EBA/Op/2021/11

27 October 2021

Opinion of the European Banking Authority on the treatment of client funds under Deposit Guarantee Schemes Directive

Introduction and legal basis

1. Article 5(1) of the DGSD provides that deposits placed in credit institutions by other credit institutions (CI), financial institutions, investment firms (IF) and other types of financial firms are excluded from deposit guarantee schemes' (DGS) coverage. In the specific case of deposits placed by credit institutions with other credit institutions, the Directive explicitly states that the exclusion from DGS coverage only applies to deposits that credit institutions 'make on their own behalf and for their own account'. The DGSD does not include similar wording in relation to deposits placed by other types of entities.

2. However, relatedly Article 7(3) of the DGSD provides that 'Where the depositor is not absolutely entitled to the sums held in an account, the person who is absolutely entitled shall be covered by the guarantee, provided that that person has been identified or is identifiable before the date on which a relevant administrative authority makes a determination as referred to in point (8)(a) of Article 2(1) or a judicial authority makes a ruling referred to in point (8)(b) of Article 2(1). Where several persons are absolutely entitled, the share of each under the arrangements subject to which the sums are managed shall be taken into account when the limit provided for in Article 6(1) is calculated.'

3. Potential lack of clarity on the interplay between Article 5(1) and 7(3) of the DGSD was noted by the EBA in the Opinion on the eligibility of deposits, coverage level and cooperation

between deposit guarantee schemes[1] published on 8 August 2019. As a result, in the Opinion the EBA recommended to the European Commission to 'enhance clarity in the Deposit Guarantee Schemes Directive (DGSD) on how the see-through approach applies to deposits placed with credit institutions by account holders who are excluded from eligibility' and that 'the topic of absolute entitlement to the sums held in an account is complex, so further analysis may be needed of how best to formulate the wording in different pieces of EU legislation. In subsequent policy considerations concerning investment firms and financial institutions, it is recommended to take a holistic view regarding the relationship between those institutions and their clients, the related safeguarding requirements and the implications they have for DGS protection.'

4. Said Opinion set out arguments in favour of clarifying that client funds placed by financial institutions and investment firms with credit institutions should be covered by a deposit guarantee scheme. The Opinion also identified some challenges which would result from clarifying that such client funds are covered. Arguments in favour of such coverage include:

   - limiting the risk of contagion between a failed credit institution and a financial institution or investment firm that placed client funds in that CI;
   - ensuring consistency of treatment of client funds irrespective of whether they are placed by a CI with another CI (which is currently covered), and those placed by financial institutions and investment firms with CIs – especially since CIs can offer payment services, and/or investment services;
   - EU law requiring safeguarding of client funds[2] [3] to ensure funds are safe, and so ensuring they are DGS protected would be consistent with the logic of safeguarding;
   - the difficulty of using customer motivation for placing funds with a particular entity as the determining factor of what is and what is not an investment decision.

5. The Opinion also included the following issues in relation to the application of the see-through approach:

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[1] https://www.eba.europa.eu/sites/default/documents/files/documents/10180/2622242/324e89ec-3523-4c5b-bd4f-e415367212bb/EBA%20Opinion%20on%20the%20eligibility%20of%20deposits%20coverage%20level%20and%20cooperation%20between%20DGSs.pdf?retry=1

[2] The Payment Services Directive (Article 10 – https://ec.europa.eu/info/law/payment-services-psd-2-directive-eu-2015-2366_en) and the E-money Directive (Article 7 – https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A32009L0110) contain safeguarding requirements in the form of provisions applicable to client funds held by payment and e-money institutions.

[3] Commission Delegated Regulation 2017/593 (Article 4 - https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017L0593&from=EN) outlines safeguarding requirements applicable to investment firms.

- Particularly in relation to client funds placed by a customer with an investment firm which it then places with a CI, it could be argued that client funds should not be covered because the customer has taken a decision to invest funds and should be aware of the risks of losing their investment.
- Coverage of client funds placed as deposits at a CI would offer more protection than if the investment firm or financial institution chooses a different safeguarding method allowed under EU law.
- There is a risk of confusion in which instances a customer of an investment firm or a financial institution is protected, and to what extent.

6. Subsequently, on 2 February 2021, the European Commission requested the EBA to provide further technical advice on issues related to the treatment of client funds placed with credit institutions by other credit institutions, payment institutions (PI), e-money institutions (EMI), investment firms and other financial technology companies[4]. The European Commission requested the EBA to provide an interim report to the Commission by 31 July 2021, and the final report by 31 October 2021. This Opinion delivers on the request to submit a final report with recommendations and aims to inform the Commission's proposals for a revised DGSD, which the Commission intends to publish in Q4 2021.

7. The remainder of this Opinion presents the methodology used for the assessment of client funds, followed by five policy recommendations based on the results of the survey on the treatment of client funds and subsequent discussions with national authorities and deposit guarantee schemes.

Methodology

8. To compile and compare current practices in relation to client funds, and, if possible, to provide any policy recommendations concerning such funds, on 10 March 2021, the EBA launched a survey addressed to national deposit guarantee schemes designated authorities of the European Economic Area (EEA). The survey asked respondents:
    - if client funds placed with credit institutions by other credit institutions, payment institutions, e-money institutions, investment firms and other financial institutions are currently covered by the national DGSs;
    - to provide data (and where regulatory data was not available, estimates based on expert judgement) on the amount of client funds placed by different types of entities

[4] Ares(2021)898555 – 02/02/2021
https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/210202-call-advice-esas-digital-finance_en.pdf

with credit institutions in their jurisdiction, and/or amounts of client funds placed by entities from their jurisdiction in credit institutions within or outside their jurisdiction;

- when and how client funds are safeguarded in their jurisdiction, including instances where safeguarding is done by entities that are part of the same group as the credit institution where client funds are safeguarded; and
- recent real-life experiences of credit institution failures where the treatment of beneficiary accounts presented challenges (including potential contagion risks).

9. Given the nature of the questions, DGSDAs were encouraged to liaise with the relevant authorities in their Member States (MSs) for the purpose of completing the survey. The deadline to submit responses to the qualitative questions was 10 April 2021, and the deadline for the quantitative information was 10 May 2021. In total, 27 of 30 EEA MSs responded to the survey.

10. Some authorities reported difficulties in gathering accurate quantitative data or providing reliable estimates for the following reasons:

    - The qualitative data was not readily available.
    - The deadline to collect it was short given the deadlines in the Call for Advice.
    - In light of the absence of a clear definition of 'identifiable client funds', some authorities reported difficulties in gathering accurate data or providing reliable estimates.

11. Moreover, where data was provided, in some instances it was data provided by the industry, which itself may have been estimated, and the reference date for the data was not homogeneous across Member States. Thus, quantitative data presented in the Opinion is not fully reliable to assess the materiality of client funds across Member States. The data should be understood as merely providing context for the policy considerations.

Recommendations addressed to the Commission

12. In what follows below, this Opinion sets out recommendations in relation to the coverage of client funds placed with credit institutions, the reimbursement of client funds and risk of contagion, and the way DGS contributions should take into account client funds.

Coverage of client funds placed with credit institutions

Current approach to client funds across the EU

13. As indicated above, the survey asked respondents if client funds placed with credit institutions by other credit institutions, payment institutions, e-money institutions, investment firms and

other financial institutions are currently covered by the national DGSs. Some respondents stated that the notion of client funds and client funds deposited on behalf of clients are imprecise which led to difficulties in deciding which funds should be included.

14. The survey results show that of the 27 EEA MSs where authorities provided responses:

- In 24 MSs client funds placed by CIs with other CIs are covered, and in 3 MS they are not of which one is in the process of amending the law to provide coverage.

- In 21 MSs client funds placed by investment firms with CIs are covered, while in 6 MSs they are not covered.

- In 16 MSs client funds placed by payment institutions with CIs are covered, in 10 MSs they are not, and in one MS the authorities were not sure.

- In 13 MSs client funds placed by e-money institutions with CIs are covered, in 13 MSs they are not, and in one MS the authorities were not sure.

- In 14 MSs client funds placed by other financial institutions with CIs are covered, in 9 MSs they are not, in 1 MS such entities could not take client funds, and in 2 MSs authorities were not sure.

15. Furthermore, in 14 MSs the same approach to the treatment of client funds is afforded to all types of financial institutions (i.e., irrespective of whether they are CIs, PIs, EMIs or IFs placing client funds with CIs), while in 13 MSs the treatment of client funds placed with a CI depends on what type of entity placed them. Among the 13 MSs where the approach to client funds is not uniform, the approaches also vary between these MSs.

16. Where client funds deposited at a CI are covered, in nearly all instances, it is done on a per-ultimate-beneficiary basis, with only one exception, where such coverage is done on a per account holder basis meaning such accounts are not treated as beneficiary accounts. Where coverage is done on a per-ultimate-beneficiary basis it means that the coverage limit of EUR 100,000 applies separately to each client who has funds in the beneficiary account. Where coverage is done on a per account holder basis, it means that the coverage limit of EUR 100,000 applies to the whole account, even where the amount in the account is much higher than the coverage limit and it included funds of many clients who separately would not be above the coverage limit.

17. This shows that currently there is a lack of harmonisation in relation to the treatment of client funds across the EEA, and no uniform approach to the treatment of client funds even within Member States, as in half of MSs, coverage depends on the type of entity that places the deposit. That is the case not because the DGSD explicitly provides for options on how to treat such deposits, but because MSs interpreted DGSD provisions differently. In consequence, depositors would currently be treated differently depending on the MSs where the credit institution holding the deposit is located, and what type of entity placed the client funds with

that CI. This gives rise to the risk of divergent degrees of consumer protection and creates opportunities for regulatory arbitrage between EU MSs. Lack of harmonisation means that entities from MSs where such deposits are not covered could purposely deposit client funds in a MSs where they are covered (or vice versa). In a subsequent section, the Opinion assesses the materiality of client funds across the EU before making a recommendation addressed to the Commission.

Materiality of covered deposits

18. The survey asked authorities to indicate the amount of client funds held by credit institutions in their jurisdiction. More specifically, it asked for the latest available figures, or expert judgement on what is the estimated overall amount, of all client funds eligible for DGS coverage, all funds covered by a DGS (or what the amount would be if such funds were eligible for coverage), and all funds deposited in credit institutions in their jurisdiction for the purpose of meeting the safeguarding requirements.

19. The survey also allowed for the possibility to provide data on the amount of client funds placed by payment institutions, e-money institutions, investment firms and other financial institutions from respondents' jurisdiction on behalf of their clients in accounts in credit institutions (irrespective of their location within or outside their jurisdiction). Where this data was provided, the survey also asked if, generally, such client funds tend to be placed with credit institutions authorised in their Member State, in other Member States or in third countries.

20. The aim of collecting this data was to understand the materiality of client funds in relation to the amount of all covered deposits in each Member State. Since the assessment was about the materiality, and not precise amounts, the analysis did not draw a distinction between estimates or regulatory data, and treated both as equally valid. Materiality was calculated by relating the amount of client funds to the most recent amount of covered deposits for 2020 reported to the EBA and published on the EBA website[5]. In most instances, the data submitted to the EBA is not part of standard reporting requirements, in many cases is based on estimates, and may mask potential volatility of such figures. Thus, the EBA used it to provide context for the policy considerations, but is not the most important factor in any recommendations presented further in the Opinion.

21. The results of the survey showed that of the 19 MSs for which the EBA has quantitative data:

    - in 13 MSs the amount of client funds constitutes (or is estimated to constitute) less than 1% of all covered deposits in that MS;

[5] https://www.eba.europa.eu/regulation-and-policy/recovery-and-resolution/deposit-guarantee-schemes-data

- of the 6 MSs, where the amount is higher than 1%, in just one MSs it is higher than 10% where it is 10.7% of which 8.2% is covered;

- in nearly all instances where client funds constitute (or are estimated to constitute) at least 1% of all covered deposits, they would already be covered by the respective DGS. This holds true under the assumption that in most instances client funds are safeguarded in credit institutions in the same respective MS. The EBA makes this assumption based on the results of the survey that show that instances where funds are safeguarded in another Member State, or a third country, are relatively rare (e.g. payment institution from 2 MSs, e-money institutions from 2 MSs, and investment firms from three MSs place client funds with safeguarding CIs in other MSs).

22. The only known instances where client funds are above 1% and currently would not be covered are client funds placed by:

    - E-money institutions with credit institutions in one Member State (estimated to be 2.7%, with six times more client funds of e-money institutions from that Member State placed in other Member States where such client funds would not be covered).

    - E-money institutions and payment institutions with credit institutions in one Member State (1.4% and 1% respectively).

23. The EBA considered the potential impact if all client funds were to be covered, as this could have implications on the level of contributions to the DGS fund. In light of the issues with the reliability of the data discussed earlier in the Opinion, it is not possible to draw robust conclusions concerning the materiality of client funds across the EU. However, the limited data that is available, allowed the EBA to arrive at the view that the inclusion of client funds in the coverage of DGSs would probably have a small impact on the overall amount of covered deposits in nearly all MSs, either because the amounts of client funds relative to covered deposits appear to be small, or because they are already covered, or both. In consequence, given the estimation that the changes in covered deposits would be limited, the EBA has arrived at the view that, currently, the estimated impact on the level of DGS contributions would probably be small, too.

Timing and form of safeguarding

24. The survey asked respondents about the point in time when different types of entities safeguard client funds, to assess whether or not there is a uniform approach across the EU. The results show that in some MSs safeguarding is generally done at the point when it is legally required, other entities safeguard funds upon receiving them (i.e., safeguard earlier than what is legally required), and in others, the approach differs between entities within one jurisdiction.

25. The results also show that, in some MSs, the approach is generally the same among different types of entities (i.e., payment institution, e-money institutions and investment firms would generally all safeguard funds at the point in time it becomes legally required), while in other

Member States the approach would differ between different types of entities or even in the same group of entities.

26. The survey also asked respondents about the extent to which different forms of safeguarding are employed by payment institutions, e-money institutions, and investment firms, given that EU law allows for different methods of safeguarding (as outlined in the background section of this Opinion). For the purpose of this analysis, the EBA determined a safeguarding method to be 'dominant' where more than 90% of client funds from a particular group of entities is safeguarded in this way.

27. The results show that while EU law allows safeguarding to be done in different ways, in most MSs, depositing funds with a credit institution is clearly the dominant, if not the only, safeguarding method used.

28. The results from 18 MSs show that in only two instances a safeguarding method other than depositing funds in a credit institution is used – that's the case in relation to payment institutions in one Member State where such firms generally safeguard funds by means of an insurance policy, and another Member State in relation to e-money institutions where such firms generally safeguard client funds by investing them in secure and low-risk assets.

29. The EBA considered whether DGS coverage for client funds of financial institutions provides an incentive for entities to safeguard client funds with credit institutions only, to the detriment of other safeguarding methods, and what the consequences of that would be. The EBA also considered whether DGS coverage for client funds of financial institutions has the opposite effect because the credit institution contributing to the DGS fund based on these client funds might pass on the cost to the entity seeking to safeguard client funds, and thereby incentivise safeguarding to be done in a different way.

30. Based on the results of the survey, the EBA opines that the coverage of client funds would not likely make a significant difference to current safeguarding practices. That is because placing client funds with credit institutions seems to be the dominant safeguarding method in nearly all MSs for which relevant responses were submitted irrespective of the treatment by the DGS. Furthermore, currently in 13 MSs, client funds are taken into account when calculating DGS contributions and in those MSs, depositing client funds with credit institutions is nevertheless the dominant safeguarding method. Thus, there is no evidence to suggest that DGS coverage increases the cost of safeguarding to make it materially more costly than other forms of safeguarding. If that was the case, safeguarding by means of placing deposits with a credit institution probably would not be the dominant method in MSs where such client funds are covered and they are taken into account when calculating contributions to DGSs.

31. While the survey results do not allow for a comprehensive picture across the EU, of the 7 MSs where client funds are currently taken into account when calculating contributions to DGS funds and for which the EBA also collected data on safeguarding methods, depositing funds with a credit institution is still the most widely used safeguarding method.

Recommendation on the coverage of client funds placed with credit institutions

32. The EBA acknowledges arguments against covering client funds placed by entities otherwise excluded from coverage with credit institutions on behalf of their clients. Firstly, DGS coverage of client funds could create some confusion for the clients of financial firms given that such client funds would be DGS protected if the credit institution where the client funds are safeguarded were to fail, but would not be DGS protected if the payment institution, e-money institution, or investment firm were to fail.

33. Secondly, it could be argued that DGS coverage is not meant to protect client funds temporarily placed as a deposit, when the customer may have never intended for the funds to become deposits (for example because they placed their funds with an investment firm for that firm to invest funds, and not merely keep them as a deposit, or because clients exchanged their money against e-money).

34. Thirdly, covering client funds deposited with credit institutions may mean that the credit institution holding these deposits would need to contribute to the DGS fund based on the amount of deposits in depositors' own accounts and in the beneficiary accounts, which would increase the credit institutions' costs. Thus, it could be argued, that the credit institution bears the cost of other types of entities safeguarding client funds by means of depositing them with the credit institution. While the EBA acknowledges that this may be the case, the credit institution is able to charge the entity that wants to deposit client funds with them an amount it deems appropriate to cover such additional costs. In turn, the entities safeguarding client funds will be able to decide whether it is more efficient to safeguard funds by means of depositing them with credit institutions, purchasing an insurance policy or other ways allowed by EU law. In addition, the classification of such deposits as eligible (and covered) deposits would lead, under certain conditions, to lower contributions to the resolution funds (including because covered deposits are deducted from the base for such contributions) and lower liquidity coverage ratio (LCR) requirements. Thus, the impact on credit institutions' costs may depend on a range of factors, and depending on the actual circumstances it may be positive or negative on an aggregate basis.

35. Finally, with regard to possible moral hazard that could be created for the firms that safeguard client funds with a credit institution, the EBA notes that Article 4 (2) of the MiFID II Delegated Regulation 2017/593 requires that investment firms exercise all due skill, care and diligence in the selection, appointment and periodic review of the credit institution where client funds are placed and the arrangements for the holding of those funds. The issue of potential moral hazard is thus addressed. Furthermore, the DGSD already requires coverage for such deposits placed by credit institutions on behalf of their clients with other credit institutions. Consequently, it would be inconsistent to deny coverage of client funds of investment firms, payment institutions, e-money institutions, etc. with credit institutions on the grounds of moral hazard, when client funds of credit institutions placed with another credit institution are already covered. Finally, a financial institution needs to have continuous access to safeguarded funds to be able to honour its client relationships, which means that such entities are incentivised to

take into consideration the financial strength of a credit institution when safeguarding client funds.

36. On the other hand, while the survey does not provide conclusive information, there are indications that entities that are required to safeguard client funds would often place such funds in the largest credit institutions in their jurisdiction, even though the client funds would be DGS protected in any credit institution in a jurisdiction that guarantees such protection. This would seem to suggest that the entity placing client funds in a credit institution considers the perceived strength of the credit institution irrespective of DGS coverage. Thus, the EBA acknowledges that there is a possibility that DGS protection may increase the level of moral hazard, but notes that there is no evidence to suggest that firms choose a credit institution to safeguard client funds with no regard to that institution's strength in Member States where such deposits are already covered.

37. In light of:

    - the arguments in favour of covering such client funds previously outlined in the EBA Opinion on eligibility of deposits, coverage level and cooperation between DGSs;

    - the current lack of harmonisation in the treatment of client funds, and subsequent risk of different treatment of depositors in different Member States or even within a Member State depending on what type of entity placed client funds as a deposit with a credit institution;

    - the assumed limited impact that extending such coverage would have on how payment institutions, e-money institutions and investment firms safeguard client funds;

    - the opportunity to avoid confusion by means of clearer rules, and clear communication to customers; and

    - taking into account the imperfect data received from the authorities, which show current immateriality of the amounts of such client funds in relation to the amount of all covered deposits in nearly all Member States, and thus probably limited impact of such coverage on the level of DGS contributions,

    the EBA proposes to the EU Commission, as articulated below, to clarify the DGSD to ensure that client funds placed by credit institutions, payment institutions, e-money institutions, and investment firms on behalf of their clients with credit institution are DGS protected in case that credit institution were to fail (including when such funds are placed in any type of account necessary to meet the safeguarding requirements). The EBA is of the view that the expected benefits of such a clarification, such as harmonisation and equal treatment of consumers across the EU, better protection for consumers, consistency with the safeguarding requirements, and assumed limited impact on the DGS contributions of credit institutions across the EU outweigh any potential downsides identified and summarised above. Furthermore, the Commission

should consider if further clarifications are necessary in other parts of EU law specifying the treatment of client funds in order to align their treatment, including in the Payment Services Directive (PSD) and E-money Directive (EMD). The Commission should also provide a clear definition of client funds to clearly distinguish them from the entities' own resources.

Recommendation 1. Clarify the DGSD to ensure that client funds deposited with a credit institution by other credit institutions, payment institutions, e-money institutions and investment firms are covered by a DGS in case the credit institution holding client funds were to fail, as long as:

- **such deposits are placed on behalf of clients who are not themselves excluded from coverage under Article 5(1);**
- **such deposits are deposited for the purpose of segregating them from the account holders' own funds as required by law; and**
- **such clients are identifiable.**

Furthermore, the Commission should consider whether or not other parts of EU law would require alignment following the introduction of the clarification in the DGSD, including in the Payment Services Directive (PSD) and E-money Directive (EMD).

Recommendation 2. When clarifying the DGSD, the Commission should include a definition of client funds specifying that it includes funds deposited by entities on behalf of their clients, in order to provide clarity on the distinction between the own liquidity of the entity placing a deposit, and the funds placed on behalf of clients.

38. The Commission's Call for Advice did not explicitly ask the EBA to assess the materiality of client funds placed by other types of entities currently excluded from DGS coverage – such as asset management companies, insurance and reinsurance undertakings, collective investment undertakings, pension and retirement funds – as well as other entities such as real estate agents, solicitors, travel agents and similar. Thus, the EBA did not collect such information and so at this stage cannot assess the materiality of such deposits.

39. However, the EBA considers that the majority of the arguments in favour of ensuring coverage of client funds placed with credit institutions by payment institutions, e-money institutions, and investment firms, may also apply to deposits placed on behalf of their clients by other types of entities. To be more precise, ensuring coverage of client funds placed with credit institutions by such entities across the EU would:

    - limit the risk of contagion from the failed credit institution to other entities that deposited client funds in that credit institution;

- ensure harmonised treatment of depositors across the EU (including mitigating the risk that client funds deposited by different types of entities offering very similar services (e.g. investment firms and asset management companies) are treated differently);

- offer better protection to customers of financial institutions;

- in the view of the EBA it would not create moral hazard for customers to be careless in the choice of their financial partner, as customers would not generally be insured against the default of the firm that shall conduct business on their behalf, but would be insured against the failure of the credit institution where that firm places client funds.

40. On the other hand, if other types of financial entities currently excluded from coverage are not required to safeguard client funds, and/or are not required to hold client funds in segregated accounts, offering the same treatment to funds they deposit may not be advisable.

41. Thus, if the Commission decided to clarify the DGSD in line with Recommendation 1 outlined above, it would appear to be inconsistent if some client funds were covered, while others would not. In consequence, the EBA proposes that the Commission should also clarify the DGSD in such a way that it would extend coverage to client funds deposited with credit institutions by other types of entities, as long as such client funds are placed on behalf of clients, are identifiable, and are in segregated beneficiary accounts.

Recommendation 3. Clarify the DGSD to ensure that in principle client funds placed by entities which are currently excluded from coverage under Article 5(1) of the DGSD, and are not already captured in Recommendation 1 in this Opinion, are also covered as long as:

- **they are placed on behalf of clients who are not themselves excluded from coverage under Article 5(1);**

- **are deposited for the purpose of segregating them from the account holders' own funds as required by law; and**

- **such clients are identifiable.**

However, as the EBA was not able to collect the necessary data, perform an impact assessment, and analyse in detail relevant provisions related to all such types of entities in the context of this Opinion, there is a need for the Commission to further develop the technical details of this recommendation or to mandate ESAs to do so in the context of a Level 2 legal instrument. Such further work could further define the technical detail of such coverage, along with any exclusions from the general principle, taking into account other requirements, including the link to the safeguarding requirements in other pieces of EU law.

Reimbursing client funds and risk of contagion

42. The survey asked respondents several questions in relation to how beneficiary accounts would be reimbursed in case of credit institution failure, including:
    - whether funds would be reimbursed to the account holder (e.g. payment institution or e-money institution), or directly to the ultimate beneficiary (i.e. the person who placed their funds with a payment institution and which the payment institution then deposited with a credit institution);
    - the approach to the treatment of depositors who have an account with a failed credit institution and that person's client funds are also deposited with the same credit institution; and
    - if the single customer view (SCV) files include the client funds that are placed by the entities excluded from coverage under Article 5(1) of the DGSD in accounts in credit institutions.
43. The survey also asked questions about potential risks of contagion and real-life experiences with reimbursing client funds. The remainder of this section presents a summary of the key findings from the previous EBA Opinions on the implementation of the DGSD, and the results of the survey, starting with the discussion of the risk of contagion, followed by who would be reimbursed (including the link to the risk of contagion), information available for reimbursing depositors directly, and, finally, the treatment of cases where a depositor has funds in their own account and in a client account in the same credit institution.

Risk of contagion

44. The risk of contagion applies to any instance where the failure of a credit institution means the account holder loses client funds and/or customers. The EBA Opinion on the eligibility of deposits, coverage level and cooperation between DGSs (EBA-Op-2019-10) highlighted the risk of contagion in cases where, following the failure of a credit institution holding client funds, the DGS reimburses the ultimate beneficiary directly, as opposed to reimbursing the account holder. The potential risk arises because:
    - the failure of the credit institution could result in an outflow of client funds from the account holder, while it is uncertain whether these clients would then return their funds to the account holder, and
    - the account holder may still be liable to return funds to the ultimate beneficiary, even though they have already been returned by the DGS. This is a matter of national law.

45. The survey asked respondents about their real-life experiences of payouts of beneficiary accounts. Two respondents experienced cases where the failure of a credit institution had a discernible impact on the account holder:

    - In one of the cases, a failure of a credit institution impacted an investment firm because client funds deposited in the bank were not covered by the DGS. In consequence, the investment firm was unable to comply with its obligations and the investor

compensation scheme (ICS) was triggered. The ICS compensated customers of the investment firm up to EUR 100,000 per investor. The investment firm went into insolvency and is currently being liquidated. Since then, that Member State has amended national law to protect deposits placed with a credit institution by an investment firm on behalf of its clients.

- In another case, an e-money institution sought compensation for the client funds it deposited with a failed credit union. Such client funds are not covered in that jurisdiction and so the DGS refused to reimburse such funds. As a consequence, the EMI appealed, and the final decision of the Supreme Court noted that the funds held by EMIs can be considered as depositors' funds only if the EMI identifies the depositors and proves that they have the rights to these funds. In that case, the EMI was unable to fulfil the criteria required by the decision of the Supreme Court (as it did not identify the depositors) and thus the insurance claim was not paid to the EMI nor the ultimate beneficiaries.

46. A special case of a contagion risk applies when the failed credit institution is part of the same group as the account holder (e.g. payment institution or investment firm). In such instances, the risk of contagion may be more pronounced because of the financial links between the constituent entities of the group and the potential sharing of the same brand name. Thus, the survey asked respondents if they were aware of instances where payment institutions, e-money institutions and/or investment firms safeguard client funds with credit institutions that are part of the same group. Authorities from 6 MSs reported being aware of such instances: it is common in three of them, and there are isolated cases in three other MSs.
47. The survey also asked respondents if there is a clear pattern in how entities safeguard client funds. Four authorities reported a pattern and in each of the four cases where they see entities placing client funds with the biggest credit institutions in their jurisdiction. In other MSs, the authorities reported that there is no clear pattern or that they don't have the information.

Reimbursing client funds

48. The EBA Opinion on DGS payouts (EBA-Op-2019-14) includes a dedicated chapter analysing the consequences of different approaches to reimbursing client funds, including repaying the ultimate beneficiary directly or repaying the account holder. Key arguments in favour of repaying the account holder is to avoid creating contagion risks and undermining financial stability. Furthermore, even if it would not directly lead to the failure of the account holder, it could significantly impact its business by breaking the relationship the ultimate beneficiary had with the account holder. The following scenario illustrates the potential impact on the relationship between the ultimate beneficiary and the account holder: where the ultimate beneficiary entrusts an investment firm with funds, which then places these funds with a credit institution for the purpose of safeguarding, and the credit institution fails, repaying funds to the investment firm means that the firm can continue its relationship with the client, and the client can draw out their funds in line with the applicable provisions in the contract. On the

other hand, where the DGS repays the ultimate beneficiary directly, the investment firm may need to convince the ultimate beneficiary to entrust their funds with them again, where following the failure of the credit institution, the contract between the ultimate beneficiary (the client) and the account holder (the intermediary) does not require a continuation of their relationship. On the other hand, where the DGS is obliged to repay the account holder, and the account holder fails (for example because it was part of the same group as the credit institution which created a knock-on effect), it would endanger customers' funds.

49. Based on the analysis, the EBA proposed to the Commission 'to further assess the need to provide clarity in relation to the payout approaches applicable to sums in accounts of which the depositor is not absolutely entitled and the implications this entails for the coverage limit, depositor protection, the continuity of the firm that safeguards funds on behalf of or for the purpose of its clients and the need to establish a hierarchy of accounts for the purpose of beneficiary accounts.' The Opinion also noted that this issue 'could potentially become more relevant in the future, considering market developments such as the rise of payment services providers and e-money institutions, which are required to safeguard the funds of their users'.

50. The EBA Opinion on DGS payouts did not benefit from a comprehensive stocktake and assessment of current approaches to reimbursing client funds. However, such a summary is now possible using the results of the survey, which showed that there are significant differences in the approaches to repaying client funds across the EU:
    - authorities from 13 out of 27 MSs would pay the ultimate beneficiary directly;
    - 11 would pay the account holder (i.e. the intermediary); and
    - 2 reported that it depends on what the ultimate beneficiary decides;
    - in 1, it depends if the ultimate beneficiary is a natural or legal person.

51. Responses to the survey also showed that there are different approaches to how information about beneficiary accounts is (or is not) captured in the SCV file:
    - In 8 MSs the SCV file identifies the ultimate beneficiary (note that 13 authorities reported that they would pay the ultimate beneficiary directly even though only 6 of them reported that they would have the necessary information in the SCV file. In 7 cases where the authority would reimburse the account holder they would not have the necessary information in the SCV file, and did not specify that they would receive the necessary information alongside, but not within the SCV file).
    - In 12 MSs the SCV file only identifies the account holders.
    - In 5 MSs the SCV does not include information on client funds.

52. The results point to an apparent mismatch between the number of authorities that would repay the ultimate beneficiary directly and the number of authorities that would have readily available in their SCV file the information needed to carry out such repayments. It also highlights how repaying the account holder as opposed to the ultimate beneficiary requires less information. That is because the DGS would only need to know of instances where the beneficiary account includes amounts in excess of EUR 100,000 for individual clients as opposed to knowing precise amounts to be reimbursed for all depositors, along with other relevant

information depending on the DGS payout method. Thus, it could be argued that such a payout could be done quicker because there is limited need to request any additional information from the account holder and/or the ultimate beneficiary. On the other hand, a payout may be done just as quickly where the SCV file already includes all the relevant information allowing the DGS to reimburse ultimate beneficiaries directly.

53. Finally, if accounts are aggregated per depositor, as is the case in the vast majority of MSs, different repayment deadlines for deposits in own accounts (7 working days), and funds in beneficiary accounts (currently 3 months), would mean that the DGS would necessarily have to repay all the covered funds in the depositors' own account. Furthermore, if the amount of client funds of that depositor added to their own funds is above EUR 100,000, only some (or no) client funds would be reimbursed to the account holder. It is beyond the scope of this Opinion, and the EBA has therefore not endeavoured, to determine whether the customer would be entitled to all their funds from the account holder, even though the account holder only received part of the funds in the DGS payout.

54. On the other hand, it could be argued that reimbursing the account holder as opposed to the ultimate beneficiary may in some instances endanger the ultimate beneficiary's funds, particularly in cases where the failure of the credit institution happens in parallel or shortly before the failure of the account holder. In such a case, there is a risk that the DGS reimbursed the account holder, which either has failed or is about to fail, and thus the ultimate beneficiaries lose the ability to take out their funds and become creditors in the insolvency of such an entity.

55. Secondly, where the SCV file includes all the information required to reimburse the ultimate beneficiary, bypassing the account holder may be a quicker way for the ultimate beneficiaries to be able to access their funds.

56. Thirdly, it could be argued that reimbursing funds to the beneficiary account of the account holder, and not the ultimate beneficiary, disallows the ultimate beneficiary from deciding where to receive their compensation, which in consequence restricts the ultimate beneficiary's access to their own funds.

57. Given the current lack of harmonisation in relation to the reimbursement of such client funds, there is a risk that ultimate beneficiaries are impacted differently in similar bank failures across the EU. The urgency of providing clarity to the reimbursement of client funds also arises from the increased importance of deposit brokerage platforms, some of which facilitate opening of bank accounts at banks that the platforms partner with, which then place deposits with the banks chosen by the clients, in beneficiary accounts, and they often do so across EU Member States.

58. Thus, the EBA proposes to the EU Commission to allow flexibility in how to repay deposits in beneficiary accounts but introduce harmonisation of the method for repaying funds in client accounts where there is a need to mitigate the risk of contagion from the failed credit institution to the account holder by virtue of how the payout is done. The method to decide

whether there is a risk of contagion would need to be developed further, including an assessment of the roles for the competent authorities, the DGS designated authorities and the DGSs, in such an assessment. The EBA also proposes that to address the risk that the reimbursement method (be it to the beneficiary account opened by the account holder in another credit institution or directly to the ultimate beneficiary) creates uncertainty as to the ultimate beneficiaries' claims, the DGSD should include provisions aimed at ensuring that ultimate beneficiaries do not receive de facto double coverage, for example by having a claim on the amount from the DGS and separately from the account holder which received the payout from the DGS. Finally, the EBA proposes that irrespective of the chosen reimbursement method, the DGSs should retain their current power to request any information from the credit institution to prepare for a repayment and to ensure reliability of data, their current power to request credit institutions to inform them about the aggregated amount of eligible deposits of every depositor at any time, and maintain current longer repayment deadline for amounts in beneficiary accounts.

Recommendation 4: Clarify in the DGSD that, where national law allows, DGSs are free to choose whether to reimburse funds in beneficiary accounts directly to the ultimate beneficiaries or to the beneficiary account of the account holder in another credit institution. To avoid the risk of double payment, in the former case, any claim the ultimate beneficiary has in relation to their client funds held by the account holder should be reduced by the amount reimbursed by the DGS to the ultimate beneficiary. In the latter case, the ultimate beneficiary has a claim on the amount of their funds reimbursed to the beneficiary account in another credit institution opened by the account holder and does not have a claim towards the DGS in respect of those funds.

In exceptional circumstances, where there is a serious risk that reimbursing the ultimate beneficiaries directly could endanger the account holder, the DGS should reimburse amounts in the beneficiary accounts to a beneficiary account opened by the account holder in another credit institution. Either the Commission, in Level 1 text, or the EBA, in a Level 2 legal instrument, should further develop the mechanism and the conditions for the relevant authorities to determine whether there is a serious risk of contagion.

Finally, in line with the current approach to reimbursing amounts in beneficiary accounts, DGSs should retain:

- **the power to request any information from the credit institution to prepare for a repayment of depositors and to ensure the reliability of data;**
- **the power to request credit institutions to inform them about the aggregated amount of eligible deposits of every depositor at any time; and**
- **the longer payout deadline.**

Treatment of depositors with funds in own accounts and in beneficiary accounts

59. The EBA Opinion on DGS payouts outlined in detail arguments in favour and against aggregating funds a depositor has in their own account at a bank, and their funds in a beneficiary account in the same bank. Aggregating funds and applying the maximum coverage limit of EUR 100,000

to the sum of funds has the benefit of strictly adhering to the principle that each depositor is protected up to EUR 100,000. By contrast, the key benefit of not aggregating deposits and applying the coverage limit of EUR 100,000 to the client funds and the depositors' individual account separately, is increased deposit protection in cases where a depositor may not be aware of the complexities of the potential interplay between their client funds and their deposits, a potentially simpler process to follow for the DGS in case of a payout, and a recognition of the observation that in many instances the depositor has no knowledge and no choice over where the account holder deposits their funds.

60. Responses to the survey show that nearly all the authorities would apply the see-through approach and then add up funds in different accounts to see if collectively they are within the coverage limit of EUR 100,000. Authorities in three Member States would apply the see-through approach to client funds and cover funds in own accounts separately meaning that they would not add up the amounts in the depositor's own accounts and in the client account and would apply the EUR 100,000 separately. Only one authority would not apply the see-through approach at all.

Operational aspect of aggregating deposits

61. As outlined in the section above, the majority of authorities reported that the credit institutions' SCV files do not contain the information on the ultimate beneficiaries. Thus, in the majority of Member States the DGS would not have all the information to be able to calculate what amount to reimburse to the ultimate beneficiaries such that it also takes into account their deposits in own accounts. In consequence, the DGS would need to request this information from the account holder, match it with their own information on own accounts, and perform the calculations, which would make the reimbursement process longer, more burdensome and more prone to errors. It would not be necessary to perform such calculations, if:

    - the reimbursement was to be made to the account holder (assuming the account holder provides evidence of what amount of the client funds is covered); and
    - deposits in own accounts, and funds in beneficiary accounts were to be treated separately.

    Finally, if that were the case, the reimbursement could be done much quicker than the currently applicable deadline of 3 months, or even the revised deadline of 20 working days from when the DGS has all the necessary information, as recommended in the EBA Opinion on DGS payouts. That is because the DGS would not require as much information as if it were to repay the ultimate beneficiary directly, and/or if it were to aggregate amounts in different accounts.

62. On the other hand, DGSs in some MSs already receive in the SCV file the data of the ultimate beneficiaries. In such instances, the ultimate beneficiary could decide where to receive the compensation to which they are entitled, and more quickly access their funds as in cases where they would like to withdraw their client funds from the account holder, they would not need to

take the intermediate step of approaching the account holder – they would receive the reimbursement directly.

Risk of arbitrage

63. It could be argued that treating separately the amount of funds depositors hold in accounts in their own name, and those in beneficiary accounts raises the risk of arbitrage as depositors could increase the amount of deposits that is covered above the EUR 100,000 by using third-party entities to place their deposits in different beneficiary accounts in the same credit institution. On the other hand, instances where a depositor would be reimbursed more than EUR 100,000 would not be very likely because for that to occur the following conditions would need to be met in parallel:

    - a depositor would need to have an own account in the same credit institution where another entity they use (e.g. a payment institution) also has a client account;
    - the sum of the amounts in the own account and in the beneficiary account relating to that depositor would need to be above EUR 100,000; and
    - the sum would need to be above EUR 100,000 at the moment the credit institution fails (the probability of which depends on for how long client funds are deposited at a credit institution, and in at least some cases, such as client funds placed by payment institutions, is likely to be very short-term). In other instances, it may be more likely, for example where client funds are placed by e-money institutions, which place such funds as deposits for longer than payment institutions.

    Most importantly, it is unlikely that the possibility of potential coverage above EUR 100,000 in such special circumstances would be used by depositors to gain undue coverage for amounts above EUR 100,000, given that they have limited, if any, control over the bank in which said entity places the funds across time. A simpler and more reliable way for a depositor to secure coverage above EUR 100,000 would be for a depositor to spread out their high deposits between multiple credit institutions as opposed to a complex set up involving client accounts in other entities (including using specific deposit brokerage platforms which facilitate placing deposits in beneficiary accounts). Thus, the EBA considers that the instances where a depositor would benefit from coverage above EUR 100,000 would likely be inadvertent rather than resulting from deliberate actions of the depositor trying to secure coverage above the EUR 100,000 limit.

64. The EBA also assessed the option of clearly informing clients of the credit institution where the relevant entity would be safeguarding their funds and what may be the impact if they already have deposits in the credit institution where their funds could also be safeguarded. While increased transparency in this regard may have some benefits, and in some circumstances it may be possible for the depositor to take action to avoid the risk of their funds being not covered, it may not always be realistic to expect a depositor to understand legal provisions

governing safeguarding, when it may occur, and how it relates to the coverage of the deposits in their own name. Furthermore, while in some instances, they may know when their funds have been safeguarded by being deposited with a credit institution, but in most cases, they would not know that because safeguarding is required in specific circumstances, and can be ensured by different means (including insurance policies). In addition, such an approach would require financial institutions to inform clients every time there are changes to how and where client funds are safeguarded, which would be a regulatory burden.

65. In light of:

- valid arguments in favour of applying coverage level separately to deposits in own accounts and beneficiary accounts, centred around ensuring better customer protection, with potential operational benefits; and
- valid arguments against applying coverage separately, centred around maintaining the principle of equal coverage of EUR 100,000 per bank per depositor, with some risk of arbitrage,

at this stage, the EBA decided not to recommend one best approach, but outline the arguments for the Commission's consideration.

DGS contributions taking into account client funds

66. Responses to the survey show that of the 26 authorities that provided a response, 13 count client funds placed with CIs when calculating contributions to the DGS fund, while 13 do not include client funds in the calculation.

67. As outlined earlier in this Opinion, the amount of client funds in relation to all covered deposits is small in many Member States. However, it is likely that in at least some Member States there are credit institutions that hold material amounts of client funds in relation to all covered deposits they hold. Thus, even if covering client funds, and explicitly requiring contributions to be calculated based on client funds would not significantly increase overall contributions to DGS funds, ensuring they are counted would ensure a level playing field between, on the one hand, credit institutions that hold only deposits in own accounts (and contribute based on all such covered deposits) and, on the other hand, credit institutions that hold own account deposits but also deposits in beneficiary accounts (and which do not necessarily contribute based on the latter).

68. Different options are available on how to establish the basis for calculating contributions to the DGS fund, taking into account the amount of funds in the beneficiary account. One way is to require that credit institutions provide a breakdown of amounts by ultimate beneficiary in each beneficiary account, which would allow for a precise calculation. Another way is to assume that all the client funds in the beneficiary account are covered, although they might not necessarily be covered, and thereby possibly overestimate the basis for calculating contributions. A third

way is to combine the first two approaches, namely to assume that all the client funds are covered, unless a credit institution can provide detailed information to perform a precise calculation. Given that client funds from at least some entities, such as payment institutions, are placed in the beneficiary account for a short period of time, it could be considered further whether there is a need to account for the volatility of the amounts in beneficiary accounts.

69. Thus, taking into account:
    - the current lack of harmonisation in the EU in relation to reflecting client funds in DGS contributions;
    - the potential level playing field issues between institutions when client funds are covered but not taken into account when determining each credit institutions' contributions; and
    - different options through which the amounts in client accounts could be taken into account when calculating contributions,

    the EBA proposes to the EU Commission to clarify that, if client funds are to be covered, they should be reflected in the DGS contributions of the credit institutions that hold them. Given the technical nature of this topic, the EBA Guidelines on methods for calculating contributions to DGS funds (EBA/GL/2015/10)[6], which the EBA was mandated to develop under the existing DGSD) would be a suitable legal instrument to also outline how to account for client funds in the contributions.

    Recommendation 5: Ensure that client funds are taken into account when calculating contributions to DGS funds, with details to be set out in a revision of the EBA Guidelines on methods for calculating contributions to DGSs.

Done at Paris, 27 October 2021

[Signed]

José Manuel Campa

Chairperson

For the Board of Supervisors

[6] EBA-GL-2015-10 GL on methods for calculating contributions to DGS.pdf (europa.eu)