

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

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1. Executive Summary

- 1.1 As part of the move by governments worldwide to secure financial stability against the threat of a systemic failure of the banking system, and the subsequent impact on the taxpayer (e.g. from government bail-outs), there has been a general move internationally to ensure that the taxpayer is not exposed to loss as a result of governments providing a deposit guarantee scheme payments (or other bail-out mechanisms) should a bank fail.
- 1.2 The Government has a responsibility to vulnerable depositors and the tax payer to ensure that any funds are repaid as quickly as possible. Ranking the deposits protected by the depositor guarantee scheme of an insolvent bank as a preferred creditor, reduces the time of reimbursement of the deposit and the risk to the tax payer of incurring a financial loss. It ensures that the funds recovered are first applied to the covered depositors and that provision of funding by the tax payer is repaid on a prioritised and timely basis.
- 1.3 This Consultation Paper seeks to explore the introduction of preferred creditor status for those eligible deposits covered by the Depositors Compensation Scheme ("DCS") into Isle of Man legislation. It proposes that these eligible deposits, and the person(s) to whom they are owed, be ranked as preferred creditors (after liquidation costs and secured creditors) in any bank failure.
- 1.4 The changes to the preferred creditor regime would place covered deposits (under the DCS) ahead of traditional Isle of Man preferred creditors.
- 1.5 It is proposed that in limited circumstances that equal priority should be given to deposits covered under the Isle of Man DCS and the deposit guarantee schemes of the other jurisdictions' deposit guarantee schemes (if they are deemed to be similar) to ensure that the depositors covered by deposit guarantee schemes receive the same outcome in the event of a bank failure. An example maybe the Channel Islands' DCS.
- 1.6 Finally, it is proposed that the Government passes enabling legislation which permits the introduction of international legislation and regulation to protect the interests of the Isle of Man depositors.

The consultation closes on 23 October 2015.

2. Background

- 2.1 An effective deposit guarantee scheme must ensure that, in the event of a bank default, vulnerable depositors must be compensated on a timely basis. Often, this will require the Government and other Isle of Man banks providing funding to the DCS in order to make payments to those depositors covered by the scheme.
- 2.2 The deposit guarantee scheme will ensure that, in the event of a bank default, covered deposits¹ will be paid out to depositors on a timely basis to protect vulnerable depositors.
- 2.3 In a previous case the Government (taxpayer) has funded this initial payment before being reimbursed by payments from the bank in default and/or levies on the participating Isle of Man licensed banks. Under the current scheme, the Government is currently liable for payments of up to £100m in any 10 year period.
- 2.4 The Government wants to ensure that the domestic eligible deposits under the Depositors' Compensation Scheme ("DCS") ranks as a preferred creditor ahead of unsecured creditors in any local bank insolvency. The covered deposits and Government (taxpayer) will thereby receive a faster recovery of monies advanced or provided in relation to compensating covered deposits under the DCS than which is currently possible. This would have significantly speeded up the recovery of the Government loan funding used in the case of Kaupthing Singer & Friedlander.

3. International Position

- 3.1 The EU Bank Recovery and Resolution Directive (the "BRRD") (Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms) introduced a new hierarchy of creditors if a bank were to become insolvent.
- 3.2 The order of creditor priorities now means that retail deposits, covered by an EU deposit guarantee scheme, placed in an EU bank (including branches of that bank in the EU) now rank ahead of other creditors. This is commonly known as "super-preference" or "primary preference". Other retail deposits²,

¹ **Deposit:** Any deposit as defined in Article 1(1) of Directive 94/19/EC¹, excluding those deposits left out from any repayment by virtue of Article 2. **Eligible Deposits** (or **Protected** or **Insured**): deposits repayable by the guarantee scheme under a national law, before the level of coverage is applied. **Covered Deposits** (or **Guaranteed** or **Reimbursable** or **Repayable**): deposits obtained from eligible deposits when applying the level of coverage provided for in national legislation

² Includes deposits from individuals and small and medium enterprises.

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including those that exceed the EU deposit guarantee scheme level and covered deposits in non-EU branches (including those covered by the Isle of Man DCS), are ranked below these "super-preferred" deposits, but above other creditors, i.e. "secondary preference".

- 3.3 Deposits from an Isle of Man subsidiary placed with its EU parent bank are treated as unsecured debts and rank below "primary" and "secondary" preferred debts.
- 3.4 In the UK, the transposition deadline for the BRRD was 31st December 2014. As a result, there have been considerable changes to bank resolution processes and new powers adopted in the UK over the last year.
- 3.5 In order to transpose the BRRD into UK law, a number of statutory instruments related to the affirmative resolution procedure were laid before Parliament. These were:
 - the Bank Recovery and Resolution Order 2014
 - the Banks and Building Societies (Depositor Preference and Priorities) Order 2014
 - the Banking Act 2009 (Restriction of Special Bail-in Provision etc.) Order 2014
 - the Banking Act 2009 (Mandatory Compensation Arrangements Following Bail-in) Regulations 2014

These instruments came into force on 1st January 2015.

- 3.6 It is important to note that changes in other jurisdictions, particularly the UK and EU, have prioritised the claims of EU covered deposits over DCS covered deposits (ie those held in an Isle of Man branch of a UK/EU bank) and over other unsecured deposits (such as "up-streamed" funds in a subsidiary model).
- 3.7 Given the exposure to the Isle of Man taxpayer, it is an appropriate time for the Isle of Man to consider updating its own regime to ensure that it protects the interests of the Isle of Man vulnerable depositors and taxpayer and meets the new international norms. In addition to the proposals in this consultation, other measures will be brought forward for consideration in due course, such as bank resolution powers.
- 3.8 As international regulations are brought into force, we require the ability to adopt standards quickly to protect Isle of Man depositors and to have in place the necessary enabling legislation. In order to achieve this we propose introducing an amendment to the Financial Services Act 2008 so that enabling legislation may to be brought before Tynwald.

4. Other Crown Dependencies' Position

- 4.1 It is suggested that a preferred creditor regime should be introduced that is wholly or partially consistent with the BRRD regime across the Crown Dependencies ("CDs") given the corporate banking structures extending across the islands.
- 4.2 The Government believes that it is in the interests of the Isle of Man and stability across the CDs that such a regime should give equal priority to deposits placed in CD branches of CD incorporated banks in the event of the insolvency of a CD incorporated bank. Of course this would only be considered where there is equivalence between the regimes and it protects the interests of the Isle of Man depositors and its tax payers.

5. Proposals

The proposals are as follows:

- 1) to amend the preferred creditor regime to place covered deposits ahead of other preferred creditors, after liquidator expenses and secured creditors. The changes to the preferred creditor regime would place covered deposits (under the DCS) ahead of traditional Isle of Man preferred creditors such as:
 - Debts to the Crown
 - Rates
 - Payments to employees, including remuneration and holiday pay
 - Payment to Reserve Forces
 - National Insurance
 - Contributions to occupational pension schemes

The Government would be able to postpone its own rights to recognise particular circumstances of a bank failure. Importantly, the payment of claims would not be delayed by calculations for creditors ranking ahead the DCS.

- 2) to introduce a power that gives Treasury the ability to recognise the deposit compensation scheme of another jurisdiction, if 'equivalent, analogous or similar' to the Isle of Man's Depositors' Compensation Scheme. The purpose of this is to allow recognition of the other schemes, if their final scheme designs are acceptable, to provide a consistency of treatment for subsidiary and branch depositors across the CDs. Further, to allow Tynwald the right to amend the ranking of the preferred creditors if considered appropriate in a particular case.
- 3) to bring forward specific amendments to the Financial Services Act 2008 to include enabling legislation to allow the adoption of international legislation to implement protections in the Isle of Man.

The views of the public and interested parties are sought in relation to the proposals above.

6. Questions for Consultation

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? - Yes/No

Do you have any issues/concerns with this creditor hierarchy and if so please give details?

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? - Yes/No

Do you foresee any issues arising as a result of these differences?

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/No

If No, please explain your reasoning.

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? - Yes/No

Please give reasons.

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

7. Consultation Process

1. Comments are invited on the proposals in the consultation document. The consultation is being conducted by the Department of Economic Development.
2. Comments should be submitted in writing, by post or email to the following:

Mr John Spellman
Department of Economic Development
First Floor
St Georges Court
Upper Church Street
Douglas
Isle of Man
IM1 1EX

john.spellman@gov.im

The consultation closes on **23 October 2015**.

3. When submitting your views please indicate whether you are responding on behalf of an organisation.
4. Additional copies of the consultation document can be obtained from the Department of Economic Development (address as above).
5. To ensure that the process is open and honest and in line with the Government's Code of Conduct on Consultation responses can only be accepted if you provide your name with your response.
6. Unless specifically requested otherwise, any responses received may be published either in part or in their entirety. Please mark your response clearly if you wish your response and name to be kept confidential. Confidential responses will be included in any statistical summary and numbers of comments received.
7. A summary of the responses received will be published within 3 months of the closing date for this consultation, and will be made available on the Government website or by contacting the above named officer.
8. The purpose of consultation is to gather information, views and evidence which will allow an informed decision to be made regarding the proposals. As in any consultation exercise the responses received do not guarantee changes will be made to what has been proposed.

Appendix 1 – Code of Practice on Consultations

This consultation will be carried out in accordance with the Government's Code of Practice on Consultation.

The Code sets out the following six criteria:

- Consult widely throughout the process, allowing a minimum of six weeks for a minimum of one written consultation at least once during the development of the legislation or policy;
- Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses;
- Ensure your consultation is clear, concise and widely accessible;
- Give feedback regarding the responses received and how the consultation process influenced the policy;
- Monitor your Department's effectiveness at consultation; and
- Ensure your consultation follows best practice, including carrying out an Impact Assessment.