability, therefore there are several factors which may influence the design of DCS. For instance, the administration of the DCS fund and its independency, the element of DCS independency from the government is important to focus on its primary goal, that is, a rescue fund for depositors. Naturally, the Directive also influences the DCS and its harmonisation with other EU DGSs. Also, our way of managing previous pay-outs have proved to be successful therefore the current structure has proved to be effective.

Interviewer: The establishment of deposit insurance may lead to moral hazard. What are your views on this?

Interviewee: In my view, the main aim of the DCS is financial stability. It should be the supervisor to monitor banks which are taking unnecessary risk as, ultimately, the DCS does not have the powers, knowledge and resources to ensure that the banks are avoiding unnecessary risk.

Interviewer: In your opinion, how can the Depositor Compensation Scheme's design and implementation system be organized so that financial stability and consumer protection are achieved while minimizing the risk of moral hazard?

Interviewee: In my opinion, financial stability and consumer protection can be achieved by improving on the element of exchange of information and rearranging the structure of the present Management Committee to minimize market influence so the DCS can focus on establishing its functions and objectives.

Interviewer: Do you have any other recommendations which may benefit the structure of the Depositor Compensation Scheme?

Interviewee: Presently there is lack of clarification in accordance with the provision of exchange of information. Pursuant to the DCS regulations, exchange of information does not cover all relevant authorities such as the CBM. In times of crisis, it is crucial that there are sufficient powers for the DCS and the relevant authorities in order to strengthen financial stability. Another recommendation to strengthen the element of exchange of information is by establishing an MoU between the relevant authorities to establish a more detailed document off the law to enforce it. Another recommendation is to amend the provisions in national legislation on the structure of the Management Committee. Expertise and diversity should be retained however, in my opinion, it is crucial to eliminate representatives from the market to avoid any unnecessary influences. Additionally, the legislator should take into consideration experts in Resolution as they would have further knowledge in terms of risk from banks and investment experts to analyse market trends which would be beneficial to strengthen the DCS fund.

Interview 2

Interviewer: The Maltese Depositor Compensation Scheme is currently a separate legal entity however, housed within the Malta Financial Services Authority (MFSA);

In your opinion, do you agree with the current system and structure of the Depositor Compensation Scheme?

Interviewee: I agree with how the current DCS is established. In terms of the legislative framework, the CA and the Management Committee have different separation of powers. On the one hand, the CA grants and revokes the licenses, so it has its own supervisory powers. On the other hand, the DCS, which is managed by a separate Management Committee, fulfils the objectives of the Scheme, particularly in terms of administering the DCS fund and the pay-out of an insolvent bank. Furthermore, I also agree with the current provisions in the DCS regulations whereby the CA appoints the members of the Management Committee.

As the DCS is a small team, it would not make sense logistically for it to be independent at this time, I believe that given its size, it should remain on MFSA property.

Interviewer: Can you mention some benefits of the current structure and administration of the Depositor Compensation Scheme, particularly due to its operational autonomy from the MFSA?

Interviewee: There is certainly less bureaucracy in terms of decisions under the DCS structure. The MC has specific decision-making authority at their level since the DCS has a separate MC. Meetings with MFSA representatives are also simpler to schedule since the DCS is situated within the MFSA. For instance, it is simpler for DCS officials to organize a meeting with MFSA, considering that the DCS Management Committee is appointed by the MFSA. Also, there is continuous communication with the CA, especially when a bank is bound for insolvency, and this may help the DCS be prepared to administer a pay-out. As a result, there exist synergies between the MFSA and the DCS.

Interviewer: Can you mention any disadvantages that the Depositor Compensation Scheme may encounter, particularly due to its operational autonomy from the MFSA?

Interviewee: Regarding disadvantages, in my experience, the MFSA does not always recognize the DCS. In the sense that it would be ideal for an agreement to be drawn up between the two entities to support the same facilities from the administration and human resources ends. This issue arises when there is a change in management, and new officials would focus on different aspects which while excluding the DCS. The DCS is currently at a disadvantage due to changes to its structure from the previous year. The former Secretary, who was also an executive-level representative of the MFSA, had the authority to negotiate some elements of the DCS within the MFSA. His departure caused a shift in structure that caused the DCS a loss in the negotiation process.

Interviewer: In your opinion, do you think that the Depositor Compensation Scheme should be housed independently from the MFSA?

Interviewee: As stated in a previous question, in my opinion, the DCS should retain its premises with the MFSA. Early on, the DCS only had one part-time employee; thus it didn't make sense for it to be housed independently of the MFSA. Since there were synergies between the two departments, conversations were eventually started, and it was decided that the Head of Resolution at the time would serve as the Secretary of the

Compensation Schemes. Given the small size of the DCS, housing it separately from the MFSA would result in a burden on administrative costs.

Interviewer: In your opinion, what factors and circumstances (e.g., political and economic factors) influence the design of the Depositor Compensation Scheme?

Interviewee: As the Scheme was initially small, the design and structure of the DCS were determined, and it was decided that the DCS would be situated within the MFSA. When Resolution and DCS were established, consumer protection was separated from the MFSA and established independently as the Arbiter for Financial Services. At the time, consumer protection was a function of the MFSA. Also, after discussions regarding the introduction of Resolution and DCS within the MFSA, it was decided that the Head of Resolution would also serve as the Compensation Schemes' Secretary. Previous pay-outs are another issue that has an impact on the DCS design. When a pay-out was initiated, the DCS requested assistance during the pay-out from MFSA employees due to the small nature of the DCS. If it were to be housed independently, the DCS would have to outsource persons, which would have incurred higher administration costs.

Interviewer: The establishment of deposit insurance may lead to moral hazard. What are your views on this?

Interviewee: I disagree with this statement, in the sense that the surviving banks will have to perform well to cover the deficit on the DCS fund if a bank fails as a consequence of higher risk-taking. Also, banks cannot market themselves as DCS participants, which is a good element in that regard. In addition to contributing to DCS contributions, banks must also contribute SRB, MFSA, and ECB contributions. The fact that banks are protected by the DCS could be an additional factor, but I don't believe they would benefit from the greater investment risk associated with deposit insurance.

Interviewer: In your opinion, how can the Depositor Compensation Scheme’s design and implementation system be organized so that financial stability and consumer protection are achieved while minimizing the risk of moral hazard?

Interviewee: Relevant authorities within the financial safety net, such as the CBM, were constantly looking into the possibility that the DCS never requires to be used as it would have a ripple effect on the remaining banks since the Scheme would request for extraordinary contributions until the deficit in the fund is covered. The bank's inability to promote the Scheme also reduces moral hazard and competition within the banking sector. In terms of the CA, supervision is crucial since, with more supervision, an issue can be identified immediately. The public should be given more information regarding consumer protection. The Arbiter's purpose is to receive complaints from financial services consumers, and on the other hand, consumer protection is a duty of the MFSA. The DCS may publish circulars on its website and the CA’s website due to its wider engagement and may provide additional information about DCS functions. Particularly more awareness of how people are protected.

Interviewer: Do you have any other recommendations which may benefit the structure of the Depositor Compensation Scheme?

Interviewee: In my opinion, the current structure of the DCS should be retained. Nonetheless, I would recommend that a detailed agreement is made between the Scheme and MFSA so that day-to-day operations, Human Resources for new DCS employees, and meetings can be conducted at MFSA without any difficulties. Thus a standardized contract between all parties is suggested to minimize any exclusions of the DCS, even when there is a change in management throughout the years.

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