

Paying out regime for joint accounts in the EEA

- Food for thought? -

EXECUTIVE SUMMARY

The use of joint accounts by two or more co-holders raises a specific compensation issue: for a given deposit base of the co-holders within the failed bank, the way those deposits are distributed among their various personal and joint accounts may change the total compensation that the co-holders collectively get from the DGS.

This issue comes from the use of individual coverage limits after the predefined split of the joint account that the DGS has legally to operate for calculating the claims of each co-holder.

For DGSs concerned about this issue and willing to collectively compensate co-holders of a joint account independently of the distribution of their funds, this note suggests, with no change in legal regimes for joint accounts and no change in the predefined (equal) split rule, to review the possibility of a marginal adjustment in the current use of individual coverage limits.

*A compensation independent from the distribution of funds implies that co-holders should in all cases get the benefit of a global coverage (e.g. €200,000 for two persons), combining their individual coverage levels. As compensations should remain individual (per depositor), and thanks to an adaptation of the applicable texts, an additional rule would then **allow the utilisation of the coverage limit not used for compensating a co-holder, to increase the compensation of other co-holders accordingly** (“joint benefit of unused coverage limits”).*

This complementary rule, which of course goes with an extra compensation cost, would offer a better protection to depositors. Incidentally, it would also offer DGSs a simple and undisputable way to correctly handle the long-standing case of individual THBs deposited on joint accounts.

Comments of the EFDI community on this proposal are welcome (questions Q1 to Q5 below).

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Questions for EFDI members

Questions below could be answered based either on the executive summary (for the sake of time), or on the whole text (for a more complete approach).

Q1: in your jurisdiction, are joint accounts a common practice for individuals and households?

[.....]

Q2: according to your own perception, does the way those depositors use joint accounts in your jurisdiction usually reflect the willingness to strictly share the property of some funds in a predefined (e.g. equal) split (**answer a**)? or rather a common involvement on some daily life operations with a looser day-to-day concern over the predefined split of property (**answer b**)?

[.....]

Q3: given the practice in your jurisdiction and the possible focus on a strict or a loose concern over the daily sharing of property (Q1 & Q2), could the implementation of the split rule in case of a failure lead to a compensation that depositors would consider as legally correct, but as also freezing a contingent distribution of their funds with detrimental consequences for them?

[.....]

Q4: in your opinion, does the proposal of a “*joint-benefit of unused individual coverage limits*” correctly address the issue identified above? Assuming the legal framework has been adjusted, what challenges or difficulties would you identify with that proposal, if any?

[.....]

Q5: as a whole, do you find some interest in this proposal? Would you positively consider an adjustment of the legal framework in that direction, at least on an optional basis? Other comments?

[.....]

Introduction

In EEA jurisdictions, the compensation of the co-holders of a joint account suffers from a specific issue: when they also have personal accounts, the compensation the co-holders collectively get depends on a highly contingent distribution of funds among their various personal and joint accounts at the time of the failure.

This note proposes a remedy to this situation, with the following impacts:

- improved protection for co-holders,
- reduction in litigation risks incurred by the deposit insurer (depending on the national legal regime for joint accounts),
- simple and definitive solution for the treatment of personal THBs which would have been deposited on joint accounts.

*

1. Uncertainty and variability of the compensation served to co-holders

This variability is a consequence of the combination of the split (usually 50/50) of the joint account balance made by the deposit insurer before compensating each of the co-holders, and of the use of individual coverage levels. This is illustrated below with an example that will be kept unchanged throughout this paper.

1 - When their bank fails, X has a personal account with €80k, Y has a personal account with a €0 balance. X and Y also have a joint account with €130k (for instance exclusively coming from Y revenues): €210k as a whole.

The joint account is split into €65k for X and €65k for Y. X receives €100k from the payout (€80k + €65k, capped at €100k), while Y receives €65k. As a whole, the two co-holders get €165k, to be compared with global assets of €210k and a combined coverage level of €200k.

Is that wrong?

Of course not. Legally speaking, the joint account represents a joint 50/50 property, and, after the split, each depositor is compensated for its exact claim vis-à-vis the bank.

But, in practice:

- Co-holders' accounts could be used in a very different way than the legal split leads to think. With their expenses, revenues, savings, transfers of one account to another, co-holders may use their accounts in accordance with the needs of their daily life, regardless of any day-to-day implications in terms of property for each one.
- As a matter of fact, in various cases, for instance for co-holders married under a joint property or community of property regime, no difference could actually be made in terms of actual property between personal and joint accounts.
- With two people (or more) authorised to move the joint-account, and the various daily uses associated with each account, respecting separate individual coverage limits at any time over those accounts might look quite challenging.

Q1: in your jurisdiction, are joint accounts a common practice for individuals and households?

Q2: according to your own perception, does the way those depositors use joint accounts in your jurisdiction usually reflect the willingness to strictly share the property of some funds in a predefined (e.g. equal) split (**answer a**)? or rather a common involvement on some daily life operations with a looser day-to-day concern over the predefined split of property (**answer b**)?

In the second case of question Q2 above, the day-to-day distribution of funds among joint and personal accounts of the co-holders at any given moment then reflects the outcome of daily life operations, more than an acknowledgement of property by the co-holders over the funds deposited in the joint account. Each co-holder being able at any time to transfer funds from the joint account to a personal account and vice-versa, the equal (or predefined) split constitutes in the end more a necessary legal tool, than a relevant measure of an actual day-to-day sharing of property (as frozen when calculating compensations in case of a failure).

2 - With the example above, what if X and Y had had the time to transfer, for any good reason, €100k from the €130k joint account to Y personal account, leaving €30k on the joint account, before the bank failed?

In such a case, X's personal balance would still have been €80k, Y's one €100k, and the joint account would display €30k. X would have been compensated for €95k (€80k + 50% of €30k), Y for €100k (€100k + 50% of €30k, capped at €100k). Finally, the community of the two co-holders would have been more effectively compensated (€195k), i.e. for a higher amount than in the previous case.

The co-holders have the same collective deposit base than before within the failed bank, they could consider that this deposit base is collectively theirs, but the collective compensation is not the same (and still below their combined coverage level of €200k).

Q3: given the practice in your jurisdiction and the possible focus on a strict or a loose concern over the daily sharing of property (Q1 & Q2), could the implementation of the split rule in case of a failure lead to a compensation that depositors would consider as legally correct, but as also freezing a contingent distribution of their funds with detrimental consequences for them?

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In the context of that question Q3, the starting point of the proposal below is the acknowledgment that the compensation of co-holders of a joint account, taken collectively, within the same deposit base, finally depends on the contingent distribution of their assets observed at the time of the failure.

For DGSs who would aim at offering the same compensation to co-holders independently of the distribution of their funds, the remedy would be based on two principles:

- The DGS should in any case abide by the existing legal rules and calculate claims along the established legal requirements (e.g. predefined equal or conventional split);

- It should also, as far as possible, stay neutral vis-à-vis the depositors' intentions, daily-life choices or even life choices, and should be authorised to offer a compensation that resists contingencies, so to limit misunderstandings, random effects or even litigations.

2. Proposal: joint-benefit of unused individual coverage limits

Compensations should remain individual (collective compensations would not comply with the general approach for a payout). Then, serving co-holders globally the same compensation independently of the distribution of their funds implies to pay them individual compensations, with the benefit of a global coverage, combining their individual protection.

The variability of the compensation globally served to the co-holders only appears when one of the co-holder's compensation hits the coverage limit and not the other. The remedy proposed here is then simply, through an adjustment of the current DGSD rules, **to allow the usage of the coverage limit not used for compensating a co-holder, so as to increase the compensation of the other co-holder accordingly.**

Instead of compensating two co-holders within separate €100k limits, this proposal would lead to allow compensating them within a global €200k coverage limit, in respect of each depositor's claim. The compensation stops depending on the distribution of funds.

How would this function in practice? Quite simply:

- as usual, the joint account would still be equally split among co-holders (no changes in property rights and claims calculations); and the compensation of each co-holder would be calculated using the usual individual coverage limit of €100k (no change compared to the usual process);
- then, before the execution of the payout, in case a co-holder has not reached the €100k limit, the "available" part of this coverage would be added to the coverage limit of the other co-holder, allowing for an increased compensation.

Illustration with the same data than above:

3 - X personal account's balance is still €80k, Y's one 0, and the joint account is at €130k. With total assets of €210k, using this new method, their collective compensation will in the end reach a total of €200k. How much is each compensation?

As usual, the joint account is split into €65k / €65k. Y's compensation is €65k, leaving a room of €35k below the coverage limit. X's coverage limit is increased accordingly, to €135k. X gets a compensation for €135k (€80k + €65k, i.e. €145k, capped at €135k).

Collectively, the co-holders get a compensation of €200k (maximal use of the combined individual coverage limits), with €210k of assets.

In case X and Y would have transferred €100k from the joint account to Y's personal account before the failure (case 2 above), the collective compensation would have been the same (€200k, with €95k for X and €105k for Y).

This method does not lead to any change in rights and claims of each depositor, neither to any transfer of resources from one holder to the other: no co-holder could be considered as

harmed by the additional compensation received by other. No holder is deprived of any right. The compensation still reflects each holder's legal rights along the legal split rule. But the compensation is made optimal for depositors.

Q4: in your opinion, does this proposal of a joint-benefit of unused individual coverage limits correctly address the issue identified above? Assuming the legal framework has been adjusted, what challenges or difficulties would you identify with that proposal, if any?

3. Other impacts

Admittedly, this change in compensation rules would go with higher, but still manageable compensation costs. Now, not only would this offer an improved protection to depositors, but also would it mitigate some litigations risks and offer an undisputable treatment of THBs deposited on joint accounts.

i/ mitigation of litigation risks

The legal regime for joint accounts depends on jurisdictions. In some jurisdictions (e.g. Czech Republic, Greece, Italy), the property of joint accounts is split in a predefined and not challengeable way, the proportion being defined in the law or in the account agreement. In other jurisdictions (e.g. UK, France), the legal or conventional split is only a presumption, and this presumption is rebuttable if the co-holders can substantiate a claim for a specific share of the account.

In such a system, how should the DGS handle a case where depositors, after the compensation, would substantiate a request for a change in the split operated on the joint account? And then sue the DGS for sticking to the equal split rule? In the proposal made, a change of the split would change individual compensations, but not the collective compensation of the co-holders.

ii/ Temporary High Balances deposited by one of the co-holders on a joint account

An individual THB deposit on a joint account illustrates and exacerbates the issues described above: also depending on the legal regime, it is rather difficult to claim that the legal split operated on the joint account (e.g. 50/50) realistically reflects the sharing of property between the co-holders, both before and after the THB has been deposited.

Various EEA jurisdictions have been struggling to find arrangements to address such situations, including:

1. use of dedicated THB personal accounts only;
2. explicit or implicit continuation of the legal predefined or pre-presumed split;
3. adjustment in the split of the joint account to optimise the use of the co-holder's respective coverage levels;
4. transfer from the other co-holder's claims to the THB co-holder's claim, of the part of the THB which fell into the other co-holder's balance because of the initial equal split; compensation of the whole THB in the hands of the actual THB co-holder;

5. split of the joint account in equal parts along with an equal split of the additional THB coverage level and recognition of the THB regime for each of the co-holders.

The 3rd and 4th options bear a change in the claims acknowledged to each co-holder before and after the THB claim. The 5th option relies on a change in the use of coverage limits.

The proposal made in this paper could be implemented the same way in a THB case. If a co-holder declares a THB after the first payout, whatever the account used, the collective coverage the co-holders will benefit in the end would be increased accordingly. First, the coverage for the person declaring the THB is increased in relation with the declared THB, and a complementary compensation paid. In case the new coverage is not exhausted, the available part is used to complement the compensation of the other co-holder.

4 - Using the above example (€80k for X, 0 for Y, €130k for the joint account, total assets of €210k), under the proposal made here, X and Y collectively get a compensation of €200k: as said (case 3 above), €65k for Y, increased coverage at €135k for X and €135k accordingly compensated (€80k + 50% of €130k, i.e. €145k, capped at €135k).

At a later stage, Y declares a THB of €40k within the initial €130k on the joint account (supposedly below the extended THB coverage). Then, the global coverage which the two co-holders will benefit from raises to €240k. With total assets of €210k, their collective compensation will then reach €210k. How will that be done?

Y's coverage limit is first increased by €40k under the THB regime. As Y already got a full compensation, this additional €40k coverage benefits to X. With a claim at €145k and an initial compensation at €135k, X then gets a complementary compensation of €10k. As a whole, the two co-holders get €210k (first €65k + €135k, then €10k).

Again, Y could have put for instance the €40k THB on the personal account with no change in the global compensation¹, just with a different split with X. Without the proposed mechanism, Y's THB would have triggered no additional compensation, neither for Y, nor for X.

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As a whole, such an adjustment of the compensation rules would:

- comply with legal provisions, in particular the legal (equal) split of joint accounts;
- not interfere with the way depositors have actually intended to share their funds;
- result in an unchanged collective compensation whatever the distribution of deposits among all accounts individually or jointly held by co-holders;
- lead to an easy and undisputable treatment of THBs;
- limit some risks of disputes and claims;
- be easily understood by depositors (collective coverage of €200k), with a use of individual coverage limits which does not need to be managed;

¹ For the sake of it:

- balances: €80k for X, €40k for Y, €90k for the joint account
- first step of compensation: €85k for Y and €115k for X, €200k as a whole as in the former case
- second step of compensation: €85k for Y, increased coverage at €155k for X, compensation of €125k for X, €210k collectively.

- last, stay manageable by the DGS in terms of process.

Q5: as a whole, do you find some interest in this proposal? Would you positively consider an adjustment of the legal framework in that direction, at least on an optional basis? Other comments?

4. Extension to more complex cases and legal implementation

i/ More complex cases: generalisation

The proposal has first to be extended to cover more complex cases: joint accounts with more than two co-holders, co-holders with joint accounts with different persons, combination of both.

This could be obtained the following way: **the coverage limit not used for compensating one of the co-holders is attributed to the other co-holders in proportion of their residual claims after the first calculation of the compensations.**

That way, all previous results stay unchanged, while all complex configurations remain manageable by DGSs.

ii/ Legal implementation

Legally speaking, Art. 7(2) of the DGSD would need to be adjusted, for instance the following way, as an option, leaving the implementation in the hands of each jurisdiction:

“The share of each depositor in a joint account shall be taken into account in calculating the limit provided for in Article 6. The limit not used for the compensation of co-holders may complement the compensation of other co-holders, in proportion of their remaining claims.”