bankenverband

Position paper

of the Association of German Banks
on the crisis management and deposit insurance (CMDI) framework review

12 July 2023

Lobby Register No. R001458
EU Transparency Register No. 0764199368-97

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USt.-IdNr. DE201591882

Management summary

On 18 April 2023, the EU Commission submitted its proposals for a review of the crisis management and deposit insurance (CMDI) framework in the banking sector. These included a review of

- The Deposit Guarantee Schemes Directive (DGSD)[1]
- The Bank Recovery and Resolution Directive (BRRD)[2]
- The Single Resolution Mechanism Regulation (SRMR)[3]
- The 'Daisy Chain' regulation[4]

The focus of the proposals is on the **expansion** of the **resolution regime** to include **small and medium-sized banks**. Furthermore, in future, **funds** from **national deposit guarantee schemes** will be allowed to be **used** for **resolution** under simplified conditions, particularly for small and medium-sized banks.

The Association of German Banks supports the general aim of the EU Commission to improve the crisis management framework and, in particular, the resolution regime. Experiences in recent years have shown that there is a need for improvement here. Credible and practicable prospects for resolution must also be created for some large but not yet systemically important banks.

However, in the association's opinion, **there is no reason to expand the resolution regime in the way the Commission has proposed**. The largely harmonised European deposit guarantee schemes have proven their ability to function, as the payout events from Greensill Bank and the cross-border case of Sberbank have shown. For the majority of institutions, it is already possible to ensure an orderly exit from the market without endangering financial market stability through national insolvency proceedings.

We are particularly critical of the planned **scrapping of the super-preference** for deposit guarantee schemes.[5] In conjunction with the proposal to considerably expand co-financing of resolutions through national deposit guarantee schemes and the opening up of the Single Resolution Fund (SRF) in principle for the resolution of small and medium-sized banks, this **would significantly increase the financing requirements of deposit protection**. In turn, this could considerably damage the **credibility** of the promise of protection and depositors' **confidence** in deposit protection. In addition, the proposals mean significant additional burdens on European banks with no corresponding additional value for financial stability or for

[1] Deposit Guarantee Schemes Directive (DGSD) 2014/49/EU.
[2] Bank Recovery and Resolution Directive (BRRD) 2014/59/EU.
[3] Regulation (EU) No 806/2014 (Single Resolution Mechanism Regulation, SRMR).
[4] Content simplified: review of the minimum requirement for own funds and eligible liabilities (MREL), particularly in the case of shareholding chains, to ensure a level playing field among banking groups with different structures.
[5] i.e. the priority of secured deposits up to 100,000 euros and/or of depositors rights from deposit guarantee schemes in insolvency proceedings. As a result of this priority, claims from deposit guarantee schemes in insolvency proceedings are given priority and are usually recompensed in full.

consumers. Although we assume that the institutional protection schemes will be less affected by the changes than the deposit guarantee schemes of the private banks, on the whole, the disadvantages clearly outweigh the advantages. **The private banks are therefore opposed to the Commission’s intended paradigm shift.**

Assessment of the proposed legislative package as part of the CMDI review

Below is our assessment of the key elements of the CMDI review.

(1) Amending the public interest assessment (PIA)

Position of the Association of German Banks:

"We reject a general preference for resolution in the event of a bank failure. For the majority of institutions, it is already possible to ensure an orderly exit from the market without endangering financial market stability through national insolvency proceedings. However, we would welcome clarification of the requirements for public interest in a resolution mechanism."

What is to be amended:

- **Positive assumption of public interest in resolution**, i.e. only preferring insolvency when this is the better way of achieving the aims of the CDMI framework than with resolution (no longer just to the same degree).[6]
- The assessment of the impact of an institution failing no longer takes place only at national level, but explicitly at the **regional level**, this means there might also be public interest if there is only a regional impact.[7]
- Restricting the opportunities for (national) **extraordinary financial support measures** for banks.[8]

Effects:

- Irrespective of the size of the bank, the amendments would make resolution the **de facto standard tool** (resolution for all) for managing a bank crisis; national insolvency proceedings would be the exception.
- The introduction of the vague legal concept of regionality **does not reduce the discretionary power** of the resolution authority **in the PIA**, which is rightly criticised in the Commission proposal. The review of public interest in a resolution would therefore continue to lead to different outcomes depending on the responsible authority.
- Today, the majority of banks are liquidated through insolvency proceedings. All institutions whose preferred future resolution strategy would no longer be insolvency, but resolution, would be faced with a considerable **additional administrative burden**, including new requirements to cooperate with national resolution authorities on resolution planning, more detailed reporting obligations and, where applicable, ensuring they have sufficient loss absorption capacity in the form of MREL.[9]

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[6] Article 18(5) of the proposed BRRD; Article 18(5) of the proposed SRM.
[7] Article 14(2), letter a) of the BBRD in conjunction with Article 2(2)(35) of the proposed BRRD.
[8] Article 14(2), letter c) of the proposed BBRD.
[9] MREL = Minimum Requirement for Own Funds and Eligible Liabilities aims to ensure that a credit institution has sufficient bail-in capital to absorb losses and to recapitalise.

- Furthermore, in the case of small and non-complex institutions (SNCIs), another consequence would be the **loss of CRR relief for SNCIs**, which presupposes, among other things, that an institution is not subject to any or only simplified requirements for resolution planning.[10]
- Increased use of the resolution process will mean that resolution authorities will be given access to SRF money[11] for a large number of banks, i.e. national losses will increasingly be compensated at the European level in future. The **costs of crisis management will therefore be further communitised**.
- The Commission's intention for greater use of SRF money and national deposit guarantee schemes will lead to a **greater financial burden** on banks.
- Furthermore, there is concern that the envisaged (co-)financing of resolution measures will lead to gaps in the financing of deposit guarantee schemes, meaning that banks will be increasingly required to pay additional contributions. This could have the **effect of exacerbating crises**, with **negative consequences** for **financial stability**.

We reject the planned paradigm shift towards a "resolution-for-all" strategy for the following reasons:

- Of the 176 institutions that are members of the Compensation Scheme of German Private Banks (Entschädigungseinrichtung deutscher Banken GmbH, EdB), around 130 are banks and less significant institutions (LSIs). More than 90% of these institutions have balance sheet totals of less than 10 billion euros, around 80% of them have balance sheet totals of less than 5 billion euros.
- **Banks would be "artificially" forced into resolution proceedings**. For most LSIs, national insolvency proceedings continue to be the most appropriate strategy because if these institutions become distressed, it can usually be assumed there will be no negative impact on financial stability. For institutions that can be liquidated using alternative measures, the corresponding mandate already exists in the deposit guarantee directive.
- For these institutions, it is already possible to ensure **an orderly exit from the market without endangering financial market stability**. Recent EdB cases provide positive examples of this:
  - Greensill (2021): ca. 22,000 depositors, ca. 1.1 billion euros compensated through the EdB (balance sheet total of 4.5 billion euros by end of 2020);
  - Sberbank (2022): ca. 35,000 depositors, ca. 950 million euros compensated through the EdB on behalf of Austrian deposit protection (cross-border compensation) (balance sheet total of 13.6 billion euros by end of 2021);
  - NCB (2023): ca. 460 depositors, ca. 17 million euros compensated through the EdB (balance sheet total of 173 million euros by end of 2021).
- The **annual risk analysis carried out by BaFin and Germany's Bundesbank** of small and medium-sized banks under the direct supervision of BaFin underscores the low risk to

[10] Article 4(1)(145), letter c) of the CRR.
[11] Single Resolution Fund (SRF).

financial stability from one of these banks failing. According to the assessment of the potential impact of a **solvency or liquidity crisis of a bank on the stability of the financial sector, there was only a high probability of this occurring for 1.4% of LSIs**.[12]

- **Ultimately, bank customers will have to pay** for this seemingly "improved" protection.

(2) Scrapping the super-preference for deposit guarantee schemes

Position of the Association of German Banks:

"To implement this paradigm shift towards a 'resolution for all', the Commission is scrapping the super-preference for deposit guarantee schemes. Without this important achievement of the Banking Union that has proven itself many times in practice, the credible financing of deposit guarantee schemes and, therefore, the overall aims of the Banking Union are massively at risk."

What is to be amended:

- The current **preferential ranking in insolvency proceedings** of deposits protected by statutory deposit guarantee schemes over unsecured claims is to be extended to include **all deposits**.
- The relative ranking between the various categories of deposits is to be replaced by a **single-tier depositor preference**, i.e. all the deposits[13] and claims of the deposit guarantee scheme from compensated deposits are to be given the same priority (pari passu).[14]
- The current **super-preference for deposit guarantee schemes is to be scrapped**, i.e. priority will no longer be given to claims from the deposit guarantee schemes for compensated deposits in case of a bank failing.[15]

Effects:

- Until now, the super-preference had ensured that, in subsequent insolvency proceedings, preference was given to the deposit guarantee scheme in terms of depositor compensation payments, meaning that losses were recovered in full comparatively quickly, and the deposit guarantee scheme generally incurred few or no losses. In comparison, alternative (resolution) measures would have been very rarely less costly/more cost effective.
- The planned removal of the priority for deposit guarantee schemes in the insolvency ranking will, in future, **delay and reduce amounts recovered** in insolvency proceedings resulting from a payout event.[16] **As a result, the net losses or costs that the deposit guarantee**

[12] As of 31 December 2022. Source: BaFin, Annual Report 2022, p.41/42.
[13] i.e. covered deposits up to 100,000 euros, uncovered deposits above 100,000 euros owned by private individuals or small and medium-sized businesses as well as other unprotected deposits.
[14] Article 108(1) of the proposed BRRD.
[15] Article 108(1) of the proposed BRRD.
[16] Reports on deposit guarantee schemes in the EU have shown that amounts recovered under the super-preference are almost 100%, compared to values of 30-60% without the super-preference.

scheme will have to be bear **will be correspondingly higher.** These costs serve as reference values for future least-cost tests.[17]

- The higher costs of depositor compensation due to **arbitrarily**[18] **lower amounts recovered** in insolvency proceedings **make resolution more likely measure** in future. As a result of the least-cost test, this now appears to be more cost-effective than a payout event for the deposit guarantee scheme. The **resolution of distressed small and medium-sized banks** is becoming the **new norm**.
- In addition, legislators are giving the Single Resolution Board (SRB) a new super-preference in resolutions occurring subsequent to insolvency proceedings.[19] This also reduces the **amounts recovered** for the deposit guarantee schemes.
- Any **funding gaps** are to be closed by **increased contributions from the banks**, if necessary by (unplanned) special contributions, which would have **the effect of making a crisis worse** with **negative consequences** for **financial stability**.

We are firmly against scrapping the super-preference for deposit guarantee schemes in insolvency proceedings for the following reasons:

- Reducing opportunities to compensate for losses arising from insolvency proceedings severely **weakens the financing basis of deposit guarantee schemes.**[20]
- The **financial burden on deposit guarantee schemes is further exacerbated** by the removal of the limit[21] on the funding contribution to be paid by the deposit guarantee scheme in the event of resolution.[22] This means that just one resolution might be enough to eat up all the financial resources available to a deposit guarantee scheme.
- Particularly in combination with more frequent recourse to deposit guarantee funds for crisis management, the scrapping of the super-preference would lead to a significant **weakening of the credibility of the financing**.
- In the event of a crisis, this could lead to **depositors losing confidence in the system and to bank runs** and therefore be counterproductive to the ultimate goal of financial stability.
- The accompanying **greater financial burden on our banks will weaken** their **position** in terms of **international competition**.
- It can be assumed that the **additional costs** will have to be **passed on to customers** and, therefore, be financed by taxpayers.

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[17] The least-cost test (LCT) is used to assess whether a deposit guarantee scheme can be replaced by measures other than paying depositors (e.g. as part of resolution). The basic principle is always to determine the most cost-effective measure. The cost of an alternative measure shall not exceed the net amount (cost) of the compensation for covered depositors (amount of compensation paid minus amounts recovered from insolvency proceedings) of the failing member institution.

[18] In its impact assessment of the legislative package, (p.282) the Commission noted: *"The type of depositor preference also impacts the maximum amount of DGS funds allowed under the LCT in resolution or to finance alternative measures in insolvency. In particular, the single-tier depositor preference unlocks the maximum amount of funds pursuant to the LCT, on average up to twenty times higher than under the current creditor hierarchy (…)."*

[19] Article 108(9) of the proposed BRRD.

[20] Reports on deposit guarantee schemes in the EU have shown that amounts recovered under the super-preference are almost 100%, compared to values of 30-60% without the super-preference.

[21] Up to now, the limit has been 50% of the target level (this is 0.8% of covered deposits and is to be accrued by 3 July 2024), see also Article 109(5) of the proposed BRRD.

[22] Article 109(5) of the proposed BRRD.

(3) Eligibility requirements for the SRF

Position of the Association of German Banks:

"We welcome the fact that the Commission plans to maintain the 8% of total liabilities and own-funds bail-in requirement. However, we reject easing access to the Single Resolution Fund for the resolution of small and medium-sized banks with funds from deposit guarantee schemes and the associated expansion of deposit protection to unprotected deposits, not least in order to ensure there is a level playing field. We reject communitisation of liabilities at the European level."

What is to be amended:

- The Minimum Requirement for own funds and Eligible Liabilities (MREL) is to be modified, in particular for banks with a high percentage of deposits and whose resolution strategy includes a (partial) sale or transfer to a bridge bank.
- In the event that resolution is required for these banks, the proposal states that, in the future, the **deposit guarantee schemes will be able to contribute** to assuming or expanding the internal loss absorbing capacity in order to achieve an (unchanged) **loss share of at least 8% of total liabilities and own funds (TLOF)**[23] **for affected banks**.[24] In this manner, affected banks could meet access requirements for SRF funds without needing to use deposits for loss sharing.
- Funds from deposit guarantee schemes could then be used to finance transfer of covered deposits – **in certain circumstances, this could also include deposits over 100,000 euros and non-covered deposits**.
- The current regulations already foresee, under specific circumstances, use of deposit guarantee schemes as part of financial contributions for the resolution of a bank. Up until now, there has been a financial **limit** on resolution contributions from deposit guarantee schemes. This limitation of **half of the deposit guarantee scheme funds**[25] is to be **scrapped**.[26]

Effects:

- The **financial contributions of deposit guarantee schemes** for resolutions will be **increased** significantly in terms of frequency and amount of co-financing required. The use of deposit guarantee scheme funds for resolution measures is to be made standard, despite the fact that this is inappropriate and unnecessary.

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[23] Total Liabilities and Own Funds (TLOF).
[24] Article 109(2b) of the proposed BRRD.
[25] Previously, the limit was set at 50% of the target level (the target level is 0.8% of covered deposits to be accrued by 3 July 2024), see Article 109(5) of the proposed BRRD.
[26] Article 109(5) sentence 2 of the proposed BRRD.

- The amount of **co-financing** to be introduced for deposit guarantee schemes is only limited by the results of least cost tests and **may require use of all available deposit guarantee funds for resolution**.
- Only protected deposits up to 100,000 euros are excluded from the bail-in; with the bridging function, deposit guarantee schemes can be extended to **include uncovered or unprotected deposits** (e.g. of large companies) **in the event of resolution**.

The European Commission plans to give national deposit guarantee schemes a more prominent role in terms of financing resolutions than was previously the case. We strongly disagree with this plan, for the following reasons:

- The removal of the upper limit for contributions from deposit guarantee schemes to resolutions **puts sustainable financing of deposit guarantee schemes at risk and therefore damages depositor confidence** in their effectiveness.
- Not only that, in the event that resolution fails, **deposit guarantee schemes are placed under a double burden**, as they are still required to provide and finance compensation for depositors.
- Extending the scope of protection to include uncovered and unprotected deposits in resolution, i.e., an **'all-inclusive package' for all deposits**, gives **wholesale investors a free pass**. This contradicts the mandate of the deposit protection scheme, which is to protect depositors in the event that a bank becomes insolvent by reimbursing up to 100,000 euros of money deposited with the bank in question (however, some types of depositors do not currently have a legal right to reimbursement. This applies in particular to government agencies and financial institutions, as these bodies are not considered to require protection in order to maintain consumer protection principles or contribute to financial stability[27]).
- The higher costs associated with this plan are to be paid for via contributions from banks that pay into deposit guarantee schemes. If there are not enough available funds, the banks would be more likely to have to pay unplanned extra contributions, which would have a **negative effect on earnings**. The possibility that this would have **procyclical effects** cannot be excluded. This, in turn, would pose a risk to stability in the banking sector.
- Deposit protection must be geared towards the **protection needs of depositors** and should, as foreseen by the DGSD, remain limited to retail investors (i.e. consumers).
- Commission references to the German deposit guarantee scheme that "already provides full protection for deposits" are misleading and incorrect, as they confuse the scope of protection required by the DGSD with the additional, voluntary deposit guarantee scheme. In addition, the voluntary deposit protection scheme has lowered the level of protection and reduced the types of depositors covered by the scheme, in particularly due to moral hazard considerations. In the end, current compensation cases, for example Greensill, show that

[27] see Recital 31 DGSD.

unprotected depositors in Germany will also experience losses – in some cases significant losses – in the event that a bank becomes insolvent.

- In addition, resolution authorities will have access to communitised SRF money for a larger number of banks, leading to **further communitised crisis management costs** at the expense, in particular, of those paying the largest amount into the SRF, specifically the French and German banking industries.
- Modified MREL in particular for banks relying heavily on financing via deposits would be "**cross-subsidised**" by the other banks.

(4) Rules relating to activities of institutional protection schemes

Position of the Association of German Banks:

"The majority of private banks in Germany are small and medium-sized institutions. These institutions, just like savings banks and cooperative banks, benefit from a stable financial market and a reliable crisis management framework. A general exception from the resolution process for institutions belonging to an institutional protection scheme would therefore not be justified. For resolution, too, the basic principle of 'same services, same risks, same rules' must be applied."

There are still no exceptions foreseen for institutional protection schemes **for the future:**

- In principle, the new rules apply equally to institutional protection schemes and to deposit guarantee schemes. However, there are clauses specific to institutional protection schemes added in various places to allow them to continue operating.
- **It is still possible to recognise** an institutional protection scheme **as a legal deposit guarantee scheme**.
- In addition to the obligatory tasks of depositor compensation and financial contribution in the event of a resolution, **preventive and alternative measures remain national options for deposit guarantee schemes.**

Effects:

- Implementing preventive measures is still an option, but it is subject to stricter requirements than was previously the case.
- Even though institutional protection schemes do not represent an exception under the rules, they will **likely be less affected by the changes than the private banks' deposit guarantee schemes**, as any crises they experience generally remain national and can be managed using preventive measures.
- This is particularly true for the financial effects of the proposals on the deposit guarantee schemes. The private banks' statutory deposit guarantee scheme does not, in contrast to the institutional protection schemes, currently have a rule mandating cost-saving preventive measures. As such, in the event that one of its institutions experiences a crisis, it will be required to contribute to resolution measures, which are likely to be more cost intensive. As a

result, private banks will, in the future, **have to contribute significantly more money towards financing guarantee schemes** than has been the case in the past.

In principle, we believe it is appropriate and proper to maintain functionality of the institutional protection schemes **within the new EU framework for crisis management.** However, concessions to activities of institutions covered by IPS should not under any circumstances be made in a way that is detrimental to the private banks' statutory deposit guarantee schemes and the banks that fund said schemes. We therefore reject a categorical **exception for institutional protection schemes**.

- We believe that the principle of "same business, same rules" should also apply here. There are many **private banks** that have **similar** or **even identical sizes and business models** to savings banks and cooperative banks.
- In light of this, rules that apply to institutional protection schemes and that lead to savings and cooperative banks being treated differently to small and medium-sized private banks contradict basic principles of **equal treatment** and **competitive equality**.
- The Deposit Guarantee Directive already allows for the use of cost-saving alternative and preventative measures via deposit guarantee schemes. The proposed drafts for revising the BRRD and DGSD, however, place strict limits on a national guarantee scheme's ability to actually implement these measures. We therefore once again return to our long-standing call for rules that allow national **deposit guarantee schemes to take preventive and alternative measures within the framework of a broad mandate**.
- Any adjustments made to the CMDI framework are, according to our assessment, only **legally permissible** in the event that they guarantee a **level playing field** and **consistent conditions** for the Banking Union in order to ensure financial stability. The CMDI review cannot incorporate any unequal treatment, in particular in regard to ensuring a level playing field and especially when it comes to European legal requirements.

(5) Bank levy

Position of the Association of German Banks:

"In addition, the CMDI review should serve to clarify that regular contributions should no longer be levied once the single resolution funds have reached their target level. The current level is already considerably higher than the originally envisaged target level which was previously considered sufficient."

What is to be amended:

- The SRB has the **option** to **defer levying ex ante contributions** for one or more years until the levied amount reaches a level that is proportionate to the costs of the collection process.[28]
- **In future**, IPCs[29] may not exceed a **maximum of 50% of the total amount levied.**[30] In addition, the call, that is the use of IPCs, is to be regulated.[31]

Effects:

- Unless clarification is provided that regular, that is ex-ante mandatory contributions, will end once the Single Resolution Fund (SRF) target level of 1% of covered deposits in the Banking Union has been reached by the end of 2023, then the SRB will continue to collect the levy if there is a further increase in covered deposits.
- In the event that covered deposits increase only minimally each year, the levying of contributions could be postponed in order to avoid creating costs that are out of proportion to the volume of the contributions.
- The SRB's option to grant use of payment commitments is to be expanded (previously, up to 30% IPC could be used).

We are calling for the CMDI review to be used to clarify that regular contributions should no longer be levied once the SRF has reached its target level at the end of 2023, for the following reasons:

- The level to be achieved by the end of 2023, around 78 billion euros, is already around 40% higher than the originally envisaged target level, which was previously considered sufficient. This increase has on no account been the result of an increase in the willingness of banks to take more risks – as noted by, among others, the SRB. It is solely due to an increase in covered deposits. By keeping this mandatory contribution in place, the fund would be considerably more overcapitalised than it already is today.

[28] Article 102(3) of the proposed BRRD; Article 69(4) of the proposed SRMR.
[29] Irrevocable Payment Commitments (IPC).
[30] Article 103(3) of the proposed BRRD; Article 70(3) of the proposed SRMR.
[31] Article 103(3a) of the proposed BRRD; Article 70(3a) of the proposed SRMR.

- It is true that the approach of postponing ex-ante contributions is appropriate. However, the **collecting of the bank levy should not become automatic**. Instead, a review process into whether contributions should continue to be collected should be triggered when a given ceiling is not reached or exceeded, also taking into account progress made on the resolvability of banks.
- An increase in the IPC share is, in principle, a good idea, however the decision on granting it and the amount of the IPC share remains subject to the discretion of the SRB. In order to improve planning capabilities, the institutions should always have **the option of using IPCs** to an amount of 50%.
- In addition, it must be ensured that adjusting the framework for IPCs (e.g. regarding IPC calls) does not change their current accounting treatment.

Glossary

Bail-in
A legal process in bank resolution; claims of a bank's shareholders and certain creditors of a bank are written off or converted into capital, which means they are forced to accept bank losses and contribute to its recapitalisation.

Creditor hierarchy
Order in which creditors' claims are to be satisfied in insolvency proceedings. Some elements of the creditor hierarchy are harmonised at EU level. For example, until now, claims from deposit guarantee schemes and covered deposits are prioritised over preferred, non-covered deposits and non-preferred, non-covered deposits and have to be repaid ahead of claims from all other deposits (known as the super preference).

Least-cost test (LCT)
The LCT assesses whether a deposit guarantee scheme can be replaced by measures other than paying out depositors (e.g. as part of resolution or through alternative measures). The costs of such measures may not exceed the net amount of compensation for covered depositors at the failing member institution. There are as yet no detailed rules for verifying least cost, and the member states implement it in different ways.

Minimum Requirement for Own Funds and Eligible Liabilities (MREL)
Minimum requirements for own funds and eligible liabilities (MREL) introduced as part of the Bank Recovery and Resolution Directive (BRRD). MREL is determined individually for each institute by the resolution authorities, taking certain requirements into account. The goal is to ensure that a bank has adequate capital for bail-ins, which can be used to absorb losses and recapitalise in the event of resolution.

Public Interest Assessment (PIA)
The national resolution authorities or the SRB shall conduct a public interest assessment to determine whether the resolution of a particular bank would be necessary to preserve financial stability, protect covered depositors and/or safeguard public funds by minimising reliance on public financial support. If the PIA is negative, no resolution measures are taken and a national insolvency proceeding takes place.