Depositor preference in the G20

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The protection of depositors in liquidation is an area of bank reform that has attracted increasing interest over the last few months. For example, the Final Report of the UK Independent Commission on Banking proposes amendments to the creditor hierarchy making (at least some) deposits rank senior to other unsecured claims and claims secured by floating charges in liquidation. Similarly, the Financial Stability Board's consultation on Effective Resolution of Systemically Important Financial Institutions is seeking comment on whether or not different treatments of depositors in liquidation across different jurisdictions is an obstacle to effective resolution of a systemically important financial institution. Finally, outside the G20, Portugal is committed, as part of its request for financial support from the IMF, to introducing depositor preference by the end of 2011.

Clifford Chance has conducted a survey of G20 countries to establish which countries have an existing regime for preferring depositors in liquidation (either directly or by other means, the effect of which is to subordinate other senior creditors of the bank). The first table below summarises our findings in this respect.

The second table below compares certain design features of existing depositor preference regimes. These include questions such as whether the preference is subject to any monetary or geographical limit, and how the preference interacts with any other depositor protection initiative (such as deposit insurance schemes).

We would like to express our gratitude to all counsel who have contributed their knowledge and expertise to this survey. A list of their contact details can be found at the back of this paper.

Executive summary

- Eleven of the G20 countries have an existing regime for preferring depositors (or the deposit protection scheme) in liquidation: Argentina, Australia, China, France, India, Indonesia, Mexico, Russia, Switzerland, Turkey and the US.

- The scope and operation of the preference differs considerably across jurisdictions:

  - The majority of countries do not impose a monetary limit on the application of the preference; where a monetary limit applies this tends to coincide with the limit for deposit insurance protection.

  - In terms of geographical scope, most countries limit the application of the preference to deposit liabilities booked and payable within the domestic jurisdiction (the main exceptions to this being Australia, Switzerland and Russia where deposits booked with foreign branches are potentially covered).

- An interesting point of comparison between the different depositor preference regimes has been how they interact with national deposit insurance schemes:

  - All countries that have a depositor preference regime also have some form of deposit insurance (with the exception of China).

  - Depositor preference and deposit insurance interacts in different ways across countries: in some countries (such as Switzerland), depositors would only make a claim on their deposit insurance once their preferred creditor status with regard to a bank's liquid assets are exhausted; in other countries, deposit insurance is the primary means of compensating depositors (so creditors would only assert their preferred status in liquidation with regard to amounts not covered or exceeding the deposit insurance).

  - One country (France) has no direct depositor preference; rather the preference operates in favour of the deposit insurance fund in certain limited circumstances.

- Other than the UK, no country has any concrete proposals for the introduction of a depositor preference regime, or for making any material amendments to any existing depositor preference regime.

Depositor preference regimes in the G20

Depositor preference regime	No depositor preference regime
Argentina	Brazil
Australia	Canada
China	Germany
France	Italy
India	Japan
Indonesia	Saudi Arabia
Mexico*	South Africa
Russia	South Korea
Switzerland	UK
Turkey	
US	

* Although Mexico has a depositor preference regime its scope is currently too unclear to be considered for the purposes of the analysis contained in this document

Summary of key features of G20 regimes

	Monetary Limit?	Retail and Wholesale Deposits?	Deposits Placed with Foreign Branches of Locally Incorporated Bank?	Deposits Placed with Local Branches of Foreign Banks?	Interaction with Deposit Insurance Scheme
Argentina	No.	Yes.	No.	Yes.	Depositors will be paid as preferred creditors in the first instance. If assets of an insolvent bank are insufficient to cover depositors, the deposit insurance scheme will cover depositors (up to ARS 120,000, approx.USD 28,800). The deposit insurance scheme itself also has a preference over creditors for sums paid to depositors.
Australia	No.	Yes.	Yes, provided deposits are denominated in AUD.	No.	Depositors will be paid via the deposit insurance scheme, up to the insurance limit (currently at AUD 1m (approx. USD 1.03m)). For the amount of a deposit (if any) not covered by the deposit insurance scheme, the depositor has preference over other unsecured creditors. The deposit insurance scheme itself also has preference over creditors for sums paid to depositors.
China	No.	No. Retail savings deposits only.	Unclear.	Yes.	Not applicable as there is no deposit insurance scheme.

	Monetary Limit?	Retail and Wholesale Deposits?	Deposits Placed with Foreign Branches of Locally Incorporated Bank?	Deposits Placed with Local Branches of Foreign Banks?	Interaction with Deposit Insurance Scheme
India	Yes Covers deposits up to INR 250 (approx. USD 5).	Yes.	No.	Yes.	Depositors will be paid as preferred creditors up to the monetary limit (note this is currently very low but could be increased in the future). Any shortfall will then be covered by the deposit insurance scheme up to a maximum of INR 100,000 (approx. USD 2,000). The deposit insurance scheme does not have preference over unsecured creditors for sums paid to depositors.
Indonesia	No.	Yes.	No.	Yes.	Depositors will be paid via the deposit insurance scheme, up to the insurance limit (currently at IDR 2 bn (approx. USD 233,000)). Claims of depositors ineligible for the deposit insurance scheme or in excess of the deposit insurance scheme limit will also rank ahead of general unsecured creditors (but below the costs incurred by the deposit insurance scheme). The deposit insurance scheme has preference over unsecured creditors for sums paid to depositors.

	Monetary Limit?	Retail and Wholesale Deposits?	Deposits Placed with Foreign Branches of Locally Incorporated Bank?	Deposits Placed with Local Branches of Foreign Banks?	Interaction with Deposit Insurance Scheme
France **(Deposit insurance scheme preference only)**	Yes. Covers deposits up to EUR 100,000 (approx. USD 137,000, being the deposit insurance scheme limit)	No. Retail deposits only.	Yes, provided the foreign branch is located in an EEA member state.	No, unless the foreign bank has its head office in a non-EEA member state (in which case it is required to hold a separate banking licence in France)	Depositors will be paid via the deposit insurance scheme, up to the insurance limit. Depositors do not benefit from any direct preference. The deposit insurance scheme will rank as a preferred creditor only if it makes a pay-out to depositors prior to the opening of insolvency proceedings. Any claims of the scheme relating to payments made after the opening of insolvency proceedings will rank pari passu with other creditors.
Russia	No.	No.	Yes.	No.	Depositors will be paid via the deposit insurance scheme (up to RUB 700,000 (approx. USD 22,000)). The deposit insurance scheme has preference over unsecured creditors for sums paid to depositors. Deposits not eligible for the deposit insurance scheme (including amounts in excess of that covered by the deposit insurance scheme) will have priority under the depositor preference regime (ranking ahead of the subrogated claims of the deposit insurance scheme).

	Monetary Limit?	Retail and Wholesale Deposits?	Deposits Placed with Foreign Branches of Locally Incorporated Bank?	Deposits Placed with Local Branches of Foreign Banks?	Interaction with Deposit Insurance Scheme
Switzerland	Yes. Covers deposits up to CHF 100,000 (approx. USD 113,000).	Yes.	Yes.	Yes.	Depositors to be paid as preferred creditors up to the monetary limit from the insolvent bank's own liquid assets in the first instance. If the liquid assets of the insolvent bank are insufficient to pay the claims of depositors under the depositor preference regime, then the deposit insurance scheme will cover any shortfall for eligible deposits up to the same monetary limit. Any amounts over and above the monetary limit will rank alongside unsecured, non-privileged, unsubordinated creditors. The deposit insurance scheme will be subrogated to the rights of the depositors and will have priority over unsecured, non-privileged creditors
Turkey	No.	No. Retail savings deposits only.	No.	Yes.	Depositors will be paid by the deposit insurance scheme, up to the insurance limit (currently at TRL 50,000 (approx. USD 30,000)). The deposit insurance scheme has preference over unsecured creditors for sums paid to depositors. Any part of the deposit not protected by the deposit insurance scheme will enjoy priority under the depositor preference regime (albeit subordinated to the claim of the deposit insurance scheme for amounts paid out to depositors).

	Monetary Limit?	Retail and Wholesale Deposits?	Deposits Placed with Foreign Branches of Locally Incorporated Bank?	Deposits Placed with Local Branches of Foreign Banks?	Interaction with Deposit Insurance Scheme
US	No.	Yes.	No, unless payable in the US.	Yes.	Depositors will be paid via deposit insurance scheme, up to the insurance limit (currently USD 250,000). Deposits not eligible for the deposit insurance scheme or in excess of the deposit insurance scheme limit will have priority under the depositor preference scheme. The deposit insurance scheme will also rank ahead of general unsecured creditors for sums paid out to depositors.

Anticipated developments for depositor preference regimes in the G20

Argentina	The Argentine government is currently considering whether one statutory preferred class of creditors currently ranked above depositors should be removed.
Australia	No anticipated changes to the depositor preference regime; however, there are proposals to amend the deposit insurance scheme including lowering the amount protected by the deposit insurance scheme and restricting coverage to domestic accounts.
China	PRC regulators are currently formulating regulations and rules for the bankruptcy mechanisms for financial institutions which are likely to affect the operation of the depositor preference regime.
UK	In its Final Report (September 2011), the Independent Commission on Banking recommended the introduction of a depositor preference regime whereby deposits insured by the Financial Services Compensation Scheme would rank above other unsecured creditors and floating charge holders in the event of a bank's insolvency.

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