

THE STATES OF DELIBERATION
of the
ISLAND OF GUERNSEY

COMMITTEE *for* ECONOMIC DEVELOPMENT

**GUERNSEY BANKING DEPOSIT COMPENSATION SCHEME
AVAILABILITY OF STATES' LOAN FACILITY**

The States are asked to decide:-

Whether, after consideration of the Policy Letter entitled 'Guernsey banking deposit compensation scheme availability of states' loan facility' dated 27th July 2017, they are of the opinion:-

1. To direct the Policy & Resources Committee to make available an on demand facility of £15 million in favour of the Guernsey Banking Deposit Compensation Scheme Board, on such terms as the Policy & Resources Committee may agree with the Board.
2. To authorise the Policy & Resources Committee, at its discretion, following receipt of a written request from the Guernsey Banking Deposit Compensation Scheme Board, to make available a facility of a maximum amount of £57 million on such terms as the Policy & Resources Committee shall agree with the Board.

The above Propositions have been submitted to Her Majesty's Procureur for advice on any legal or constitutional implications in accordance with Rule 4(1) of the Rules of Procedure of the States of Deliberation and their Committees.

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THE COMMITTEE *FOR* ECONOMIC DEVELOPMENT
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The Presiding Officer
States of Guernsey
Royal Court House
St Peter Port

28th July 2017

Dear Sir,

1. Executive Summary

1.1. This report recommends that the States of Guernsey (the “**States**”):-

- (i) direct the Policy & Resources Committee (the “**Committee**”) to make available an on demand facility of £15 million in favour of the Guernsey Banking Deposit Compensation Scheme Board (the “**Board**”), on such terms as the Committee may agree with the Board (the “**Primary States Facility**”); and
- (ii) authorise the Committee, at its discretion, following receipt of a written request from the Board, to make available a facility of a maximum amount of £57 million on such terms as Committee shall agree with the Board (the “**Secondary States Facility**”).

The Primary States Facility and the Secondary States Facility are together referred to as the “**States Facilities**”.

1.2 The purpose of the States Facilities is to provide the Guernsey Banking Deposit Compensation Scheme (the “**Scheme**”) with greater liquidity in respect of payments which may be required to be made, by it, in accordance with the terms of the Guernsey Banking Deposit Compensation Scheme (Bailiwick of Guernsey) Ordinance, 2008 (the “**Ordinance**”).

2. Background

2.1 The Scheme was established by the Ordinance in 2008, at the height of the Global Financial Crisis¹. A bank licensed in the Bailiwick of Guernsey (a “**Licensed Bank**”) by the Guernsey Financial Services Commission (the “**Commission**”) is automatically a participant in the Scheme. The Scheme provides compensation, when a bank is in default, as follows:

- (i) it covers deposits by individual retail depositors, and some other limited types of depositor such as Retirement Annuity Trusts, registered charities and accounts held for the benefit of children;
- (ii) it provides compensation of up to £50,000 (or equivalent in a foreign currency) to qualifying claimants²;
- (iii) compensation is payable within three (3) months of the date of declaration of a bank default³ (or receipt of a valid claim if later); and
- (iv) compensation is capped at a total of £100 million in any five (5) year period⁴. If claims exceed this cap, compensation will be reduced on a pro rata basis.

2.2 The Board has the power, under the Ordinance, to charge levies on Licensed Banks in the event of default by another participant.

3. Current Funding of the Scheme

3.1 The Board has a maximum obligation to pay up to £100 million in any five (5) year period⁵ funded on the following basis:-

- (i) £10 million which is levied on all Licensed Banks equally (excluding any in default) (the “**Primary Levy**”); and
- (ii) £90 million which is levied on all Licensed Banks (excluding any in default) and is apportioned between such Licensed Banks according to a formula set out in the Banking Deposit Compensation Scheme (Liability of Participants to Compensation Levy) (Bailiwick of Guernsey) Regulations, 2010 (the “**Regulations**”) (the “**Secondary Levy**”)

The Primary Levy and the Secondary Levy are together referred to, in this report, as the “**Levies**”.

¹ See Billet D’Etat XIX 2008, 26th November 2008.

² See section 12 of the Ordinance.

³ This obligation is subject to specific limitations in sections 14 and 15 of the Ordinance allowing for interim payments and a longer payment period if considered appropriate by the Board.

⁴ Subject to the limitations set out in Section 15(2) and 15(3) of the Ordinance.

⁵ See section 14 of the Ordinance.

4. The Primary Levy

- 4.1 The Primary Levy, is payable in equal shares by all Licensed Banks. It is envisaged that the Board would be able to issue notices directly once a Licensed Bank is declared to be in default⁶ and would expect the Primary Levy to be payable immediately on receipt of the notice⁷. It is anticipated that the Board would be in receipt of the required £10 million within seventy two (72) hours of a Licensed Bank being declared in default.

5. The Secondary Levy

- 5.1 The amounts payable by each Licensed Bank in respect of the Secondary Levy are calculated via a formula (set out in the Regulations) which is expressed, in general terms, as a proportion of the deposits held by that Licensed Bank against the total deposits held by all Licensed Banks. The timing, in respect of payment of the Secondary Levy, has a restriction so that the Board cannot request that payment be made earlier than fourteen (14) days after the date of the notice (effectively providing a minimum two (2) week grace period).

6. Payment Issues

- 6.1 While the maximum the Board can claim, in respect of the Secondary Levy, is £90 million, this in turn is limited by a restriction, in the Ordinance, which caps a Licensed Bank's payment obligation, in any calendar year, at a maximum of £1 million or, if less, 50% of average profits for the previous three years⁸. There are currently twenty four (24) Licensed Banks in the Scheme which reflects, in conjunction with the limitations in the Ordinance, a material restriction on the amount which can be collected pursuant to the Secondary Levy.
- 6.2 The Board's obligations mean that, technically, it could be required to pay out the maximum of £100 million within three (3) months, but on the Board's calculations it would only have access to £28 million in this time frame (although it can demand further sums in each subsequent year). This leaves a, potential, funding gap of £72 million.
- 6.3 The Scheme has the power to make compensation payments in instalments and, in the absence of any third party financing facility, it would be obliged to do so. In light of the size of the potential funding gap the Board considers, that initial payments to depositors would need to be limited to approximately one quarter of the potential final sum due.

⁶ Section 9 of the Ordinance sets out the events which will be treated as a default and obliges the Commission to make a declaration in respect of the same within a twenty one (21) day time limit.

⁷ Section 18(7)(c) of the Ordinance permits the Scheme board to specify a date when payment must be made by a Licensed Bank.

⁸ The Committee for Economic Development is also consulting on whether the 50% cap should be removed and on increasing the threshold from £1 million to £2 million.

- 6.4 The principle of instalment payments has been accepted by the Board, since the Scheme's inception, as an appropriate, reasonable and viable method of payment, in the context of the Scheme's existing funding model.
- 6.5 The cap does not reduce the liability of a Licensed Bank to pay the Secondary Levy but merely permits the Secondary Levy to be paid in instalments. Interest will apply to any such deferred payment at two per cent. (2%) above base rate. Under these circumstances and on the assumption that Licensed Banks should be able to borrow at, or around, base rate it is reasonable to assume that it would be commercially prudent for them to pay directly, even if they had no obligation to do so.

7. Proposed Funding Profile

- 7.1 On the basis that these proposals are approved the Board has calculated that the total immediate funding would be made up of the following:

Funding Element.	£ Million.
Total Amount Payable by the Board.	100.
Less:	
Primary Levy.	(10).
Secondary Levy.	(18).
Primary States Facility.	(15).
Shortfall.	£57.

8. The States Facilities/Depositor Payment

- 8.1 The Primary States Facility (in conjunction with the Levies) if provided would allow the Board to have access to over 40% of its total payment obligation pursuant to the Ordinance.
- 8.2 The £57 million shortfall could be addressed by the Board demanding further payments in subsequent years from the Licensed Banks, but for the larger Licensed Banks the cap could extend the final payment for several years, leading to a slow payment profile for depositors (if the States Facilities are not fully provided). The Committee is of the view that this is not appropriate. This exposure is the principle reason for the requirement of the (discretionary) Secondary States Facility⁹ which would help to ensure that all claimants receive payment as soon as is practicable (possibly within six months) thereby reducing the risk of hardship being suffered by depositors.
- 8.3 As a result the Board has consulted on amending the Ordinance to clarify its ability to pay differing percentages of compensation to different claimants. In the context of a Licensed Bank going into default the intention is to allow the Board, if felt appropriate,

⁹ It should be noted that depending on the size of the Licensed Bank and the scale of the deposits affected the Secondary States Facility may never be called upon.

to pay out initial compensation, of a sum up to £10,000, and to pay the balance as soon as practicable thereafter. This amendment is intended to benefit the smaller depositor, who is likely to be the most significantly impacted by any Licensed Bank default.

8.4 The costs associated with the States Facilities will be addressed on the following basis:

- (i) the costs of maintaining the Primary States Facility (prior to drawn down) will be met from the Board's existing financial resources and therefore indirectly by the Licensed Banks; and
- (ii) all costs (including interest) payable in respect of use of the Facilities, would be met by the Licensed Banks in accordance with the terms of the Ordinance.

8.5 It is proposed that the States Facilities, to the extent draw down is made, would be repaid as and when instalment payments are received from Licensed Banks pursuant to the Secondary Levy.

9. Consultation

9.1 The Policy & Resources Committee has been consulted and supports the proposals within this report and advises that due consideration will be taken when determining the States' corporate banking and investment arrangements.

10. Propositions

The States of Deliberation are asked to decide whether they are of the opinion to:-

1. direct the Policy & Resources Committee to make available an on demand facility of £15 million in favour of the Guernsey Banking Deposit Compensation Scheme Board, on such terms as the Policy & Resources Committee may agree with the Board; and
2. authorise the Policy & Resources Committee, at its discretion, following receipt of a written request from the Guernsey Banking Deposit Compensation Scheme Board, to make available a facility of a maximum amount of £57 million on such terms as the Policy & Resources Committee shall agree with the Board.

11. Committee Support for Propositions

11.1 In accordance with Rule 4(4) of the Rules of Procedure of the States of Deliberation and their Committees, it is confirmed that the propositions above have the unanimous support of the Committee *for* Economic Development.

Yours faithfully

P.T.R Ferbrache.
President

J. Kuttelwascher.
Vice-President

A.C. Dudley-Owen.
J.S. Merrett.
J.I. Mooney.