

Structured deposits – MIFID II

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Structured deposits : MIFID II (2014/65/EU) definition (1)

MIFID II Article 4 par. 1 (43):

*'structured deposit' means a deposit as defined in point (3) of Article 2(1) of Directive 2014/49/EU of the European Parliament and of the Council, which is **fully repayable at maturity** on terms under which interest or a premium will be paid or is at risk, according to a formula involving factors such as:*

- (a) an index or combination of indices, excluding variable rate deposits whose return is directly linked to an interest rate index such as Euribor or Libor;*
- (b) a financial instrument or combination of financial instruments;*
- (c) a commodity or combination of commodities or other physical or non-physical non-fungible assets; or*
- (d) a foreign exchange rate or combination of foreign exchange rates;*

DGSD, 2014/49/EU, Article 2 par. 1(3):

*'deposit' means a credit balance which results from funds left in an account or from temporary situations deriving from normal banking transactions and **which a credit institution is required to repay under the legal and contractual conditions applicable**, including a fixed-term deposit and a savings deposit, but **excluding** a credit balance where:*

- (a)...*
- (b) its principal is not repayable at par;*
- (c) its principal is only repayable at par under a particular guarantee or agreement provided by the credit institution or a third party;*

MIFID II: Deadline for application of measures 3.1.2018
MIFID II was incorporated in Greece by means of Law 4514/2018

Structured deposits products : key characteristics

- ✓ Fully repayable at maturity;
- ✓ Guaranteed return (fixed interest rate)
- ✓ Return based on fluctuation of factors (interest/premium at risk)

Accounting treatment of structured deposits:

It seems that there are no specific supervisory requirements relevant to structured deposits. Therefore, the applicable requirements depend on the accounting treatment of structured deposits by credit institutions (eg. Liability side, off-balance sheet).

Structured deposits: Issues at stake

Upon bank failure, the structured deposit is covered by a DGS, an ICS or both?

DGS

- Coverage up to 100.000?

ICS

- Coverage of investment service (not the value of structured deposit) up to 30.000?

DGS /
ICS

- A combination of both schemes by means of segregating the structured deposit product partly as “deposit” and partly as “investment service”?

Structured Deposits: deposits or investments?

1. MiFID II is an investment services directive.
2. Par. 39 of MiFID II Preamble provides that:

Structured deposits have emerged as a form of investment product but are not covered under any legislative act for the protection of investors at Union level, while other structured investments are covered by such legislative acts. It is therefore appropriate to strengthen the confidence of investors and to make regulatory treatment concerning the distribution of different packaged retail investment products more uniform in order to ensure an adequate level of investor protection across the Union. For that reason, it is appropriate to include in the scope of this Directive structured deposits. In this regard, it is necessary to clarify that since structured deposits are a form of investment product, they do not include deposits linked solely to interest rates, such as Euribor or Libor, regardless of whether or not the interest rates are predetermined, or whether they are fixed or variable. Such deposits should therefore be excluded from the scope of this Directive. –

This wording provides explicitly for the treatment of structured deposits as investment products.

Structured Deposits: deposits or investments?

3. The “*structured deposit*” of article 4 par. 1 (43) of MiFID is defined by means of a reference to the “*deposit*” of article 2 par. 1 (3) of DGSD. For the deposit of article 2 par. 1 (3) of DGSD, the **existence of a credit balance, repayable at any given time** is required for a product to be considered as deposit.

➤ **existence of “a credit balance in SD**

Should this not be the case for structured deposits, namely if they are not connected to “*credit balances*” available for repayment at any time, it could be argued that such products **appear to present more similarities with investments products rather than deposits.**

▪ Similarities to fixed term deposits:

Interconnection of structured products with deposit accounts, where credit balances shall be repayable upon maturity. It seems that prior to such maturity, the credit balance (principal) of the structured deposit product is not ‘visible’ in the account by the owner of this product. To our knowledge, credit balances reflecting structured deposit products are booked with other client account deposits in the same liability accounts of a credit institution’s consolidated financial statements.

Fixed term deposits are explicitly included in the DGSD deposits’ definition

Structured Deposits: deposits or investments?

➤ **repayable at any given time;**

“Repayable at maturity”:

This element of structured deposit’s definition gives rise to legal ambiguities as to the exact time the structured deposit should be fully repayable. Is it **solely upon maturity** or it could be also argued that such a product could be also considered as fully repayable **until its maturity?**

▪ Similarities to fixed term deposits:

In principle, fixed term deposits are repayable at maturity.

In case of early termination, penalties shall not result in repayment of an amount less than the initial capital.

Would early termination of SD result to repayment of an amount less than the initial capital?

4. Who bears the risk?

the customer ? ⇨ investment

the Bank? ⇨ deposit

Structured deposits products: Concerns, if covered by DGS

1. Coverage for all structured deposits or per SD product?

Given the ambiguities arising out of SD definition in MiFID II and the variety of SD products, should SDs be assessed as “covered” or “not covered” by a DGS in an aggregate manner OR on a “stand alone” basis, assessing specifically each individual product?

↳ If per product,

who shall determine, the DGS or the Issuing bank, and under which criteria whether the structured product is:

- a deposit ⇒ coverage by a DGS or
- an investment product ⇒ coverage by an ICS

↳

- If the Issuing bank ⇒ DGSs may face the following issues:
 - Under / over estimation of covered deposits,
 - No contributions raised, but eligibility for coverage
- If the DGS ⇒ high administrative cost and legal risks

Note: According to TEKE’s (DGS & ICS) statutory law, in case of a depositor/investor whose claim against a credit institution cannot be easily classified as deposit or claim arising out of an investment service, TEKE’s Board may, at its discretion, assign it to the most appropriate category.

Structured deposits products: Concerns, if covered by DGS

2. Which part of SD to be compensated by a DGS?
 - i. None
 - ii. Initial capital + any return already credited + return of guaranteed interest due on bank failure date
 - iii. Initial capital + any return already credited + return of guaranteed interest due on bank failure date + return of interest/premium at risk due on bank failure date
 - ↳ but, is it possible to determine such interest/premium on bank failure date?

3. SCV file:
Should the SCV file be flagged with respect to structured deposits ?

Survey on trends pertaining to the treatment of structured deposits (Feb.2018)

Coverage by			
<i>(number of DGSs)</i>			
Deposit Guarantee Scheme (DGS)	Investor Compensation Scheme (ICS)	Combination of DGS & ICS	No answer
5	2	1 (UK – for selling and advise)	8

Coverage of			
<i>(number of DGSs)</i>			
Initial capital	Initial capital + interest rate return	Initial capital + return based on fluctuating factors	No answer
6	5	3 (2 DGSs under conditions)	4

Thank you