

Summary of Responses to the Consultation on

THE INTRODUCTION OF PREFERRED CREDITOR STATUS FOR BANK DEPOSITS COMPENSATED UNDER THE ISLE OF MAN DEPOSITORS' COMPENSATION SCHEME

Public Consultation period: 11th September to 23rd October 2015

CONTENTS

1. Background
2. Summary of responses
3. Findings
4. Key Issues Raised
5. Conclusion

Appendix: Analysis of Consultation Responses

1. Background

Amongst the principles of an effective deposit guarantee scheme is one that ensures, in the event of a bank default, eligible depositors are compensated in a timely fashion. Often, this will require the Government, and participating banks, to provide funding to a deposit guarantee scheme in order that payment can be made to eligible depositors more quickly.

Previously, the Isle of Man Government, by using existing financial reserves, has funded the initial payment, for those eligible under the Depositors' Compensation Scheme ("DCS"). It has then been reimbursed from the bank in default and, if required, from levies on the Isle of Man depositing taking banks that participate in the DCS. Under the current DCS, the Government is currently liable for contributions of up to a maximum of £100m in any 10 year period.

The Government wants to make a change to the ranking of preferred creditors in order that the portion of eligible deposits under the Depositors' Compensation Scheme will rank as a preferred creditor ahead of all other preferred creditors for banks incorporated in the Isle of Man. This will mean that the DCS (or eligible depositors that have not claimed under the DCS) will thereby receive a faster recovery of the monies outstanding than is currently possible.

Furthermore, the Government believes that it is in the interests of the Isle of Man and for ensuring financial stability, for example across the Crown Dependencies ("CDs"), that such a regime should give equal priority to deposits placed in local branches of foreign incorporated banks and vice versa. This would only be considered where there is equivalence between the domestic and the foreign depositor compensation regime, there is mutual recognition and that it ultimately protects the interests of the Isle of Man and its tax payers.

The intention of the proposals made was to:

- 1) Amend the preferred creditor regime to place deposits eligible for compensation, as defined by the DCS, ahead of other preferred creditors but after liquidator expenses and secured creditors.
- 2) Introduce a power for Treasury to proposed the recognition of the deposit compensation scheme of another jurisdiction if 'equivalent, analogous or similar' to the DCS.
- 3) Allow Treasury the right to forego the ranking of its preferred creditor position in relation to debts owed to the DCS, if considered appropriate.
- 4) Bring forward specific amendments to the Financial Services Act 2008, as part of the Financial Services Authority review on resolution and recovery, to include enabling legislation allowing the adoption of international legislation to protect the Isle of Man. This would have been subject to the existing requirement to consult with the public, seek approval from the Council of Ministers and, if supported, to propose secondary legislation to Tynwald.

2. Summary of responses

The Department of Economic Development received a total of **nine** responses to the public consultation. The responses were from a variety of sources and can be broken down as follows:

2 Regulators, 1 Local Government Authority, 5 Banks, 2 Businesses

The responses provided a broad range of views with some including supporting economic arguments. While the number of responses was relatively few given the nature of the proposed changes, they were felt to be representative of the sectors impacted and pertinent issues had been raised.

3. Findings

Overall, the feedback from the Consultation has shown that there is support for giving priority ranking to the portion of eligible deposits covered by the DCS as a preferred creditor, after liquidation expenses and secured creditors but before floating charges and unsecured creditors.

There was also strong support for the proposal that preferred creditor status would be available for deposits eligible for compensation as defined under the Isle of Man DCS or an equivalent foreign scheme. This was believed to be relevant in cases where an Isle of Man incorporated bank has a branch in another jurisdiction (or vice versa) in order to ensure that the outcome for depositors is broadly consistent, irrespective of jurisdiction where the deposit was placed. This was seen as particularly important for multinational organisations with offices in more than one Crown Dependency location operating a subsidiary and branch model.

However, a number of respondents also suggested that the Isle of Man should introduce "secondary" preferred creditor status for some deposits e.g. sums of money in excess of the deposit limit to those eligible under the DCS. Further that this increased amount available for preferential treatment could be restricted to a limited class of depositor yet to be defined. These deposits would not rank equally with deposits eligible for compensation under the DCS but ahead of unsecured creditors.

When considering the introduction of "secondary preference", the focus of the current proposals has been to better protect the interests of the taxpayer and that of lower value depositors for those banks that are incorporated in the IOM. The concept of "secondary" preference for deposits in excess of those amounts covered by the DCS was not part of the intention of this consultation.

It is recognised that introducing another "secondary" layer of depositor preference for a class of deposits (to be defined) may be necessary as part of the wider review of bank resolution in the Isle of Man. If introduced, this would need to be consistent with the framework in place in the EU and UK but would need to be defined in order to be effective

in an Isle of Man context. Not least, the potential impact upon competitiveness and the approach taken in competitor jurisdictions.

4. Key Issues Raised

There were some concerns raised covering:

- The impact of the changes to employees where they are owed money at the time of insolvency;
- The potential situation that depositors may be better off placing their deposit directly with an UK/EU licensed bank (including those with branches in the IOM) rather than with an IOM incorporated deposit taking bank;
- The proposed amendments to the Financial Services Act 2008 and that they were not included in the consultation.

4.1 Employee Claims

Whilst it is accepted that there is an argument to be made that the interests of employees should be protected in the event of bank insolvency, it should be remembered that the creditor hierarchy in the IOM is a list of the order of preference. Therefore, the liquidator is not able to pay out to the next creditor on the list until all higher ranking claims have been paid out. From past experience, it has been found that it can take a considerable period of time for the liquidator to finalise the amounts owed to employees.

Under Employment Act 2006 sections 147-155 and Redundancy Payments Act 1990 sections 25-28), where an employer has become insolvent or ceased carrying on business in the Isle of Man, the Treasury may pay certain debts of the employer out of the Manx National Insurance Fund which it would recover from the insolvency. These cover:

- arrears of pay for 8 weeks;
- pay during any period of statutory minimum notice;
- arrears of payment for time off for trade union duties, looking for work, carrying out duties as a pension scheme trustee or ante-natal care;
- up to 6 weeks' holiday pay accrued in the preceding 12 months;
- any unpaid basic award of compensation for unfair dismissal;
- any unpaid statutory redundancy payment;
- employer or employee's contributions to the scheme unpaid in the 12 months within specified limits.

Any remaining amount owed would still rank as a preferred creditor albeit behind those of deposits eligible for compensation. Directors of a bank would be excluded from the ability to claim from the National Insurance Fund.

Therefore, it is proposed to proceed with the implementation of a creditor hierarchy that will prioritise deposits eligible for compensation under the DCS. However, the legislation proposed will be drafted with the ability for Treasury to amend this category of preferred creditor by order of Tynwald. One of the uses of this provision is could be, when needed, to protect other employee claims.

4.2 Competitiveness

There is a risk that the regime will be considered as less competitive than the UK scheme. These concerns will be included in the future consultation on the DCS when considering reform the current legislation.

In the short term, given the barriers to the establishment of international accounts in onshore locations, this is currently not considered to be an increased risk than experienced at present.

4.3 Financial Services Act Changes

The proposed amendments to the Financial Services Act 2008 that were being considered were to help facilitate bank resolution in due course. Given the consultation responses, it has been decided that, as more work is still required in the area of bank resolution, no changes will be brought forward at the present time.

5. Conclusion

The Department of Economic Development would like to thank all those who have contributed to the Consultation.

Department of Economic Development, January 2015

Appendix A: Analysis of Consultation Responses

Q1. The proposed preferred creditor regime will rank claims made on the DCS as a preferred creditor after liquidation expenses and secured creditors but before floating charges and unsecured creditors. Do you agree with this proposal? Do you have any issues/concerns with this creditor hierarchy and if so please give details?

Yes – 8 No – 1

The majority of consultation responses supported the proposal that deposits, which meet the definition of a covered deposit under the DCS, should rank as a preferred creditor.

The main issue raised (by three respondents) was the adverse impact on employees if they were to rank behind covered deposits. In particular, one response commented that retaining skilled staff during the liquidation was important as their expertise can be of considerable assistance to the liquidator. It was proposed in this response that employee related creditors should rank equally with covered deposits.

Another issue raised (by two respondents) was that the proposal from the IOM differs to the current scheme in the UK. One response suggested that deposits in excess of the covered deposit should receive some level of preference whilst another response queried whether the proposal created a competitive disadvantage for IOM incorporated banks compared to their UK counterparts. It was recommended that a comparison be undertaken between the creditor hierarchy in the Isle of Man proposal compared to the UK and EU prior to any legislation being introduced.

One respondent who was not in favour of preferred creditor status being introduced for covered deposits stated that wholesale/commercial depositors would look to move their business to a bank which was not covered by the DCS. The respondent believed that, upon the introduction of preferred creditor status for covered deposits, this would mean that those depositors not eligible would now subsidise the other depositors in the event of a bank failure. It should be noted that the majority of banks in the Isle of Man are required to be members of the DCS and therefore this risk is not considered to be significant.

One respondent commented that a depositor should not be at a disadvantage, though eligible to claim under the DCS, chooses not to claim. The proposed legislation will recognise a deposit, if it is eligible to be covered under the DCS, irrespective of whether or not the depositor has made a claim under the DCS.

Comments included:

- “Concern has been expressed in terms of the effect the measures would have on employees costs, in particular pensions, which should be near the top of the hierarchy. In addition, it is felt that retail deposit balances beyond the DCS limit also deserve some level of preference.”

- “It is broadly consistent with the changes to existing EU-wide bank insolvency creditor hierarchies made as a result of the introduction of BRRD”
- “We can’t see anything controversial with this proposal – this is effectively bringing the IOM into line with changes already made in the UK & EU.”
- “We believe that the proposed solution is consistent with current international practice and represents the best approach available given all the circumstances, and notwithstanding that, if implemented, it may be detrimental to larger depositors, who presently would rank (in respect of the bulk of their claims) pari passu with the DCS/eligible depositors in the event of any insolvency event.”
- “it would be useful for a full comparison to be made between the proposal outlined in this consultation, and the current position in the UK / EU and Jersey (where creditor preference was introduced for deposits covered by the Jersey deposit compensation scheme), before a final decision is taken”
- “Whilst we can see that the government, as the main beneficiary of the current preferred regime might wish to sub-ordinate its preferred interest, we see possible problems if people, whose assistance may well be invaluable to the liquidation efforts, are adversely affected.”
- “brings the islands DCS in line with Bank Recovery & Resolution Directive regimes implemented in other jurisdictions”

Q2. The preferred creditor regime in the Isle of Man will differ from that in the UK in that funds in excess of the covered balance (i.e £50,000 for individuals, £20,000 for corporates) receive unsecured status only. Do you agree with this proposal? Do you foresee any issues arising as a result of these differences?

Yes – 4 No – 4 Unknown – 1

There was no clear consensus of opinion to this question.

The responses which agreed with the proposal, acknowledged that the scheme must be affordable. One respondent also stated that a differentiated position between the IOM compared to the UK could provide the opportunity for IOM deposit taking banks to demonstrate a competitive advantage in attracting new deposits.

However, a common theme (mentioned by four respondents) was that some form of secondary preference should be introduced for deposits in excess of the covered deposit for eligible depositors. It was also mentioned that depositors in IOM incorporated banks should not be worse off than depositors in IOM branches of UK or EU banks.

In addition, it was proposed that the current international standard was that a form of secondary preference be introduced and that this should be followed by the IOM. It was also highlighted that the position for a depositor in an IOM licenced bank would be significantly influenced by whether their deposit was placed in an IOM branch or IOM incorporated bank (subsidiary).

Comments included:

- “If Isle of Man consumers and customers are worse off than their UK/EU counterparts in terms of protection this is intrinsically unfair and may have a negative impact on the competitiveness of the Island
- “if the Island is going to enter into any form of joint arrangement with the other Crown Dependencies there is a need for the arrangements and limits to be consistent across the 3 jurisdictions.”
- “A technical explanation is required to explain the above difference in depositor insolvency protection to the general public”
- “If one of the aims, as stated, is to bring the IOM arrangements into line with “new international norms” then in our view the proposal above stops a little short of that in that balance above covered balance receive unsecured status only, whereas EU/UK deposits in excess of the covered balance rank above unsecured, secured and non-preferred creditors”
- “This is a qualified agreement as the level of compensation paid is a political judgment. Many of the Government’s strategies are focused on international compliance. In this case the level of compensation does not meet the levels envisaged by EU-compliant schemes. At the same time, other aspects of the DCS are held to be EU compliant when it is unlikely that they can actually be implemented under the current rules (eg payment timetable).”
- “The arrangement must be affordable”
- “any depositor who holds an eligible protected deposit (as defined in the DCS) should be a preferred creditor up to the amount covered by the DCS (the “covered” deposit) even if they do not make a claim on the DCS.”
- “In the absence of having the draft legislation provided within the consultation paper it was difficult to ascertain if the above matter had been fully considered”
- “It may even result in the Isle of Man becoming more of an attraction as a location for institutions who may not have, for reason of concern about contingent liability associated with the existing DCS, established here to date.”
- “the balance of retail deposits should receive some sort of preference although this should be lower ranking than DCS payment recovery”
- “We suggest that the IOM preferred creditor regime follows that of the EU i.e. funds in excess of the covered balance rank above other creditors”

Q3. It is proposed that preferred creditor status would be available for covered deposits under the Isle of Man DCS or a CDs equivalent scheme (if approved by Treasury) to ensure that the outcome for depositors covered by a CD deposit guarantee scheme is the same irrespective of the CD where the deposit was placed. Do you consider that this approach is appropriate?

Yes – 9 No – 0

The respondents all agreed that this approach is appropriate.

Across all the responses was the repeated theme that, if the Island were to enter any form of arrangement with the other Crown Dependencies, then the arrangement and the limits

should be consistent across the jurisdictions (and possibly that the criteria used to assess equivalence be made public).

One respondent argued that the scheme should align to the EU Directive 2014/49/EU, to provide consistency of consumer protection, with particular attention given to disclosures and pay-out timescales. One response questioned as to whether an arrangement solely between the Crown Dependencies could be legally be restricted to those jurisdictions.

One response also proposed to extend the agreements to those jurisdictions where the Islands' banks have a host relationship.

Comments included:

- "this does create the need for consistency"
- "our preference would consequently be for a wholly aligned Crown Dependency DCS"
- "The proposed recognition of depositor compensation schemes in other jurisdictions 'if equivalent, analogous or similar' is to be welcomed."
- "We can't see any disadvantages with this proposal, assuming that all of the CD Regulators are on board."
- "Qualified yes – considerable care will be required to ensure that there is appropriate alignment between the legal operations of each CDs and Isle of Man statutes."
- "we consider this would be an appropriate way to proceed, provided that the regulations were drafted so as to ensure that every material aspect of the compensation regimes in the two jurisdictions were identical, rather than them just being broadly equivalent."
- "in principle, such an approach is attractive. However, [the entity] it is likely that there will be practical difficulties in implementing such a mutual recognition process across jurisdictions which have differing legislative frameworks, are not covered by one overarching piece of legislation (e.g. unlike the EU) and where coverage levels / types of depositor protected may differ."
- "Given the corporate set up of the main participants in the Isle of Man banking sector, we see this as a sensible proposal that will maintain a level playing field between the jurisdictions."
- "However it should be noted that non-trivial differences exist between the Isle of Man DCS and DCS schemes elsewhere. In particular, while the Jersey and Guernsey DCS schemes cover individual deposits to the same level as the IOM DSC, they do not, in general terms, provide protection for corporate deposits - unlike the £20K maximum DCS protection for Isle of Man corporate deposits. The decision-making process to be followed in making such a DCS equivalence determination would also need to be detailed. Can such an agreement legally be restricted to just the Crown Dependencies?"

Q4. Do you foresee any issues arising as result of implementing the enabling legislation in the Financial Services Act 2008 to facilitate the implementation of international standards in order to protect the interests of the Isle of Man Depositors and taxpayer? Please give reasons.

Yes - 3

No – 4

No response - 2

Three respondents agreed that enabling legislation should be enacted to allow legislation to be introduced on a timely basis, where required. It was acknowledged in these responses that appropriate consultation should still be required prior to any new legislation being brought forward in order to ensure that it will not adversely impact the Isle of Man.

Comments were made by other respondents that legislation should not be introduced without consultation.

Comments included:

- “The public understanding of bank insolvency creditor hierarchies may be increased on publication/interpretation of the IOM BRRD-enabling legislation. This may focus attention on the differences in priority for DCS-limit exceeding deposits held by individuals and small businesses in the IOM vs those in the UK.”
- “we interpret this as a proposal to adopt legislation enabling the rapid adoption of international standards without any prior consultation.”
- “One of the key features of EU deposit guarantee schemes is the speed of pay out. The reality of ‘large’ country implementations of compensation schemes is that the scheme itself is not invoked, or is not the mechanism for protecting depositors. The book of protected deposits is transferred to another bank and underwritten by Treasury (or its equivalent) and the recovery of the loss is via the respective compensation schemes. The Isle of Man cannot do this as it does not have the reserves available to follow such a course of action.”
- “although as discussed in another context any implementation of underlying regulations should be subject to prior consultation, to help mitigate the risk of unforeseen consequences arising therefore.”
- “If a change to the Financial Services Act is proposed, it is unclear what change is suggested and whether it is necessary. No ‘enabling legislation’ is needed to be able to introduce regulations to protect depositors. Further information and explanation is needed for us to be able to comment.”
- “Such a move should, we feel, make it easier for the Isle of Man to respond to future changes in a timely manner”
- “sight of specific comment from the legal community on this issue would be welcome.”

Q5. Please give any other comments which you consider are relevant to the changes proposed above.

A number of other comments were made by respondents which are detailed below:

- “At present, under the existing insolvency law, there is a requirement for a liquidator to apply to the court or seek permission from a class of creditors prior to paying out a particular class of creditor in full. These laws should be updated.”
- “The current DCS legislation requires detailed depositor identification and verification to be undertaken prior to a payment being made under the DCS. This process will

need to be amended to allow a payment to be made under the DCS on a timely basis."

- "It is recommended that the term vulnerable is not used in future when referring to the DCS on the basis that the term is used differently in other Government policy areas which may cause confusion."
- "The definition of 'eligible' and 'covered' deposit needs to be clearly defined in the legislation in the appropriate places."
- "Clear information should be provided to depositors so that they are clear as to what element of their deposit is covered under the DCS."
- "Important that there is consistency amongst the Crown Dependencies."