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European Banking Union: Improving crisis management – strengthening self-accountability

BVR position paper on effective and efficient crisis management for banks in Europe

Introduction

Crisis management for banks under scrutiny

In November 2019, German Finance Minister Olaf Scholz announced his goals for the European Banking Union in an unofficial position paper. Core aspects addressed a more efficient supervisory system and crisis management, further risk mitigation, a European deposit insurance scheme, in the form of liquidity assistance between national deposit guarantee schemes and the avoidance of (tax) arbitrage. Strengthening crisis management for banks that have run into difficulties was also a major concern of the German Presidency of the European Council in the second half of 2020. Against this backdrop, the European Commission announced at the end of November 2020 its plan to review the entire “Crisis Management and Deposit Protection Framework”, including in particular the BRRD¹, SRMR² and DGSD³.

To this end, the Commission intends to present a corresponding legislative package, including a European Deposit Insurance Scheme (EDIS), in Q4 of 2021.

The crisis management for banks is a central part of the overall architecture of the Banking Union. Well-functioning crisis management is an indispensable prerequisite for sustainable financial market stability, and not just as a byproduct of the financial crisis. The question of how the crisis management should be designed in tangible terms is not easily answered. Not least for this reason, the ideas in the individual EU member states differ greatly. In principle, two broad directions may be distinguished in the political discussion, as to how the Banking Union could be further developed: First, an extension of the European resolution regime to Less Significant Institutions (LSIs) combined with further centralization of relevant decisions or, second, consistent subsidiarity in the resolution of LSIs from the decision to the conclusion of the proceedings.

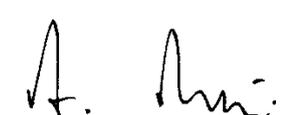
The BVR intends to submit its insights on crisis management in this position paper, with a view to contributing to this important debate.



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¹ Bank Recovery and Resolution Directive (BRRD), Directive 2014/59/EU.

² Single Resolution Mechanism Regulation (SRMR), Regulation (EU) 806/2014.

³ Deposit Guarantee Schemes Directive (DGSD), Directive 2014/49/EU.

Crisis management in the banking sector: More than a management of a crisis

Summary

- The BVR supports the further development of the European Banking Union.
- Crisis management for Less Significant Banks (LSIs) should strengthen existing and proven structures.
- Private banking crisis management solutions, including measures of institutional protection schemes, must take precedence over state intervention.
- Changes to crisis management must not lead to a direct or indirect communitarisation of liability for third-party risks or an introduction of an EDIS through the back door.
- Banking supervision of LSIs must remain decentralized, as must crisis management.
- EU State aid law should be included in any review of crisis management to increase legal certainty.

The BVR supports the strengthening of the banking union and intends to play an active role in shaping it. Specifically, in view of the tense economic situation in the EU, as a result of the COVID-19 pandemic, coordinated European approaches in various policy areas are of great importance. For a banking union that aims to promote the functioning and stability of the financial system, it is important to establish the measures required for dealing with failing banks. The design of bank crisis management - centralized, from Brussels, or decentralized, building on proven structures in the respective Member States - should be coined by our European economic model.

The BVR's guiding principles for the further development of crisis management are effectiveness, efficiency, self-accountability, proportionality and practicability. Maintaining depositors' confidence in the existing structures and respecting the principle that decision-making, financing and liability must lie in the same hands are also of special importance. These principles, which are recognised in the EU, must also guide crisis management.

1. Predictability of the framework: avoid jeopardizing trust

Depositors' confidence in the stability of the banking and financial system is a valuable asset that has grown over the decades. The crisis management, which only came into force in 2015, is still in its youth. It is still at the stage of being implemented. Given the exceedingly small number of resolution cases so far, the actual empirical test of the functioning of the European resolution regime with the SRB as the primary responsible authority is still pending. Specifically, in the case of cross-border failures of larger banks, considerable doubts remain in this regard, as there are a variety of political, legal, social and technical challenges in such cases. In seeking to further strengthen crisis management, it should be borne in mind that severe changes to the framework regarding LSIs and a departure from the policy choices underpinning current crisis management may undermine depositors' and financial market actors' confidence in financial stability. Because trust requires predictability and calculability, among other things. Changes, specifically, to responsibilities in the relatively new framework, even before it has been able to prove itself sufficiently in real settlement cases, are not very convincing. In any case, changes should, therefore be limited to points that are absolutely necessary, insofar as these can be determined with sufficient precision at all. A fundamental questioning of the crisis management introduced in 2015 and its governance could have exactly the opposite effect of what is intended: The reduction of confidence in the reliability of European politics and ultimately also the stability of the financial market.

2. Proven structures must be strengthened

Further development of crisis management should therefore focus on strengthening existing and proven structures. These include national deposit guarantee schemes and the clear differentiation between banks whose systemic importance requires resolution by the SRB and less significant banks (LSIs), for which the ordinary insolvency procedure of the Member State concerned applies in the event of insolvency. Substantive improvements, both in the resolution regime and in insolvency law, may achieve more in the short and medium-term than a complete reversal of responsibilities for bank crisis management and linking the issue to the political goal of a European deposit insurance scheme. How-

ever, this is precisely what the European Commission seems to be aiming for when it not only links the resolution regime with deposit insurance but at the same time now calls for the introduction of a European deposit insurance scheme in this context, after little progress has been made due to the lack of preconditions for such measures. Reinventing the wheel in the area of bank resolution with a very uncertain outcome is not advisable.

3. The functioning of Institutional Protection Schemes must not be impaired

Institutional Protection Schemes, such as that of the German cooperative banks, make an important contribution to financial stability. They have shown their effectiveness in real life for many decades. The great advantage of Institutional Protection Schemes lies in their preventive approach - instead of paying out money to depositors when a bank fails, the aim is to prevent banks from becoming insolvent in the first place. They thus pursue a proactive, risk-reducing approach. We, therefore, clearly advocate that the functionality of the Institutional Protection Schemes must be adequately considered in any form of crisis management. An expansion of the resolution regime to include purely regionally active banks in combination with premature intervention by the resolution authorities would severely restrict the ability of Institutional Protection Schemes to act. This is because it is in the nature of an Institutional Protection Scheme to identify undesirable developments in the banks affiliated to it at an early stage and to take countermeasures without the bank becoming insolvent and requiring the intervention of a state resolution authority.

4. Options under the Deposit Guarantee Directive must be used

Even without substantial changes, existing bank crisis management could be strengthened. Thus, further and full implementation of the Deposit Guarantee Directive should and must be pursued. Specifically, this includes ensuring that the specified level of funding for protection systems is reached in all Member States. Moreover, there can be no exceptions to the funding requirement for deposit insurance schemes of 0.8 % of covered deposits, as is the case in France, for example, with a target level of only 0.5 %. In addition, the instruments provided under the Deposit Guarantee Schemes Directive must

be implemented and used. These include the application of preventive and alternative measures by deposit guarantee schemes. In Germany, Institutional Protection Schemes have been successfully adopting preventive measures for many decades. Other guarantee schemes, on the other hand, are limited to a pure payout function in the event of compensation, although alternative measures could in many cases conserve the resources of deposit guarantee schemes.

5. Existing resolution tools must be adopted consistently

Existing resolution tools for systemically important banks need to be adopted more consistently to mitigate systemic risks. Adoption of the European resolution rules for less significant banks (LSIs), also indirectly via extensive affirmation of public interest in the examination of the preconditions for a bank's resolution, is to be rejected. Extending the resolution regime to small and medium-sized banks runs counter to the objective of not increasing the administrative burden. Proportionality considerations for small, non-complex institutions recently laid down in CRR/CRD for good reasons would be thwarted by such a measure. Moreover, while the issues of resolution and deposit protection may need to be better aligned, structurally, they should remain separate. A combination would contradict the political agreements and could gamble away trust, especially among depositors, if there were any suspicion that deposit guarantee funds could be depleted for crisis management in an emergency so that deposits would be less safe.

6. State intervention must remain ultima ratio

Private, market-based solutions are an established and proven part of crisis management in the event of bank failure and should always be preferred to state intervention, as they generally lead to better and more cost-effective solutions. It would also conserve State or Community resources. In the social market economy, the State should act in a subsidiary manner and not take over competences that may be performed equally well by the private sector. Proven private Deposit Guarantee Schemes/Institutional Protection Schemes must not be restricted or even jeopardized by state intervention.

7. No back door communitarisation of liability for third-party losses

A change in the existing crisis management framework must not lead to direct or indirect communitarisation of liability among banks. Decision-making, financing and liability must lie in the same hands for both state and private measures - this is an important regulatory principle. Financial resources of national deposit guarantee schemes may therefore only be used for the resolution of LSIs if the measures are adopted by the national deposit guarantee scheme. We, therefore, reject centralization of the decision on resolution measures at Single Resolution Board (SRB) level. The far-reaching interference in the property rights of creditors and shareholders of a regionally active bank by way of an order for creditor participation by the SRB in Brussels, as the European authority, would have serious disadvantages. It is doubtful that a central authority with little knowledge of national or regional markets would make better decisions. Acceptance among the population is likely to be low, or criticism of 'Brussels' is likely to increase. The more robust the intervention, the less it should be taken centrally unless it is absolutely necessary due to the systemic relevance of a bank. The same applies to the financing of SRB resolution measures at regional banks in other Member States.

8. No European Deposit Guarantee Scheme without prior fulfilment of key conditions of risk reduction and insolvency law

The creation of a European Deposit Insurance Scheme (EDIS) must not be part of, or collateral damage to, any change in bank crisis management, either based on the existing proposal or any alternative proposal. The economic, legal and political preconditions for an EDIS have still not been met. The Commission and Member States should work on this aspect and, the original Commission proposal from 2015 should be withdrawn. Making EDIS part of the revised crisis management framework also risks extending the continuing divergent views

in Member States to the entire crisis management and preventing progress.

9. Centralized crisis management for LSIs with consequences for banking supervision

Further centralization and extension of the resolution regime for all banks, i.e., including LSIs, would immediately raise the question of whether all banking supervision should not also be centralized. This would mean that LSIs would also be directly supervised by the ECB and that the national supervisory authorities would either become obsolete or would merely be sub-offices of the ECB and bound by its instructions. The divergence between the responsibility for the resolution of banks and the responsibility for the supervision of LSIs could hardly be justified in the long term. The BVR considers it essential to uphold the principles of proportionality and subsidiarity in the areas of bank resolution and banking supervision. The national authorities responsible for these functions have a deep understanding of the markets and their frameworks. Their intensive involvement results in a positive efficiency knock-on effect and advantages regarding the systemic stability of the financial system.

10. Compatibility of crisis management with State aid law must be ensured

State aid law must be involved in any review of crisis management to avoid legal uncertainty regarding the compatibility of crisis management measures and deposit insurance with state aid law. The EU Commission's Banking Communication from 2013 - i.e., the rules on state aid to banks - urgently needs to be revised in the light of crisis management introduced since 2015 to eliminate inconsistencies. It would be desirable and necessary for improved cooperation to take place within the EU Commission in the future, so that such issues do not arise in the first place.

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The BVR is the central association of the cooperative banking industry in Germany. These banks include the 841 cooperative banks, Sparda banks, PSD banks, banking institutions for churches and other special institutions such as Deutsche Apotheker- und Ärztebank (German Bank for Pharmacists and Physicians). The President of the BVR is Ms Marija Kolak. The other members of the Board of Managing Directors are Gerhard Hofmann and Dr. Andreas Martin. The BVR represents the interests of the Cooperative Bank Financial Network throughout Germany and internationally. Within the Group, the BVR coordinates and develops the joint strategy of the local cooperative banks.

It advises and supports its members in legal, tax and business management matters. The BVR also operates two institutional protection schemes. These are: the wholly-owned subsidiary "BVR Institutssicherung GmbH", which represents the officially recognized deposit guarantee scheme and the voluntary "BVR protection scheme" - the oldest bank protection scheme in Germany. The BVR is active in Berlin, Bonn and Brussels. Information on the BVR and its topics may be obtained via politik@bvr.de or under +49 (0)30 2021 1605 or at the Website www.bvr.de.