

STATES OF JERSEY



DEPOSITOR COMPENSATION SCHEME (S.R.10/2009): RESPONSE OF THE MINISTER FOR ECONOMIC DEVELOPMENT

**Presented to the States on 8th December 2009
by the Minister for Economic Development**

STATES GREFFE

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Introduction

The Department values the important role that the Economic Affairs Scrutiny Panel (“**the Panel**”) plays in ensuring that legislation developed by the Economic Development Department (“**EDD**”) is fit for purpose and of the highest quality.

EDD has carefully considered the Panel’s Report on the Depositor Compensation Scheme (“**DCS**”) and whilst EDD does not accept many of the Report’s findings, the Report does raise some issues which EDD has undertaken to address either as part of the implementation of the DCS or in further separate pieces of work. EDD’s response to each of the Panel’s findings and recommendations is set out below:

	Findings	Comments
3.1.1	The Jersey authorities and other key stakeholders believe that a depositor compensation scheme is not necessary, in the sense that it will never need to be used, due to the rigour of the bank licensing policy in Jersey and the Jersey Bank Business Model.	<p>There are 2 parts to this finding.</p> <p>The first is that a depositor compensation scheme is not necessary and the second is that it is highly unlikely that it will be called upon. EDD agrees with the finding that it is extremely unlikely that a deposit compensation scheme will be used based on the current business model. In this regard EDD notes the evidence given to the Panel by the Jersey Financial Services Commission (“JFSC”), the Viscount and other industry experts that due to the rigorous licensing regime and the nature of the banking sector in Jersey, the risk of a bank failure is very small.</p> <p>However, with regard to the first part, following a change in international standards, and in the expectations of depositors, EDD considers that a DCS to protect depositors and to maintain the public finances is necessary.</p>
3.1.2	The world has changed since the onset of the world financial crisis and global recession. The political climate has changed markedly. Different approaches to bank failure are now under consideration, leading to an increased	<p>EDD agrees with the finding that the nature of the banking industry has undoubtedly changed considerably and further changes can be expected in the future.</p> <p>However, EDD rejects the finding that there is an increased likelihood that a bank or banks could fail in Jersey. The action taken over the past year demonstrates that</p>

	likelihood that a bank or banks could fail.	jurisdictions with parents or head offices of Jersey subsidiaries or branches are not only supporting but also have the capacity to support their systemic banks. Measures currently being considered in other jurisdictions are yet to be finalised and it is not at all clear that the measures once adopted will lead to an increased likelihood that a bank or banks could fail. Oxera indicate that any such measures will be designed so as to make it even <u>less</u> likely that systemic retail banks are allowed to fail.
3.1.3	The Jersey Banking Business Model is not without risk, as has been identified by the International Monetary Fund. A depositor compensation scheme is required to protect retail depositors.	EDD agrees that no banking model is without risk, but as stated above, the evidence is that the risk of a Jersey bank failure is very low. EDD agrees that a deposit compensation scheme is now necessary. It should be remembered that the world has seen a financial crisis of enormous proportions and no Jersey Bank has failed in that time.
3.1.4	The final Oxera Report appears to have been tailored to bolster the preferred scheme of the Economic Development Department.	EDD disagrees with this finding. Oxera are independent economic consultants with an international reputation for providing expert advice in the area of Depositor Compensation Schemes. EDD notes in this regard that the Panel's Report does not criticise any of the actual findings of the Oxera Report.
3.1.5	The development of the scheme has been carried out in a less than transparent manner.	EDD disagrees with this finding. Although the tight deadline set by the States Assembly for developing a proposed DCS meant that a full public consultation was not possible, EDD did consult key stakeholders and industry experts. It is also important to note that all relevant documentation has been provided to the Panel.
3.1.6	There has been a lack of co-operation with the Panel during its evidence gathering from a number of key stakeholders.	EDD co-operated fully with the Panel's review and understands that no lack of co-operation is alleged with regard to EDD. EDD is not able to comment on the co-operation given to the Panel by third parties.

3.1.7	Although consultation took place with one of the main stakeholders, the Jersey Bankers Association, and with amongst others the Jersey Financial Services Commission, the Law Officers and Viscount's Department on technical issues, there was no consultation with the small business community, who were left out of the scheme, or with the General Public.	<p>EDD agrees that in the limited time available, a full public consultation was not possible.</p> <p>EDD did consult the key stakeholders listed along with other experts. No data were available to allow the inclusion of small businesses in the DCS to be adequately costed, as confirmed subsequently by both the Institute of Directors and the Jersey Chamber of Commerce. The Minister has undertaken to carry out the necessary research and to report his findings back to the States Assembly within 5 months of the legislation being agreed by the States Assembly.</p>
3.1.8	The £50,000 payout per eligible depositor per bank is consistent with comparable jurisdictions and is a credible level of compensation.	EDD agrees with this finding.
3.1.9	The coverage of Jersey resident and international retail depositors is appropriate and consistent with international standards.	EDD agrees with this finding.
3.1.10	It is appropriate that charities and children's trusts are covered by the scheme.	EDD agrees with this finding.
3.1.11	The scheme does not cover small businesses and insufficient consideration was given to establish if this would be achievable.	<p>EDD disagrees that insufficient consideration was given to the inclusion of small businesses in the proposed DCS.</p> <p>No data could be given by the banks that would enable the analysis of the breakdown of deposits along with the differing factors that normally differentiate the size of business. Consequently no definition of small business could be determined and the cost of including small businesses could not be quantified quickly during the development of the scheme with the resources available. The Minister has undertaken to carry out the necessary research which involves doing a full scale survey and to report back to the States Assembly (see also point 3.1.7).</p>

3.1.12	The proposed scheme is not world class and does not comply with all of the IADI core principles.	<p>EDD disagrees with this finding.</p> <p>The proposed DCS is tailored to the banking industry in Jersey and with the right implementation is capable of complying with at least the majority of IADI Core Principles, as confirmed by the Jersey Financial Services Commission. In particular, EDD notes that a post-funded DCS is not incompatible with IADI Core Principles.</p>
3.1.13	There is no evidence of a risk management strategy for the States' liability in the scheme.	<p>EDD disagrees with this finding.</p> <p>A risk management strategy has been central to the development of the scheme. Work was carried out by the Treasury and Resources Department in order to identify the most appropriate source of States' shortfall and liquidity funding. Oxera have produced models showing the likely States contribution in a variety of scenarios. Critically, the Scheme has been devised to minimise the costs to the States. Both the States and the DCS will receive independent legal advice with regard to the terms of any loan agreement for the provision of liquidity funding in order to ensure that the risks are appropriately managed.</p>
3.1.14	The drive to keep down the costs for the commercial benefit of the banks has dominated the development of the scheme to the detriment of the principles of protecting depositors and limiting the exposure of taxpayers.	<p>EDD agrees that the proposed DCS was designed to keep unnecessary costs to a minimum, but disagrees that this has dominated the development of the DCS.</p> <p>The main driver behind the development of the proposed DCS was the need to establish a <u>credible</u> DCS in accordance with international standards as quickly as possible in order to protect depositors and maintain the public finances.</p>
3.1.15	Depositor Compensation schemes should not be used as competitive tools. Jersey should have consulted with the Isle of Man and Guernsey with a view to co-operation on developing standard approaches to the protection afforded to depositors.	<p>EDD disagrees with this finding.</p> <p>EDD did consult with Guernsey concerning their scheme and closely followed the developments in the Isle of Man. However, the different groupings of banks and size of deposits in each jurisdiction means that no one scheme would be properly suited to the specific circumstances of all 3 jurisdictions. Further, EDD does not see why</p>

		competitiveness should not be a relevant factor in the development of finance industry legislation.
3.1.16	The 5 year cap is unique to the Guernsey scheme and to that proposed in Jersey. It is designed to minimise the costs to the banks but this is to the potential detriment of depositor protection.	<p>EDD disagrees with this finding.</p> <p>All schemes have some form of cap in place. EDD considers that the 5 year cap is necessary in order for the proposed DCS to be competitive with schemes in comparable jurisdictions. Further, the data analysis demonstrates that the amount of the cap is consistent with international standards relating to DCS.</p>
3.1.17	An ex-post funded scheme lacks credibility.	<p>EDD disagrees with this finding.</p> <p>The Jersey scheme has been designed in accordance with Principle 11 of the IADI Core Principles which requires that a credible source of liquidity funding is in place. In the proposed DCS, liquidity funding is provided to the DCS by a loan from the States whose ability to pay £100 million gives the required stamp of credibility.</p>
3.1.18	Hybrid funded schemes are becoming increasingly common.	<p>EDD agrees that there are many hybrid schemes in existence however there are also many post funded schemes.</p> <p>It is considered that hybrid schemes (incorporating a pre-funded element) are appropriate for jurisdictions in which there are regular bank failures. EDD does not consider that hybrid funding would be appropriate for Jersey as the evidence suggests that the risk of a failure in Jersey is very small.</p>
3.1.19	A permanent Board would be able to react more effectively to a bank failure than a Board established post failure.	The Viscount, who is the expert used to dealing with insolvencies on a regular basis gave evidence that the EDD proposals concerning a Board were credible and practical. However, in response to Scrutiny's concerns, the Minister has undertaken to appoint the Board to administer the DCS as soon as possible.

3.1.20	Public awareness of the scheme will be an important element of its credibility. It is not clear who will be responsible for promoting Public Awareness of the scheme.	EDD agrees that public awareness of the DCS should be promoted and has appointed a project officer to prepare papers on the appropriate manner to promote the DCS.
3.1.21	A permanent Board would be more credible to depositors and would be well placed to undertake roles including promoting Public Awareness of the scheme.	EDD has undertaken to appoint the Board to administer the DCS as soon as possible. EDD does not consider that it would necessarily be appropriate for the Board to be responsible for promoting public awareness of the DCS, when other participants in the safety net are arguably better equipped to address this issue. A conclusion will be reached on this issue once the project officer has completed the necessary research.
3.1.22	The Board as proposed is not sufficiently independent.	EDD disagrees with the finding partly because the Regulations establishing the DCS state clearly that the Board is an independent body, and partly because a memorandum of understanding can resolve any residual issues in this area.
3.1.23	The proposed aim for a seven day payout is currently unrealistic and undermines the credibility of the scheme.	EDD disagrees with this finding. EDD considers that the requirement for an interim compensation payment to be made to depositors within 7 working days of receipt of a valid claim is credible and notes the Viscount's evidence to the Panel in this regard.
3.1.24	There are significant cross border asset recovery concerns.	EDD agrees that international bank failures can lead to complex cross-border insolvency issues, but considers that it is impossible for Jersey to address this unilaterally. Considerable work is currently underway in order to address this issue internationally and Jersey will join the appropriate forums in order to assist in this process.

3.1.25	There is no separate insolvency law for banks in Jersey despite the likely complexity of the liquidation of a failed bank.	EDD agreed that there is no separate insolvency law for banks. This issue was raised in the recent IMF report and is being considered separately.
3.1.26	Claims of high recovery levels from of a failed Jersey bank's parent company are untested and not guaranteed.	EDD disagrees with this finding. Whilst there have been no Jersey bank failures as a result of the recent international financial crisis, there have been bank failures in both the Isle of Man and Guernsey. In both of those cases recoveries are expected to exceed 70p in the pound.

Recommendations

	Recommendations	Accepted/ Rejected	Comments	Target date of action
3.2.1	The Minister for Economic Development should make provision for coverage to be extended to small local businesses.	Further work is necessary in order for the Minister to form a view.	No data were available to allow the inclusion of small businesses to be adequately costed, as confirmed subsequently by both the Institute of Directors and the Jersey Chamber of Commerce. The Minister has undertaken that EDD will carry out the necessary research and will report back to the States Assembly.	The Minister will aim to report back to the States Assembly by the first sitting in April 2010.
3.2.2	A hybrid funding structure should be adopted.	Rejected.	EDD considers that hybrid schemes (incorporating a pre-funded element) are appropriate for jurisdictions in which there are regular bank failures. Jersey does not face regular bank failures and EDD does not consider that hybrid funding would be appropriate in Jersey.	n/a

3.2.3	In order to raise the credibility of the scheme for depositors a real, permanent Board should be established.	Accepted.	EDD has undertaken to appoint the Board to administer the DCS as soon as possible.	A timescale is being developed in consultation with the Jersey Appointments Commission.
3.2.4	A permanent Board should be funded in advance outside of failure periods by an administration fund collected from bank levies.	Rejected.	EDD considers that it would be unfair to levy banks without their prior consultation. EDD has undertaken to fund the first year's administrative costs of the Board and to undertake a consultation with regard to its long-term funding.	The results of the consultation will be fed into the annual review of the DCS.
3.2.5	There should be a permanent Board funded by the banks and more demonstrably independent of the States and industry practitioners. Its remit should include public awareness, monitoring of international standards in depositor protection and the administration of the scheme.	Rejected.	EDD has undertaken to appoint a permanent Board as soon as possible and has also agreed to the Scrutiny Panel's amendments that the States should make such appointments on the recommendation of the Minister. EDD will be considering the remit of the Board as part of the annual review process.	EDD will appoint a permanent Board and consider the remit of the Board as part of the annual review process.
3.2.6	A separate insolvency law for banks should be established.	Being considered separately.	The issue of a separate insolvency law for banks was raised in the recent IMF report and is being considered separately by the IMF strategy group chaired by the Chief Minister's Department.	n/a

Conclusion

EDD appreciates the Panel's hard work and contribution to the development of the DCS. EDD considers that the work of the Panel has been highly beneficial in highlighting areas where elements of the proposed DCS can be strengthened. In particular, EDD has accepted that the Panel's recommendation that a permanent Board should be established to administer the DCS as soon as possible and has agreed that appointments should be made by the States on the recommendation of the Minister. EDD would welcome the Panel's further input in the annual review of the DCS.