

■ Deposit protection in Germany

The Deposit Guarantee Act (Einlagensicherungsgesetz) entered into force on 3 July 2015, transposing into German law the harmonised requirements of the amended European Deposit Guarantee Scheme Directive. The new Deposit Guarantee Act supersedes the Deposit Guarantee and Investor Compensation Act (Einlagensicherungs- und Anlegerentschädigungsgesetz), which entered into force in 1998 and at the time implemented both the EU Deposit Guarantee Scheme Directive and the EU Investor Compensation Scheme Directive. The report begins by summarising the current legal situation and then goes on to explain the new harmonised provisions and how they are being implemented in Germany. The statutory depositor compensation scheme set up in 1998 for private and public-sector banks will remain in place, while important changes will be made to the institutional protection schemes of the German banking industry. Overall, the protection level for depositors will improve further. On this basis, the German deposit protection system will remain anchored at the national level. The report will conclude by presenting and assessing the current plans for a common European deposit insurance scheme (EDIS).

Experience of statutory depositor compensation in Germany since 1998

Statutory depositor compensation scheme in Germany created in 1998

The implementation of the EU Deposit Guarantee Scheme Directive (94/19/EC of 30 May 1994) in Germany created harmonised structures for a statutory depositor compensation scheme, which then entered into force on 1 August 1998 as the Deposit Guarantee and Investor Compensation Act (*Einlagensicherungs- und Anlegerentschädigungsgesetz*), or DGICA.¹ This act established two statutory compensation schemes, one for private-sector banks and the other for public-sector banks, located at the level of the respective banking associations; these compensation schemes and their tasks and powers have remained unchanged since then. The structures created at the time have also been perpetuated by the transposition into German law of the recast Deposit Guarantee Scheme Directive (2014/49/EU) of 16 April 2014 through the Deposit Guarantee Act (*Einlagensicherungsgesetz*), which entered into force on 3 July 2015.

Statutory deposit protection and institutional protection schemes specific to each group of banks

Since the entry into force of the DGICA, all banks providing deposit-taking services have been required to belong to a statutory depositor compensation scheme. The statutory compensation schemes of the Association of German Banks (EdB) and of German public banks (EdÖ) act here in a private-law capacity under a statutory mandate as “entrusted compensation schemes”.² By contrast, the institutional protection schemes of the German Savings Banks and Giro Association (DSGV) and the Federal Association of German People’s Banks and Raiffeisen Banks (BVR), pursuant to Article 113 (7) of the Capital Requirements Regulation (CRR), are associations of multiple banks which have entered into a liability arrangement. Their main function is institutional protection, ie averting the bankruptcy of a member institution. They have been regarded thus far as “alternative” systems within the meaning of the 1994 EU Deposit Guarantee Scheme Directive, which meant that their members were exempted

from the provisions of the DGICA and thus did not have to belong to any statutory depositor compensation scheme. The term “alternative” refers to systems which protect depositors indirectly through an existing institutional protection scheme.

The statutory deposit protection scheme is supplemented by the voluntary deposit insurance arrangements within the separate deposit guarantee schemes established by each banking group association. Since the DGICA was originally introduced with a statutory guarantee of up to 90% of liabilities up to a maximum amount of €20,000 per depositor and institution, the voluntary deposit protection systems at private and public banks have been providing additional deposit protection regarding the limit, volume of insured deposits and definition of protected depositors. For competitive reasons, a large percentage of credit institutions also belong to a voluntary guarantee scheme. The type and scope of the protection for individual investors are determined by the private-law statutes of the respective guarantee scheme. The private deposit protection fund of the Federal Association of German Banks currently voluntarily insures the deposits of each individual customer up to 20% of that respective bank’s regulatory own funds. As of 1 January 2012, the Federal Association of German Banks decided to gradually reduce the limit for its voluntary deposit insurance to 8.75% of its liable capital by 2025.

Voluntary deposit protection supplements statutory protection

All statutory and voluntary deposit guarantee schemes in Germany are funded by members’ regular annual *ex ante* contributions. Systems

How statutory compensation schemes are funded

¹ See Deutsche Bundesbank, Deposit protection and investor compensation in Germany, Monthly Report, July 2000, pp 29-45. The present article will deal with deposit protection; it will not cover any aspects of investor protection.

² The tasks and powers of a statutory compensation scheme may be transferred to legal entities under private law if they meet the requirements for fulfilling the statutory task. Non-public-law shareholders of a depositor compensation scheme are given the function of “entrusted compensation schemes” upon whom a public task is conferred. This means that compensation schemes organised under private law can issue administrative acts.

Overview of deposit insurance in Germany

CRR credit institutions	Statutory deposit guarantee schemes pursuant to the Deposit Guarantee Act (<i>Einlagensicherungsgesetz</i>)	Institutional protection schemes; ¹ voluntary deposit insurance
with a private legal form		
Credit cooperatives and regional institutions of credit cooperatives	Statutory protection ² Provided by: Federal Association of German People's Banks and Raiffeisen Banks (<i>BVR Institutssicherung GmbH</i>) ³	Institutional protection Provided by: Protection Scheme of the Federal Association of German People's Banks and Raiffeisen Banks (<i>BVR-Sicherungseinrichtung</i>) ⁴
Other CRR credit institutions	Statutory protection ² Provided by: Compensation Scheme of German Banks (<i>Entschädigungseinrichtung deutscher Banken GmbH</i> , or EdB)	Supplementary protection for deposits not covered by deposit guarantee schemes pursuant to the Deposit Guarantee Act; per depositor up to 20% of the respective bank's liable capital relevant for deposit insurance ⁵ Provided by: Deposit Protection Fund of the Association of German Banks (<i>Einlagensicherungsfonds des Bundesverbandes deutscher Banken e.V.</i>)
with a public legal form		
Savings banks, Landesbanken, public building and loan associations	Statutory protection ² Provided by: German Savings Banks and Giro Association (<i>Deutscher Sparkassen- und Giroverband</i> , or DSGV), regional savings bank associations ⁶	Institutional protection Provided by: German Savings Banks and Giro Association (<i>Deutscher Sparkassen- und Giroverband</i> , or DSGV), regional savings bank associations ⁷
Other CRR credit institutions	Statutory protection ² Provided by: Compensation Scheme of the Association of German Public Sector Banks (<i>Entschädigungseinrichtung des Bundesverbandes Öffentlicher Banken Deutschlands GmbH</i> , or EdÖ)	Supplementary protection for deposits not covered by deposit guarantee schemes pursuant to the Deposit Guarantee Act up to the full amount ⁸ Provided by: Deposit Protection Fund of the Association of German Public Sector Banks (<i>Einlagensicherungsfonds des Bundesverbandes Öffentlicher Banken Deutschlands e.V.</i>)

¹ Institutional protection schemes of the banking industry at the level of the respective associations; protect member institutions by virtue of statutes in the event of economic difficulties, with support and recovery measures to prevent insolvency. ² Deposit protection covers all savings, time and transferable deposits as well as registered savings bonds. Deposits denominated in euro and foreign currency are covered. Bearer debt securities and certificates are not subject to depositor compensation. Under all of the schemes, claims of up to €100,000 per depositor per institution have to be compensated, with claims of up to €500,000 being permitted in special cases. Protected depositor group: primarily private individuals. In particular, the deposits of credit institutions, institutional investors and public bodies are not protected. ³ BVR Institutssicherung GmbH guarantees statutory compensation claims (depositor compensation) and practises institutional protection. Institutional protection is a recognised form of deposit insurance pursuant to the Deposit Guarantee Act. ⁴ In addition, protection is provided by the BVR's voluntary protection scheme within the framework of the institutional protection function in accordance with its articles of association. ⁵ Gradual lowering of protection ceiling to 8.75% of relevant liable capital by 2025. As an exception to this rule, the protection ceiling for new institutions joining the fund amounts to only €250,000 up to the end of the third calendar year of their participation in the deposit protection fund. All non-bank deposits are protected. ⁶ The previous protection scheme of the Savings Bank Finance Group (Sparkassen-Finanzgruppe) is being expanded to include a deposit protection function. ⁷ Joint-liability scheme. ⁸ Deposits of private individuals, business enterprises and municipalities are protected.

Deutsche Bundesbank

funded *ex ante* have an advantage over *ex post* funded systems in that funds which have already been paid in can be used immediately in a compensation or insurance case; compensation is thus independent of the paying institutions' current profitability and liquidity. The size of contributions, method of calculating them, any relevant one-off contributions and, as appropriate, the minimum volume of the insurance fund are governed by the DGICA or the corresponding legal regulations as well as the associations' own private-law articles of association or statutes.

In order to enhance depositors' confidence in the security of their deposits, which suffered a heavy blow during the financial crisis, the EU Deposit Guarantee Scheme Directive raised the protection limit in two stages, first to €50,000 and then, as of 1 January 2011, to €100,000. In order to be able to cope with these higher harmonised compensation claims, the deposit guarantee schemes needed a higher volume of DGICA funding. In the implementing contribution regulations adopted in 2009, the annual contribution was raised from 0.008% to 0.016% of the assessment base (liabilities vis-à-

Adjusting fund volumes to higher protection limit

vis customers).³ The moderate pattern in the number of compensation cases means that no significant financial sustainability risks have arisen for institutions required to make payments.

Steps towards a more risk-based method of calculating contributions

The Contribution Regulations of the Deposit Guarantee Scheme of German Banks were amended again on 12 December 2011 to introduce criteria for the risk-based calculation of contributions. The aim of calculating contributions in a risk-based manner was to distinguish institutions' contributions by default risk in order to fund the compensation scheme more in accordance with the "polluter pays" principle. The procedures being considered are based largely on the method of calculating contributions that has been practiced for many years already by the voluntary deposit protection fund of the Federal Association of German Banks.

Compensation cases in Germany and consumer confidence

Since the introduction of statutory depositor compensation in Germany, there have been a number of individual compensation cases. In these cases, depositors' claims pursuant to the DGICA were successfully satisfied out of the funds provided by the statutory compensation scheme. The compensation cases also included those in which only the statutory compensation claim applied since the institutions involved were not members of a voluntary deposit guarantee scheme established at the level of the respective banking association.

Further developing the EU Deposit Guarantee Scheme Directive of 1994 at the European level

Experience of and amendments to the EU Deposit Guarantee Scheme Directive since 1998

Directive 94/19/EC was based on the principle of minimum harmonisation. Member states were given the right, in clearly defined cases, to insure depositors above and beyond the harmonised amounts; however, cover provided under national rules was not permitted to be less than that under the binding harmonised rules. This initial harmonisation step within the European Union was not able to fully erase the differences between individual member states' deposit guarantee schemes, such as with regard to the definition of protected depositors. In addition, within the context of subsidiarity, the systems were governed entirely by the member states. In order to comply with calls for harmonised conditions in the financial markets within the EU and to contribute towards the completion of the internal market, at EU level – also in the aftermath of the financial crisis in 2008 – the aim of greater harmonisation of deposit protection was pursued. It was not least the financial crisis which showed just how important depositor confidence is for the ability of the banking market to function properly. Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit protection schemes advanced the cause of harmonisation by increasing the protection limit in stages to €100,000 and reducing the payout delay from three months to 20 working days. Moreover, the amending directive dropped the 10% deductible introduced by the first Deposit

Financial crisis in 2008 and consequences for statutory depositor compensation

³ See Regulations Amending the Contribution Regulations of the Deposit Guarantee Scheme of the Association of German Banks (EdB) and of the Federal Association of Public Banks (EdÖ) of 17 August 2009.

Guarantee Scheme Directive, which was intended to encourage depositors' risk awareness; experience showed that the deductible had no material impact on depositors' behaviour.

Extensive reform of EU deposit protection

Consultation on a more fundamental reform of harmonised deposit protection standards at the European level began in 2010. They culminated in the adoption of the new EU Deposit Guarantee Scheme Directive (2014/49/EU) on 16 April 2014. The starting point was a European Commission proposal which was published on 12 July 2010. The aim was to achieve a more comprehensive harmonisation of national deposit guarantee schemes by largely doing away with the principle of minimum harmonisation and going toward maximum harmonisation and EU-wide harmonisation of the funding of protection schemes, which under existing legislation had been regulated at the national level under the principle of subsidiarity.

Changes brought about by the new EU Deposit Guarantee Scheme Directive of 2014

Maximum harmonisation and improvement of consumer protection

The "new" EU Deposit Guarantee Scheme Directive (2014/49/EU) follows the principle of maximum harmonisation. This means that statutory protection above and beyond the harmonised level is no longer possible. The changes were so material that major sections of the directive had to be rewritten. However, member states, as before, have retained national responsibility for implementing deposit protection in their jurisdictions.

Harmonised funding of protection schemes is based on covered deposits

The new harmonised rules impose specific requirements for the available financial means of protection schemes. The financial means of protection schemes should generally amount to 0.8% of "covered deposits". These deposits, which are now a material determinant for quantifying the funding volume of national deposit guarantee schemes, are defined as deposits which do not exceed the repayable

cover limit of €100,000 per depositor and bank. Under certain conditions based on the concentration of the national banking sector, the target level for available financial means can be reduced by member states to 0.5% of covered deposits. In Germany, with its numerous institutions, the conditions for such a reduction are not met.

The financial means have to be raised within ten years through mandatory *ex ante* contributions by credit institutions. Contribution amounts are based not only on the amount of covered deposits but also on the degree of risk incurred by the credit institution. In order to bring about the uniform use of risk-based amounts with a view to creating a level playing field in the EU, the European Banking Authority (EBA) has developed guidelines for risk-based contributions within the meaning of the EU Deposit Guarantee Scheme Directive. Financial means also include irrevocable payment commitments of banks, the share of which shall not exceed 30% of the total amount of available financial means. The EBA has also developed guidelines on the uniform application of such irrevocable payment commitments pursuant to the Deposit Guarantee Scheme Directive (EBA/GL/2015/09 of 28 May 2015).

Coverage remains limited to a maximum of €100,000 per customer and credit institution. This limit applies to any depositor known by name, ie to any "identifiable" depositor. Pursuant to the Deposit Guarantee Scheme Directive, "eligible" deposits include primarily those by individuals. Deposits by financial institutions, investment firms, pension and retirement funds, insurance undertakings or public authorities are therefore not protected. Member states which had higher national statutory coverage levels when the directive entered into force have until the end of 2018 to reduce the limit protection to €100,000.

The directive added a social welfare component to the harmonised protection limit: certain deposits that relate to personal affairs or social

New financial means in detail

Limit of coverage for protected depositors still €100,000

welfare are given a higher level of protection. Such deposits include those resulting from real estate transactions relating to private residential properties or contributions which serve social purposes laid down in national law. In the case of a depositor's life events, such as marriage, divorce, retirement, dismissal, redundancy or invalidity, deposits in excess of €100,000 are protected for a period of up to twelve months.

Funds can also be used for resolution and ...

The statutory deposit protection scheme's available financial means are primarily intended for repaying depositors. However, the funds can now also be used for the resolution of credit institutions. The resolution authority, following consultation with the deposit guarantee scheme, shall determine the amount by which the deposit guarantee scheme is liable.⁴

... alternative measures

The directive also provides for alternative measures to be taken as part of an expanded deposit protection mandate. Within the meaning of the directive, alternative measures are construed to be such uses of funds that serve to prevent the failure of an affiliated credit institution. However, this is permitted only if the resolution authority has not undertaken any resolution action, and only on the condition that the costs of the measure do not exceed the costs of fulfilling the statutory mandate of the deposit guarantee scheme.⁵

Improved information and faster repayment

For depositors in Europe, the directive distinctly improves their potential claims to repayment in several ways. One is that the repayment period has been reduced from 20 to seven working days. Another is that the deposit guarantee schemes are now required to make available to depositors improved information about how their deposits are being protected. Moreover, there is, across Europe, an obligation to provide a pre-defined target level of *ex ante* funding, which means that the statutory deposit guarantee scheme has the means to satisfy its payment obligations in the same way across Europe.

The directive allows member states to permit their deposit guarantee schemes to lend to other deposit guarantee schemes within the EU under certain conditions if the borrowing member state's available financial means are insufficient to fulfil obligations to its depositors. As lending between individual member states' deposit guarantee systems is voluntary, there is no provision for a general communitisation of risks arising from deposit insurance.

Deposit guarantee schemes can lend to one another across borders on a voluntary basis

The new Deposit Guarantee Scheme Directive implemented in Germany in July 2015 by the Deposit Guarantee Act

Changes for all deposit guarantee schemes

Member states had until 3 July 2015 to transpose the provisions contained in the "new" EU Deposit Guarantee Scheme Directive 2014/49/EU (DGSD) into national law. This was accomplished in Germany by means of the Act Implementing the DGSD (*DGSD-Umsetzungsgesetz*). On the basis of this act, the DGICA, which implemented the EU Deposit Guarantee Scheme Directive and the EU Investor Compensation Directive jointly, was split up into two separate acts: a Deposit Guarantee Act (*Einlagensicherungsgesetz*) to implement the requirements imposed by the Deposit Guarantee Scheme Directive and a largely unchanged Investor Compensation Act (*Anlegerentschädigungsgesetz*).⁶ This means that repayment claims for securities transactions remain capped at 90% of the

Deposit Guarantee Act and Investor Compensation Act: separate items of legislation

⁴ See Article 11 (1) and (2) of the Deposit Guarantee Scheme Directive.

⁵ For details, see Article 11 (3) of the Deposit Guarantee Scheme Directive.

⁶ The EU Investor Compensation Directive has not been reformed hitherto, so the broadly similar path followed by the two sets of legislation has been broken. The Investor Compensation Act will incorporate the current DGICA provisions governing investor compensation without substantively amending the existing legal status quo.

liabilities from securities transactions and an equivalent value of €20,000.

Broad statutory protection requirement and enlarged group of deposit guarantee schemes ...

In order to statutorily ensure a comprehensive protection requirement, all credit institutions covered by the Capital Requirements Regulation (CRR) have been required to join a statutory deposit guarantee scheme since July 2015. Institutions will continue as before to be assigned by group of institution to statutory depositor compensation schemes for private and public banks. In addition, those institutions which had previously been exempted from membership of a statutory depositor compensation scheme owing to membership of an institutional protection scheme are now also subject to a statutory obligation to compensate depositors.

... involving two types, ...

The Deposit Guarantee Act generally envisages two types of protection schemes in order to compensate depositors as required by law:

- deposit guarantee schemes which repay depositors only if a bank has declared insolvency (statutory compensation schemes) and
- institutional protection schemes which focus on assisting member institutions and which can apply to be recognised as deposit protection schemes.

... but no provisions governing cross-border lending

No provisions governing possible cross-border lending to deposit guarantee schemes in other EU member states were incorporated into the Deposit Guarantee Act.

Uniform per depositor level of statutory depositor protection at all CRR institutions

The Deposit Guarantee Act sets forth general rules which are applicable to all deposit guarantee schemes with regard to statutory depositor protection and also additional requirements which apply specifically to recognised institutional protection schemes. In general, every depositor at a CRR credit institution has a legal right to repayment up to the limit on protection of €100,000, irrespective of where the CRR credit institution is grouped; this means that as of now, depositors of an institutional

protection scheme have this legal right as well. The act defines as protected deposits credit balances, including time deposits and savings deposits, to be repaid by a CRR credit institution pursuant to the applicable laws and contractual terms. Even foreign currency deposits are protected, although they will be repaid in euro.

Since the directive has opened up the possibility of increasing the coverage amount for social welfare reasons, the Deposit Guarantee Act has envisaged an increase in the level of depositor protection to up to €500,000 for a period of up to six months after crediting of the amount provided the credited amounts are connected to certain major "life events" of the depositor such as those listed in the EU DGSD and are therefore deemed particularly worthy of protection.

As envisaged by the directive, all deposit guarantee schemes governed by the Deposit Guarantee Act are required to raise, by 2024, available financial means of up to 0.8% of covered deposits by collecting contributions from the institutions belonging to the respective schemes. If a deposit guarantee scheme has used more than 0.8% of the amount of the covered deposits for payouts by the end of 3 July 2024, the period during which the respective deposit guarantee scheme must reach the target level shall be prolonged until the end of 3 July 2028. In order to identify the respective target funding amount, institutions are required to report once a year (starting at the 31 January 2016 reporting date) the amount of covered deposits as of 31 December of the previous year to the deposit guarantee scheme pursuant to the Deposit Guarantee Act.⁷

The Deposit Guarantee Act also opens up the possibility, envisaged in the directive, of funding up to 30% of the available financial means through irrevocable payment commitments.

Higher level of depositor protection for certain life events deemed worthy of protection

Rules for raising financial means for the deposit guarantee scheme through regular contributions and ...

... irrevocable payment commitments

⁷ Such data have not yet been collected under the previous legal basis created by the DGICA.

The EBA guidelines are also of relevance here. Under these guidelines, for instance, the payment commitments should be able to be recognised only if they are fully collateralised and the collateral is available to the deposit guarantee scheme. The collateral shall consist entirely of low-risk assets and shall be unencumbered by any third-party rights.

Greater resilience through extraordinary contributions and extraordinary payments

The protection schemes are entitled to levy a number of extraordinary contributions and extraordinary payments per accounting year. Extraordinary contributions are payments made to cover the funds required if a compensation event occurs, whereas extraordinary payments are used for the repayment of loans taken out to cover the required funds. There are, however, limits with regard to the amounts that can be demanded from contributory institutions. Each year, member institutions can be required to pay a maximum of 0.5% of their covered deposits as extraordinary contributions or extraordinary payments if accumulated funds prove insufficient to finance a current compensation event. With the consent of the German Federal Financial Supervisory Authority (BaFin), the statutory deposit guarantee scheme can, in exceptional circumstances, demand higher extraordinary contributions in order to safeguard the functional viability of the compensation scheme. The deposit guarantee scheme may also borrow funds to cover temporary financing needs.

EBA guidelines for risk-based contributions

The risk-based calculation of contributions stipulated in the directive, and which has now been made compulsory by the Deposit Guarantee Act, has essentially already been implemented in Germany, as the German protection schemes already have risk-based contribution systems in place. The EBA's guidelines for risk-based contributions drafted in accordance with the directive are to be implemented by the competent authorities by the end of 2015. They stipulate that 75% of the calculation base is to be constituted by compulsory, ie harmonised, categories with predefined indicators, while the remaining 25% can be specified

according to national criteria in order to take account of particular national requirements. In Germany, the details governing the levying of contributions are not set out in the Deposit Guarantee Act, but rather in a separate regulation for statutory deposit guarantee schemes and in articles of association for recognised institutional protection schemes.

The Deposit Guarantee Act shortens the repayment deadline for depositor compensation from 20 working days at present to seven working days as of 31 May 2016, as required by the directive. While it is true that the Directive on Deposit Guarantee Schemes provides an option of incrementally reducing the repayment deadline from 20 to seven working days over a ten-year period, in Germany it has been decided to switch over in a single step in the interest of enhancing depositor protection.

Shortening of the repayment deadline

The EU's Directive on Deposit Guarantee Schemes gives member states the option of creating a legal basis that allows deposit protection schemes to also use their funds for support measures. On this basis, the German implementing legislation allows officially recognised institutional protection schemes to carry out such measures provided that they meet the requirements stipulated in the Deposit Guarantee Act.

Support for institutions possible under Deposit Guarantee Act

A statutory deposit guarantee scheme also protects deposits held at branches of German institutions in other EU member states. While the deposit guarantee scheme of the host member state is responsible for administering the depositor compensation, the necessary funds are provided by the deposit guarantee scheme of the home member state before payouts are made. Similarly, compensation in Germany for deposits at branches of institutions from other EU member states is carried out in the name of the deposit guarantee scheme of the home member state. As there are several statutory deposit guarantee schemes in Germany, BaFin designates the deposit protection scheme responsible for settling the compensation

Depositors at branches in other EU countries protected by Deposit Guarantee Act

event. In most cases, this will be the Compensation Scheme of the Association of German Banks (EdB).

Changes affecting deposit guarantee schemes of private and public-sector banks

Previous system used under DGICA to be maintained

The Deposit Guarantee Act retains the existence of two statutory compensation schemes, one for private-sector CRR credit institutions and one for public-sector CRR credit institutions. The pre-existing statutory compensation schemes (EdB and EdÖ) can therefore continue to carry out their functions as “entrusted compensation schemes”. BaFin assigns institutions to the relevant compensation scheme on the basis of the institution’s legal form. Upon request, BaFin can alter a credit institution’s assignment to a compensation scheme.

New provisions on the accumulation and use of funds

The deposit guarantee schemes of private and public-sector banks must fulfil the provisions that have been transposed into German law on the basis of the new Directive on Deposit Guarantee Schemes, particularly those on compensation and the accumulation and use of funds. On the whole, however, the changes in connection with the new directive are relatively limited for this group of institutions, as they do not entail any major material changes to the deposit guarantee schemes.

Changes to institutional protection schemes

Institutional protection schemes hitherto not covered by the statutory framework

Up until now, institutional protection systems were classed as alternative systems and did not fall within the statutory framework of the DGICA and were essentially exempt from its rules. Pursuant to the DGICA, they were, however, already subject to supervision by BaFin.

Pursuant to the Deposit Guarantee Scheme Directive, all CRR credit institutions must join a recognised deposit guarantee scheme. For Ger-

many, this comprehensive statutory protection requirement means that institutions which are members of the voluntary protection schemes of the *Sparkassen-Finanzgruppe* (DSGV) or the Federal Association of German People’s Banks and Raiffeisen Banks (BVR) now explicitly fall within the remit of the Deposit Guarantee Act. The amended EU Deposit Guarantee Scheme Directive is therefore of special significance for institutional protection schemes in Germany.

The existing institutional protection schemes, ie the DSGV and the BVR, had to decide whether to be recognised as institutional protection schemes within the meaning of the Deposit Guarantee Act or whether to fulfil the statutory depositor compensation requirements through separate, organisationally segregated structures. Both institutional protection schemes have been recognised as deposit guarantee schemes by the competent authority, BaFin, and are thus subject to full BaFin supervision pursuant to the Deposit Guarantee Act. Institutions that belong to an institutional protection scheme which is recognised as a deposit guarantee scheme are exempt from being assigned to another statutory deposit guarantee scheme (section 24 (5) Deposit Guarantee Act).

A recognised institutional protection system must provide identical depositor protection for all affiliated CRR credit institutions. Moreover, its organisation, financing and use of funds must comply with the statutory requirements. The basis of any institutional protection scheme continues to be its own articles of association, in which the requirements of the CRR and the Deposit Guarantee Act are implemented.

In addition to the general requirements applicable to all protection schemes, additional legal requirements apply for the recognition of institutional protection schemes. The conditions necessary for liability arrangements, which protect the institutions and, where necessary, ensure their liquidity and solvency, must be fulfilled in accordance with Article 113 (7) of the CRR. Institutional protection schemes must

All CRR credit institutions must join a recognised deposit guarantee scheme

Need for action on the part of existing institutional protection schemes

General legal requirements for institutional protection schemes

Additional legal requirements for institutional protection schemes

additionally provide "reasonable assurance" of the orderly performance of their tasks pursuant to the Deposit Guarantee Act, which means there must be at least two reliable and suitably qualified managers. Furthermore, a suitable supervisory body is required which is subject to the conditions of reliability pursuant to section 25d (1) of the German Banking Act (*Kreditwesengesetz*). The available funds must be administered and invested separately from the scheme's other assets. Moreover, the institutional protection scheme must dispose of suitable and uniformly regulated systems for the monitoring and classification of risk so as to enable a complete overview of the risk situations of all the individual members and the institutional protection scheme as a whole. In order to be able to react to a deterioration in the risk situation, the institutional protection scheme must be able to exercise influence over its member institutions.

Legally compliant articles of association

The articles of association must comply with the minimum statutory requirements stipulated in the Deposit Guarantee Act and include rules on the following points in particular: contributions, conditions for carrying out support measures, inspection rights, information rights and disclosure rights, conditions for and scope of forwarding the organisation's own secrets and those of other parties, rules on potential borrowing, rules on the transfer of funds to another deposit guarantee scheme in the case of recognition being revoked, rules on the exclusion of a member institution and rules on changes to the articles of association. Furthermore, liability arrangements must ensure that the institutional protection scheme can meet its obligations and provide the necessary support using funds that are readily available to it.

Support measures are possible under certain conditions

On this statutory basis, a recognised institutional protection scheme remains entitled to carry out measures to avert a going concern risk, particularly to ensure the liquidity and solvency of a member institution. However, with regard to such support measures, the institutional protection scheme is subject to new

statutory requirements pursuant to section 49 of the Deposit Guarantee Act, including the following:

- the resolution agency must not have undertaken any resolution measures
- the costs of the measures to avert a going concern risk may not, in principle, be higher than the costs that would be incurred by providing compensation for the covered deposits
- conditions must be imposed which, at the very least, entail stricter risk monitoring and more extensive inspection rights for the protection scheme than under the previous provisions
- the funds used for support measures must be repaid, through extraordinary contributions where necessary, if depositors need to be compensated and funding equals less than two thirds of a statutory deposit guarantee scheme's target level or if the available funds are less than 25% of the target level⁸
- BaFin must, following an evaluation, confirm the ability of the member institution to pay the required extraordinary contribution.

Contributions raised by recognised institutional protection schemes must comply with the EBA guidelines, the provisions of which are to be implemented by the competent authorities by the end of 2015. The EBA guidelines stipulate that contributions are not only to be based on the level of covered deposits, but must also appropriately take institutional risk into account. This accommodates the institutional protection schemes in particular, as their central institutions, on account of their business model, gen-

Contributions based on the respective articles of association and in compliance with EBA guidelines

⁸ The target level, at 0.8% of covered deposits, is the same for all protection schemes and is to be achieved within ten years of the Deposit Guarantee Act entering into force.

erally have only a relatively low level of covered deposits in relation to total assets.

Recognised institutional protection schemes provide a statutory right to compensation

With regard to strengthening trust, it is to be welcomed that depositors at institutions that are members of a recognised institutional protection scheme will, in future, also have a statutory right to compensation for their deposits up to an amount, in principle, of €100,000, even though this right will not need to be exercised if the institutional protection scheme is invoked. However, as the member institutions of the institutional protection schemes still do not have a legal entitlement to receive support measures and a default on the part of an institution cannot be completely ruled out, the statutory right to compensation for depositors now in place represents a substantial improvement for the depositor. Therefore, in principle, the same statutory deposit protection conditions apply to all deposit-taking institutions in Germany.

Implementation at the level of the individual associations

Existing institutional protection schemes can choose their own implementation method

The new Deposit Guarantee Scheme Directive and the Deposit Guarantee Act do not provide detailed requirements on how the parts of the new legal requirements specific to institutional protection schemes are to be implemented. The associations therefore have a certain degree of flexibility.

Liability arrangements pursuant to Article 113 (7) CRR a prerequisite

The requirements of Article 133 (7) CRR on the application of zero risk weights and on the non-deduction of participating interests in other institutions within the same institutional protection scheme stipulate that the institutional protection scheme must be able to grant support necessary under its commitment using funds readily available to it. In addition, the institutional protection scheme must be able to monitor risks and take influence.

With regard to risk management of the institutional protection schemes, Article 113 (7) CRR

requires uniformly regulated systems for the monitoring of the classification of risk, which should provide a complete overview of the risk situations of all the individual members and the institutional protection scheme as a whole. In order to be able to react to a deterioration in the risk situation of member institutions, the CRR foresees possibilities to exert influence.

Due to their differing situations, the associations were faced with different challenges in terms of fulfilling the new statutory requirements to be recognised as institutional protection schemes.

The previous structure of the BVR's institutional protection scheme consisted of a guarantee fund and a guarantee network (BVR protection scheme). In order to set up a system recognised as an institutional protection system, the BVR set up a separate company as a wholly-owned subsidiary (*BVR Institutssicherung GmbH*, hereinafter referred to as BVR-ISG) with the aim of operating a recognised institutional protection scheme. BVR-ISG is operated in parallel to the BVR protection scheme with largely similar structures (hence the term "dual protection system"). The BVR protection scheme is still operated in its original form as an institutional protection system at the level of the association, but without official recognition.

Previous and amended structure of the BVR protection scheme ("dual protection scheme")

BSV-ISG has an opening balance of funds provided by the BVR protection scheme. Its funds must be accumulated in accordance with the requirements of the Deposit Guarantee Act by 2024. A liability arrangement between the BVR protection scheme and BVR-ISG ensures that the funds of the BVR protection scheme are also readily available to BVR-ISG.

Funding of the BVR-ISG

Membership in the BVR-ISG exists in parallel to membership in the BVR protection scheme. All domestic CRR credit institutions that are members of the BVR and the BVR protection scheme are also members of BVR-ISG. Accession takes place via a special declaration of accession and commitment.

Members of BVR-ISG

Institutional protection scheme will continue with a decentralised structure

In contrast to the liability structure of the BVR, which was already centralised, the institutional protection scheme of the Savings Bank Finance Group undertook changes, on account of its decentralised and regional structure, to meet the requirements of a uniformly run system. This concerns, in particular, the decision-making framework necessary for support measures within the regional protection schemes.

Recognition of the Savings Bank Finance Group's protection scheme

The members of the DSGV adjusted the protection scheme of the Savings Bank Finance Group in May 2015 to bring it into line with legal requirements. The principle of institutional protection for all German savings banks, Landesbanken and state building and loan associations has been retained in this process. The function of institutional protection continues to be assumed by the existing protection schemes of the Savings Bank Finance Group.

Compensation function centralised within the DSGV for the entire group

However, as required by the Deposit Guarantee Act, the previous institutional protection scheme is being supplemented with a deposit protection function. In the case of a compensation event, the DSGV will perform the protection function centrally for the entire group.

Member institutions do not have a legal right to receive support measures

Under the institutional protection schemes recognised in Germany, member institutions do not have a legal right to receive support measures. Although the provisions of the Deposit Guarantee Act do not provide member institutions with an enforceable legal right to receive support, the private-law articles of association of the respective association do, however, contain support commitments in the context of institutional protection that stress the association's mandate of solidarity. However, a new aspect for institutional protection schemes is that support measures within the statutory framework can only be granted if the aforementioned conditions of section 49 of the Deposit Guarantee Act (see page 56) are met.

Outlook: deposit protection and banking union

The "five presidents" of the various European institutions presented a report in May 2015 containing objectives for the completion of economic and monetary union. Among other things, it called for the creation of a common European Deposit Insurance Scheme (EDIS). The European Commission has since added further substance to this objective and presented a roadmap with a step-by-step approach to implementing EDIS. According to this roadmap (see the box on page 59), the European deposit insurance scheme would begin as a re-insurance system for national insurance schemes as of 2017 and enter a co-insurance phase as of 2020, by which time the share of contributions and possible compensation payments borne by EDIS would increase each year. As of 2024, EDIS alone would be responsible for covering all compensation events. The proposal of the European Commission builds on the idea of creating a banking union, according to which the common deposit insurance scheme would constitute the third pillar alongside the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM). The European Commission's rationale for EDIS is to be better able to contain, in a European context, the effects of economic shocks that affect one country and overwhelm its national deposit guarantee scheme. EDIS is also intended to reduce the dependence of banks on the economic situation of their respective country. Overall, through this approach, it is hoped that the trust of depositors in the security of deposits in a European context will be strengthened.

Deposit protection as the "third pillar" of the banking union

However, important preconditions for a European deposit insurance scheme are not yet met. Further steps towards integration in Europe are necessary before a European deposit insurance scheme can be created.

A key precondition for a common deposit insurance scheme is de-risking at banks. In

De-risking at banks necessary

European Commission's plans for a European Deposit Insurance Scheme

The European Commission published a proposal to amend the Single Resolution Mechanism (SRM) Regulation on 24 November 2015. This outlines a European Deposit Insurance Scheme (EDIS), to be established in three sequential stages.

The first stage would be a re-insurance scheme from 2017 to 2019, followed by a co-insurance stage from 2020 to 2023 and, finally, full insurance from 2024 onwards. In the third stage, a central fund is to be created which would ultimately assume the full deposit protection function for all member states participating in the Single Supervisory Mechanism, or SSM. In the full insurance phase from 2024 onwards, it is envisaged that the national deposit guarantee schemes, which have been established in line with the EU Deposit Guarantee Schemes Directive up until now, will cease to function independently. The share of the institutions' contributions to the national guarantee schemes – which have received all of the resources up until now – would gradually decrease over the individual stages, while the contributions to the common EDIS fund would increase correspondingly. As the European-level fund grows, the financial contributions to be made by EDIS, too, would rise steadily during the first two stages. If compensation needs to be paid out during the first stage of "re-insurance", the national fund would be first in line to cover these compensation payments. Once the compensation funds at the national level have been fully depleted, EDIS would, during this stage, provide liquidity of up to a maximum of 20% of the refund costs, and the national guarantee schemes would have to pay back these funds to EDIS. According to the European Commission's plans, in the second stage (co-insurance),

the national deposit guarantee schemes would only have to pay part of the compensation from their own funds before seeking EDIS funding. There would thus be a gradual introduction of risk-sharing across all participating states. In the final phase, it is assumed that risks will be shared in full among all participating member states. In this phase, all compensation cases in the participating states would be paid out via EDIS. The European Commission's plans envisage that the Single Resolution Board, or SRB, which has already been established at the European level, should assume responsibility for implementing European deposit protection, in the form of EDIS, together with the participating national deposit guarantee schemes (or the authorities designated responsible for administering the participating deposit guarantee schemes). Participation would ultimately be compulsory for all euro-area member states, while the idea is that non-euro-area member states could voluntarily participate in the SSM and thus automatically enrol in the SRM and the common European Deposit Insurance Scheme.

addition to the supervisory rules that have already been adopted, abolishing the preferential supervisory treatment of sovereign exposures could also make a significant contribution in this regard, as it would help make the economic situation of banks less dependent on the situation of their respective home country. Otherwise, were the home country to default, there would be a danger of the direct economic fallout being communitised under EDIS via the direct effects on national banks. Ultimately, there would be a danger that the deposit guarantee scheme would, indirectly via this contagion channel, be made liable for the sovereign debt of other countries.

Harmonisation of insolvency law required in the individual member states

Another key point is insolvency law. Rules governing corporate or personal insolvency have direct consequences for the risk situation of banks and the burden that creditors must bear in the event of insolvency. If a common European deposit guarantee scheme were to be set up without the requisite preconditions being in place, the consequences of insolvency regimes that favour the national private sector over creditor banks could, for example, be communitised. Barriers to rapid compulsory enforcement by lenders are an example of such favourable treatment. Differences in the speed of integration would obviate the alignment of liability and control, which is necessary for rational economic decision-making. Significant

steps are still needed in order to prevent false incentives and undesirable economic consequences. Until these steps have been taken, a common European deposit insurance scheme must be rejected.

The European Commission also sees dangers in its plan and highlights the necessary steps that must be taken in advance, such as de-risking at banks, the harmonisation of insolvency law and the implementation of the Bank Recovery and Resolution Directive (BRRD) in all member states. The implementation of this directive across all EU countries would reduce the likelihood of the deposit insurance scheme being called upon, as it increases banking supervisors' powers of early intervention if institutions appear to be at risk and strengthens the position of covered deposits because of the bail-in rules for other liabilities. The European Commission also points out the need for the Deposit Guarantee Scheme Directive to be implemented in all member states and for the national target amounts to be attained in conformity with the directive. It is therefore important that the steps taken are made in the correct order, ie that all necessary preconditions are in place before a common deposit insurance scheme is created and that the objective of stability is not jeopardised by an ambitious timetable for creating a common deposit insurance scheme, which could run counter to this objective.