German Banking Industry Committee

Die Deutsche
Kreditwirtschaft

Comments

on the European Commission proposal for a regulation establishing a European Deposit Insurance Scheme

Contact:
Corinna Streiter
Advisor
Telephone: +49 30 1663-2540
Fax: +49 30 1663-2599
E-Mail: corinna.streiter@bdb.de

Berlin, 22 January 2016

Coordinator:
Association of German Banks
Burgstraße 28 | 10178 Berlin | Germany
Telephone: +49 30 1663-0
Telefax: +49 30 1663-1399
www.die-deutsche-kreditwirtschaft.de

The European Commission presented its proposal for a regulation establishing a European Deposit Insurance Scheme (EDIS) on 24 November 2015. The proposal provides for EDIS to be built up gradually over time and to be fully implemented by 2024.

The German Banking Industry Committee (*Die Deutsche Kreditwirtschaft* – "GBIC") is opposed to the Commission proposal on EDIS for the following reasons:

1. Better regulation

The introduction of a Single Supervisory Mechanism (SSM) and a Single Resolution Mechanism (SRM), including a Single Resolution Board (SRB), created the basic framework for the Banking Union. The SRM and SRB only became fully operational recently. The upcoming implementation of the regulatory requirements is highly complex and imposes an enormous workload on banks.

Moreover, many Member States are still in the process of transposing the Directive on Deposit Guarantee Schemes (DGSD) into national law. Additional regulatory changes associated with the introduction of EDIS would create even more complexity.

It is therefore imperative for the discussion of an EDIS that a full impact assessment is conducted by the Commission. While the proposal refers to a quantitative analysis, it is not publicly accessible. It is therefore not clear to what extent the proposal has taken this analysis into account. This is in blatant contradiction to the Commission's transparency standards and better regulation principles.

Furthermore, no comprehensive public stakeholder consultation was held.

2. Comprehensive deposit protection already in place

Under its long-standing deposit insurance systems, Germany's banking sector operates both statutory DGSs and additional contractual schemes or institutional protection schemes (IPSs), thus giving customers a level of deposit protection that goes well beyond that provided by law. This strengthens depositors' confidence in their bank.

The transfer of the funding of deposit insurance systems and – at least de facto – of decision-making power to a European body ignores national specificities (such as different insolvency law) and the know-how built up over the years by many national DGSs. The national deposit insurance systems are to remain responsible for meeting the compensation claims of depositors, yet would in future be dependent on the EDIS for their funding. These national systems would thus be left with the liability without being in a position to fulfil the claims for compensation on their own. This discrepancy may seriously undermine the confidence of depositors in their national deposit insurance systems.

In the interests of accommodating existing national differences, GBIC is also opposed to the collection of contributions by a European body. The Commission's objective of reaching the target level of 0.8% of all covered deposits per Member State or deposit insurance system would not be jeopardised.

The transfer of responsibility to European level also imposes an additional burden on banks. For small banks especially, the involvement of a new, additional body would mean a considerable extra workload. This has already happened with the bank levy: the interaction between national and European authorities has generated an increased workload for small banks in particular.

3. Level playing field

a) Unequal treatment between the Eurozone and the rest of the EU

Unlike the DGSD, which had to be transposed into national law by all EU Member States, EDIS - as the third pillar of the Banking Union - applies solely to the Eurozone. Transposition of the Commission proposal would therefore lead to blatant differences in the treatment of banks in Eurozone Member States and in non-Eurozone Member States.

A Banking Union by no means calls for a fully mutualised system of deposit guarantees at European level, as foreseen by EDIS. The separation of liability and responsibility inherent in EDIS causes, on the contrary, serious moral hazard, since all Eurozone banks are jointly liable for depositor losses whereas responsibility for what caused these losses remains largely at national level. This encourages excessive risk-taking and poor business decision-making by banks, increasing the probability of payouts occurring. These additional payouts are ultimately made at the expense of all bank customers in the Eurozone.

DGS mandate

As a consequence of full "lowest common denominator" harmonisation, EDIS provides for a curtailed DGS mandate limited to a pure payout function and participation in bail-in. In practice, this denies DGSs the ability granted to them in the DGSD to take alternative or preventive measures under certain conditions, including Institutional Protection. This is because national DGSs will in future have no financial resources for such measures in spite of the fact that alternative measures are normally less costly than is the task of compensating depositors in the wake of a payout event. Such an approach fails to take due account of the importance of national DGSs. Experience has shown that alternative measures enable DGSs to successfully safeguard financial stability and preserve depositor confidence while conserving financial resources in the process (see also Section [8]).

On the other hand, non-Eurozone DGSs can continue to take alternative measures. This would put Eurozone DGSs at an enormous disadvantage since, in addition to reaching the target level of 0.8% of covered deposits, they would have to levy additional contributions to cover alternative measures. The resulting double burden on the banks would merely benefit the Deposit Insurance Fund without any positive impact on either the banks or the national DGS.

The de facto elimination of alternative measures will therefore result in substantially increasing the overall burden on banks within the Eurozone.

Target level

The Commission proposal, in its current form, sets a target level of 0.8% of all covered deposits for all Eurozone DGSs. This will ensure consistency within EDIS because it is the only way to achieve a uniform level of funding responsibility inside the Eurozone. But the upshot will be to place all banks in the Eurozone at a massive disadvantage compared to banks in the rest of the EU, which is totally at odds with a level playing field. This is because DGSs outside the Eurozone will still be able to take advantage of the reduction to 0.5% or zero permitted under the DGSD.

Payment commitments

The funding means in the form of payment commitments introduced by the DGSD are not foreseen in the Commission proposal. This again ultimately results in strongly unequal treatment of Eurozone and non-Eurozone banks.

b) Different treatment within the Eurozone

EDIS also leads to banks facing unequal burdens even within the Eurozone since the level of protection differs sometimes widely from one Member State to another. The higher levels of protection in some Member States will have to be funded by banks in all euro countries.

This unequal treatment at the same time exacerbates the aforementioned moral hazard problem within the Eurozone. Examples of different levels of protection are the rules governing Temporary High Balances (THBs) and set-off arrangements under national law.

Temporary High Balances

A huge problem is the nationally differing rules on THB, where deposits are protected in special cases above the minimum coverage level of EUR 100,000. When it comes to THBs, there are significant differences with regard to the amount of additionally covered deposits, the length of coverage and the circumstances in which such additional coverage applies.[1]

Set-off rules

Differing national provisions also exist for set-off arrangements. In Austria, a bank's receivables from its customers can be taken into account when calculating the payout amount. Germany and Finland, on the other hand, do not provide for that possibility.

The resulting different national coverage levels distort competition in the internal market and lead to unequal recourse to the common Deposit Insurance Fund and thus – indirectly – to Eurozone banks. What is first needed is further harmonisation of DGSs, which only makes sense from 2024 once the DGSD has been fully transposed into national law.

c) Steps needed before mutualisation of deposit guarantees

Before any discussion about a mutualised system of deposit guarantees, the following steps are required at European level:

Uniform, fulfilled target level and definition of target level

Before introducing a common deposit insurance scheme, the target level for national funds needs to be uniformly defined.

Though the DGSD generally sets a target level of 0.8% of covered deposits to be reached by 2024. A reduction to 0.5% (France and the Netherlands aim to this) is possible under the directive. In countries where funds are collected by means of a mandatory contribution scheme and are available to DGSs where needed (e.g. bank levy in the UK), the target level may even be set at zero. Such differences between countries inside and outside the Eurozone are incompatible with the introduction of an EDIS, however.

The funds also need to be filled up to the prescribed target level before a European deposit insurance scheme can be introduced. This is because national DGSs have widely differing financial resources – some are in debt, for example, while others already fully comply with the target level. The solution envisaged

---

[1] Amount of covered deposits: in Germany and Austria, the coverage level for THBs increases to a total of EUR 500,000. The Netherlands protects THBs for an additional EUR 500,000, i.e. up to a total of EUR 600,000. Finland does not actually set any ceiling on coverage of THBs; neither does France where deposits are based on compensation for criminal injuries. Length of coverage: the Netherlands and France protect THBs only for a period of three months, Germany and Finland for a period of six months, and Austria for a period of 12 months. Conditions: Finland and the Netherlands provide coverage only if the THB was created by selling previously occupied residential property. Germany and Malta, on the other hand, have fully transposed the categories listed in the DGSD into national law.

by the Commission's proposal – namely to exclude DGSs from EDIS if they have not yet achieved the target level – is not acceptable. It would mean that the only DGSs obliged to participate in EDIS were those which had no real need of it. By contrast, systems in debt would be excluded from a European Deposit Insurance Scheme specifically designed to support them.

Harmonisation of framework conditions

Before implementing an EDIS, the relevant framework conditions also need to be harmonised. Insolvency laws, in particular, require further harmonisation to ensure uniform treatment of DGSs in insolvency proceedings. Since key aspects such as the powers of administrators, right of appeal or the length of proceedings have not been harmonised, this can lead to widely differing insolvency dividends and recovery rates.

Reduction of considerable legacy risks at banks

In addition, the risks still carried in banks' balance sheets need to be further reduced to a significant extent (de-risking) before any cross-liability of DGSs in the EU is implemented. Currently, a mutualisation of deposit insurance would mean a mutualisation of sovereign debt risks, since under the current capital rules government bonds are still deemed to be risk-free for banks. Unless the existing legacy risks are reduced, there is the danger that a wrong incentive may be set, culminating in a mutualisation of such risks.[2]

4. No legal basis for an EDIS

The introduction of a fully mutualised deposit insurance scheme lacks an adequate legal basis. The Commission bases its proposal for a regulation and the introduction of an EDIS on Article 114 of the Treaty on the Functioning of the European Union (TFEU). However, in GBIC's view, this article does not provide an adequate legal basis for the mutualisation of national schemes. The Commission proposal has, in fact, serious negative implications for the integrity and functioning of the internal market, as it would mean unequal treatment of Eurozone and non-Eurozone banks.

When it comes to setting up new institutions or modifying ones already in place and transferring existing financial resources of national schemes to an EDIS, GBIC believes that an amendment of the TFEU or a measure under Article 352 of the TFEU is required. Alternatively, an intergovernmental agreement, as already adopted in connection with the SRM, could be considered.

5. Breach of the principle of subsidiarity

[2] Current statistics backing up this argument are available from the Statistical Data Warehouse on the European Central Bank's website, which gives a detailed overview of nationally differing NPL ratios.

The Commission's proposal does not comply with the principle of subsidiarity as defined in Article 5(3) of the TEU. Under the principle of subsidiarity, the European Community does not take action unless it is more effective than action taken at national, regional or local level and the political objectives can be better achieved at Community level. This is not the case here.

The DGSD already ensures – or will do so once fully transposed into national law – a largely harmonised system of deposit insurance through national DGSs within the EU. Thanks to their experience and their knowledge of the national financial market, national DGSs are also in a position to gauge the risk of a payout event occurring and to react swiftly and appropriately. Particularly where banks not subject to SSM supervision are concerned, national DGSs are best able to assess quickly and accurately their member banks' risk exposure and the likelihood of a payout. The problem is that the uniform financing of DGSs via EDIS will prevent national DGSs from taking measures based on their own risk assessment. Normally, increased risk would lead to increased contributions. However, this option will no longer be open to national DGSs once EDIS is introduced. The separation of monitoring risk and levying contributions will therefore drastically weaken deposit protection overall.

In addition, transferring deposit guarantees to a European body harbours the danger of less efficient depositor compensation in the event of a payout, as national DGS capacities in terms of know-how and staff would have to be cut back.

6. Breach of the principle of proportionality

Replacement of the tried and tested national DGSs by EDIS is, moreover, not proportionate, as there are other, less far-reaching measures suitable for achieving the Commission's aim of increasing the resilience of the financial system.

The Commission explains the need for an EDIS by referring to the inadequate harmonisation of deposit guarantees. The logical consequence of this approach would be further developing and harmonising the existing rules before deposit insurance is moved fully to Banking Union level through the establishment of an EDIS.

The Commission also fears that the financial resources of national DGSs may be insufficient and takes this as justification for establishing a common fund for EDIS. GBIC questions, in principle, the need for a common EDIS fund at European level. Any liquidity squeezes experienced by individual national DGSs could be overcome much more easily by using credit facilities, for example.

Further harmonisation could be considered from 2024 once the DGSD has been fully transposed into national law. With the principle of proportionality in mind, this would be a less severe and more suitable means of achieving the aims pursued by the Commission.

7. Full transposition of the DGSD and BRRD into national law

The new DGSD was to be transposed into national law by 3 July 2015. So far, only 21 of the 28 EU Member States have fully transposed the DGSD. Two other Member States have given notice of partial transposition. The primary objective must therefore be that the remaining five Member States implement the DGSD without further delay and that national DGSs are designed in line with the directive and fully endowed with the necessary financial resources.[3] The parallel establishment of an EDIS will bring the efforts required in this respect to a standstill. The same applies to the Bank Recovery and Resolution Directive (BRRD). The BRRD has so far been fully transposed into national law in 24 of the 28 Member States.[4] In this case, too, full transposition into national law in all Member States is first required.

Besides pure implementation of the directives into national law, the new legislation first needs to be tested in practice to obtain accurate empirical data. In particular, it would be helpful if the workability of the resolution tools specified under the BRRD were to be tested in a practical bail-in case. Another key prerequisite is setting appropriate conditions to enable banks to hold sufficient bail-inable liabilities at national, European and international level. In Germany, the necessary legal provisions have already been adopted (e.g. treatment of senior unsecured debt). Other Member States must take similar steps.

8. Loss of competition and consumer protection

The introduction of EDIS and the transfer of funds from national DGSs to EDIS deprives national schemes within the Eurozone of the possibility and the incentive to take alternative measures.

Alternative measures have proved highly effective in the past, especially with a view to maintaining financial stability and preserving customer confidence. Yet EDIS wrongly gives national DGSs a powerful incentive to completely dispense with preventive measures prior to the failure of a bank in order to subsequently make a costly payout with the aid of EDIS funds.

In addition, GBIC sees a significant risk that EDIS will wrongly set incentives for banks to pursue a riskier business policy. The consequence of joint liability is an additional burden on banks with a conservative business policy and high-deposit customers. The introduction of EDIS means that deposits would be shifted to a number of different banks, as depositors would lose confidence and redistribute deposits above EUR 100,000. Banks with a hitherto low risk profile will therefore be affected by the withdrawal of

---

[3] GBIC notes that the Commission opened infringement proceedings in December 2015 against ten Member States which had not yet complied with their obligations to transpose the directive into national law.

[4] The Commission opened infringement proceedings against six Member States in October 2015 and requested them to transpose the BRRD into national law without delay.

customer deposits as well as by the costs of deposit protection for banks pursuing a riskier business policy. Ultimately, EDIS will "infect" previously stable banks and financial marketplaces with risks that other banks would not be able to take in the absence of a common deposit insurance scheme.

9. Single Resolution Board is not a suitable body to manage an EDIS

Moreover, GBIC does not see the Single Resolution Board as a suitable body for administering EDIS. Administration of EDIS by the SRB could lead to clear conflicts of interest, as the SRB is then responsible for two different pillars of the Banking Union, along with their respective funds. The Commission's proposal thus paves the way for merging the second and third pillars of the Banking Union in the medium term. This harbours the danger of a misallocation of the financial resources accumulated for payouts, which the SRB may use in the future for bank resolution throughout the EU.