Proposal COM(2023) 228 of 18 April 2023 for a **Directive** amending Directive 2014/49/EU **as regards the scope of deposit protection, use of deposit guarantee schemes funds, cross-border cooperation, and transparency**

DEPOSIT INSURANCE

cep**PolicyBrief** 12/2023

LONG VERSION

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Key elements of the EU proposal

Note: Unless otherwise indicated, the article references in this cepPolicyBrief refer to the proposal for an amended Deposit Guarantee Schemes Directive [COM(2023) 228].

1 Context and objectives

- In the wake of the global financial crisis, the European legislature established a crisis management and deposit insurance (CMDI) framework to facilitate the orderly resolution of failing banks, safeguard financial stability, preserve taxpayers' money and enhance the protection and confidence of depositors (p. 1).
- The current CMDI framework mainly consists of the following three legal acts (p. 1):
  - the Bank Recovery and Resolution Directive (BRRD, 2014/59/EU), which lays down rules and procedures relating to the recovery and resolution of banks (see cep**PolicyBrief 1** and cep**PolicyBrief 2**);
  - the Single Resolution Mechanism Regulation (SRMR, (EU) No 806/2014), which
    - lays down uniform rules and a uniform procedure for the resolution of banks that are established in participating Member States, i.e. Member States whose currency is the euro (see cep**PolicyBrief**), and
    - establishes the Single Resolution Board (SRB) and the Single Resolution Fund (SRF); and
  - the Deposit Guarantee Schemes Directive (DGSD, 2014/49/EU), which lays down rules and procedures relating to the establishment and the functioning of deposit guarantee schemes (DGSs) (see cep**PolicyBrief**).
- On 18 April 2023, the Commission published a set of legislative proposals to revise the current CMDI framework (CMDI reform) including amendments to the BRRD [COM(2023) 227], the SRMR [COM(2023) 226] and to the DGSD [COM(2023) 228].
- The CMDI reform aims to establish a more consistent approach to bank resolution and to improve the existing depositor protection framework. Among other things, it aims to increase the incentives for small and medium-sized banks to resort to the European bank resolution frameworks, ensure a more coherent application of the depositor protection rules and achieve a level playing field in this regard. [p. 1]
- In this cep**PolicyBrief** we take a closer look at the revision of the DGSD. The DGSD harmonizes the mechanisms for the protection of depositors in the EU. It obliges Member States to establish at least one national deposit guarantee scheme (DGS) and sets the harmonized level of depositor protection at € 100,000. Beyond reimbursing protected deposits in case of a bank failure, a DGS can also contribute to bank resolution and other measures in order to safeguard depositors' money. [p. 2 and 3]
- The Commission wants to revise the DGSD, because it has identified [p. 3]
  - concerns about the scope of depositor protection,
  - that the conditions for using DGS funds other than for the payout of covered deposits are interpreted differently among Member States,
  - deficiencies in the operational effectiveness and efficiency of DGSs,
  - too much scope for interpretation of the rules by the Member States ("national discretions and options"), and
  - a need for better coordination between resolution and deposit insurance safety nets.
- Consequently, the proposed DGSD revision aims, in particular, to [p. 4]
  - clarify the scope of depositor protection,
  - establish clear rules on the use of preventive and alternative measures, i.e. DGS interventions other than the payout of covered deposits,
  - simplify the existing administrative procedures of DGSs to enhance their functioning,
  - increase convergence of DGS practices, and
  - strengthen the cross-border cooperation between DGSs.

2 Scope of depositor protection

The Commission proposes to clarify the scope of depositor protection, further harmonise the standards of depositor protection, and extend it to cover further types of depositors and deposits:

2.1 Treatment of deposits of public authorities

- Currently, the bank deposits of public authorities are excluded from any repayment by a DGS [Art. 5 (1) (j)]. However, Member States may decide that deposits held by local authorities with an annual budget of up to € 500,000 euro are protected up to the coverage level of € 100,000 [Art. 5 (2)].
- In future, the deposits of public authorities will no longer be excluded and will generally be protected up to the coverage level of € 100,000 [deleted Art. 5 (1) (j) and (2)].

2.2 Treatment of dormant accounts

- Currently, DGSs must, in general, repay deposits within seven working days [Art. 8 (1)]. However, they may defer repayments in case of "dormant accounts", i.e. accounts where there has been no transaction relating to the deposit within the last 24 months. Where the value of the deposit in the dormant account is lower than the administrative costs that would be incurred by the DGS in making such a repayment, the DGS is not obliged to make a repayment at all. [Art. 8 (9)]
- In future, DGSs may still defer repayments in the case of dormant accounts, except where a depositor also has deposits on another account with the same bank that is not dormant [new Art. 8 (5) (c)]. Furthermore, in future, DGSs do not proactively have to repay depositors of dormant accounts, if the deposits of those depositors are below a threshold of administrative costs set by the respective DGSs. However, if requested by the respective dormant account holder, DGSs are obliged to repay. [new Art. 8 (9)]

2.3 Treatment of client funds deposits

- "Client funds deposits" are funds deposited with a bank by account holders that are non-bank financial institutions – investment firms, e-money and payment institutions –for the account of their clients [new Art. 2 (1) (20)].
- In future, such client funds deposits will be specifically covered by DGSs, if [new Art. 8b (1)]
  - they are placed on behalf and for the account of clients, whose deposits are eligible for deposit protection,
  - they are deposited by the non-bank financial institutions in compliance with requirements on safeguarding and segregating client funds, and
  - the clients of the non-bank financial institutions are identified or identifiable.
- DGSs must repay client funds deposits to [new Art. 8b (3)]
  - the account holder for the benefit of each client, or
  - the clients directly.

2.4 Treatment of temporary high balances

- Currently, Member States must ensure that certain deposits are protected [Art. 6 (2)]
  - above the standard coverage level of € 100,000 , and
  - for at least three and no longer than 12 months.

  This applies to deposits [Art. 6 (2)]
  - resulting from real estate transactions relating to private residential properties,
  - that serve social purposes; e.g. deposits linked to retirement, marriage or redundancy, and
  - that serve purposes such as the payment of insurance benefits.
- In future, Member States must ensure that certain deposits are protected [new Art. 6 (2)]
  - as a minimum to an amount of € 500,000, and
  - for 6 months.

  This applies to deposits [new Art. 6 (2)]
  - resulting from and intended for real estate transactions relating to private residential properties, and only if concluded in the short term by a natural person who can prove such transaction,
  - that serve social purposes; e.g. deposits linked to retirement, marriage or redundancy, and
  - that serve purposes such as the payment of insurance benefits.

  In future, the burden of proof of whether these conditions are met, and of whether there is an absolute entitlement to the deposits lies with the depositor [new Art. 7a].

2.5 Treatment of liabilities fallen due and negative interest rates

- Currently, depositors' liabilities against a bank must not be considered when calculating the repayable amount. However, Member States may decide that liabilities, which have fallen due, are considered, if this is possible under statutory and contractual provisions. [Art. 7 (4) and (5)] In future, Member States will no longer have this option and thus, liabilities in general must not be considered [deleted Art. 7 (5)].
- Currently, DGSs must reimburse interest on deposits which has accrued but has not been credited [Art. 7 (7)]. In future, interest that has not been "debited" must also be reimbursed to reflect situations where interest rates are negative [new Art. 7 (7)].

3 DGS interventions

- Currently, there are basically two mandatory and two optional – at the discretion of Member States – types of DGS interventions [Art. 11]:
  - The two mandatory types are (1) the payout of depositors as a consequence of the failure of a bank and (2) support in the financing of resolution actions.
  - The two optional types are (1) preventive measures to avoid a bank's failure and (2) alternative measures in insolvency proceedings.
- Now, the Commission proposes to clarify and harmonise the conditions for the use of the four different types of intervention:

3.1 Payout of depositors

- As currently, the available financial means of DGSs will primarily be used to repay depositors [old and new Art. 11 (1)]. In future, this will apply "without prejudice" to using additional financial means collected by DGSs in order to fulfil DGS mandates not related to depositor protection. [new Art. 11(1)]

3.2 Financing the resolution of a bank

- Currently, the available financial means of DGSs "shall" also be used to contribute to the financing of the resolution of a bank. The resolution authority determines the amount for which a DGS is liable, after having consulted the DGS. [Art. 11 (2)]
- In future, such consultation must include consideration of the results of a harmonized "least cost test" (see also chapter 3.5) which compares the estimated cost of resolution financing with the estimated cost of a depositor's payout [new Art. 11 (3), new Art. 11e].

3.3 Alternative measures

- Currently, if Member States allow it, the available financial means of DGSs "may" also be used to finance "alternative measures", i.e. measures to preserve depositors' access to covered deposits in national insolvency proceedings, such as measures to support the transfer of deposits and assets of the failing bank to another bank (e.g. via cash contributions or guarantees). Such measures may only be enacted if their costs are lower than compensating covered depositors of the bank [Art. 11 (6)]. In future, such "alternative measures" may only be applied, if [new Art. 11 (5), Art. 11d and Art. 11e]
  - the DGS concerned confirms that the costs are lower than compensating covered depositors, applying a harmonized "least cost test" and
  - the bank concerned markets the bank's assets, rights and liabilities that it intends to transfer in a way that it can be regarded as
    - open and transparent,
    - non-discriminatory with respect to potential purchasers,
    - free of any conflict of interest, and
    - aiming at maximizing the sale price.

3.4 Preventive measures

- As currently, if Member States allow it, the available financial means of DGSs "may" also be used to finance "preventive measures", i.e. measures to support a bank in distress to prevent its failure (e.g. via capital instruments, guarantees or loans) [Art. 11 (3)].
- Currently, such preventive measures may only be enacted by a DGS, if [Art. 11 (3) and (4)]

- there has not been any resolution action taken by the resolution authority yet; such resolution action being conditional on
  - the competent authorities' and, if provided for by a Member State, the resolution authorities' determination that the bank is failing or likely to fail,
  - the lack of any reasonable prospect that alternative private sector measures would prevent the bank's failure within a reasonable timeframe, and
  - it being necessary "in the public interest";
- the competent authority concludes that the conditions for resolution are not yet met.
- their costs do not exceed the costs of fulfilling the DGS's statutory or contractual mandate,
- their use is linked to conditions imposed on the bank that is supported by the DGS, and
- the bank that is being supported commits to secure access to covered deposits.

- ► In future, such preventive measures may only be enacted by a DGS, if [Art. 11 (3), Art. 11a, Art. 11b and Art. 11e]
  - the resolution authority, in consultation with the competent authority, has not yet concluded that the bank is failing or is likely to fail,
  - the DGS concerned confirms that the costs are lower than the cost of compensating covered depositors, applying a harmonized "least cost test",
  - the bank requesting support presents to its competent authority a "note" with measures which it commits to undertake to strengthen its liquidity and capital position and to limit the outflow of funds, and consults on those measures with the authority,
  - their use is linked to conditions imposed on the bank that is supported by the DGS,
  - the bank that is being supported commits to secure access to covered deposits, and
  - the designated authority confirms that all the conditions mentioned here have been met.

- ► The "note" that banks requesting support must present to their competent authority must [Art. 11b (1)–(4)]
  - contain all actions that the bank commits to undertake,
  - in case of a capital support measure, specify the capital raising measures the bank can implement, and
  - in case of a liquidity support measure, provide for "a clearly specified repayment schedule".

  The envisaged preventive measures in the note must be in alignment with [Art. 11b (5) and (6)]
  - the capital conservation plan, i.e. a plan that banks must prepare, in case they fail to meet their respective combined capital buffer requirement, and
  - the restructuring plan, i.e. a plan that banks must submit to the Commission, if the EU State aid framework is applicable.

- ► In future, DGSs must inform their competent authority, in case a bank cannot fulfil the commitments envisaged in the note and is not able to repay the support granted. If this is so, the competent authority has to request a "remediation plan" from the concerned bank. If it is not convinced of the plan's credibility or feasibility, the DGS must cease to provide preventive support to the bank. [Art. 11c]

- ► Currently, financial support provided by DGSs in the context of preventive measures, in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability, may be considered "extraordinary public financial support". This, by implication, may force resolution authorities to conclude that a bank is failing or likely to fail, triggering a bank's resolution and undermining the aim of the preventive measure in the first place. [Art. 32, BRRD] In future, financial support provided by DGSs in the context of preventive measures will not be considered "extraordinary public financial support", if [Recital 17, new Art. 32 (1) (d) and Art. 32c (1) (b), BRRD]
  - it is granted "to preserve the financial soundness and long-term viability" of the bank,
  - the conditions for using the preventive measures are fulfilled, and
  - the bank does not meet any of the conditions for being deemed as failing or likely to fail.

- ► As currently, an Institutional Protection Scheme (IPS) is defined as a contractual or statutory liability arrangement that safeguards member banks and ensures that they have the liquidity and solvency necessary to avoid bankruptcy [Art. 113 (7), Capital Requirements Regulation [CRR, (EU) No 575/2013]. Member States may recognize such an IPS as a DGS, if it [Art. 4 (2)]
  - complies with the requirements of the DGSD, and
  - fulfils several criteria laid down in the Capital Requirements Regulation [CRR, (EU) No 575/2013], such as the requirements that
    - the IPS must ensure the solvency and liquidity of its member banks,
    - the IPS is able to grant support from funds readily available to it, and

– there are no practical or legal impediments to transferring own funds or to the repayment of liabilities to member banks.

Now, the Commission stipulates that the amended conditions for the use of available financial means for preventive measures should be without prejudice to the question of whether an IPS fulfils the criteria laid down in the CRR and mentioned above [Recital 25].

3.5 Harmonized least costs test

► In future, DGSs must perform harmonized "least cost tests". Such tests will determine the cost-efficiency of using DGS funds and are intended to compare the estimated costs of a depositors' payout with the estimated costs of either resolution financing, alternative measures or preventive measures [p. 6, Art. 11e (1)].

► In general, the amount used for resolution financing, alternative measures or preventive measures must not exceed the amount of the bank's covered deposits, i.e. those interventions must be cheaper than payouts [Recital 27, Art. 11e (3)].

► For estimating the costs of resolution financing, alternative measures or preventive measures, DGSs must consider the "expected earnings, operational expenses and potential losses" [Art. 11e (2) (a)].

► The estimation of the costs of a depositors' payout must be based on [Art. 11e (2) (b)].
  – a fair, prudent and realistic valuation of the bank's assets and liabilities, and
  – an estimate of the shareholders' and creditors' treatment, if the bank were to be wound up under normal insolvency proceedings

  as compared with resolution financing or alternative measures.

► For estimating the costs of a depositors' payout, DGSs must consider [Art. 11e (2) (c)].
  – the expected ratio of recoveries,
  – the cost of replenishing the DGS for the DGS's member banks, and
  – the potential additional funding costs for the DGS

  as compared with resolution financing, alternative measures or preventive measures.

► For estimating the costs of a depositors' payout, DGSs have to multiply the expected ratio of recoveries by 85% as compared with alternative measures [Art. 11e (2) (d)].

► Based on regulatory technical standards and within 12 months after the entry into force of the amended Directive, the EBA must specify the methodology for the calculation of the estimated costs of the four different measures. Those standards must [Art. 11e (5)]
  – account for "the change in value of money due to potential accrued earnings over time",
  – when defining the methodology for calculating the estimated costs for a depositors' payout as compared with preventive measures, account for the importance of such measures for the DGSs mandate, including with respect to institutional protection schemes (IPSs).

3.6 Ranking of deposits

► Currently, there is a three-tier depositor preference in the hierarchy of claims in normal insolvency proceedings [Art. 108 (1) BRRD]
  – Covered deposits and DGSs' claims have a "super-preference" and rank above "non-covered preferred deposits", i.e. eligible deposits from natural persons and SMEs exceeding the € 100,000 coverage level.
  – "Non-covered preferred deposits" rank above the claims of ordinary unsecured creditors.

  There is no EU rule with respect to other deposits, i.e.
  – non-covered non-preferred deposits, i.e. deposits from corporate non-SMEs exceeding the coverage level, and
  – excluded deposits, i.e., in particular, deposits from financial sector entities and pension funds.

► In future, there is a two-tier depositor preference [new Art. 108 (1) BRRD]:
  – "Any" deposits – i.e. covered and excluded deposits as well as non-covered preferred and non-covered non-preferred deposits – and DGSs claims all have the same priority ranking and rank above the claims of ordinary unsecured creditors.

4 Claims of DGSs against residual banks or entities

► Currently, DGSs that support the financing of a resolution have a claim against the relevant bank equal to the payments they provide. There is no distinction between resolution tools and thus the provision applies to

both open-bank bail in resolutions and transfer strategies, i.e. sale of business or bridge bank resolutions. [Art. 9 (2)]

- In future, DGSs have a claim, if they refer to [new Art. 9 (2)]
  - transfer strategies in resolution, i.e. sale of business or bridge bank resolutions, or
  - alternative measures in insolvency proceedings (see chapter 3.3).

  DGSs have such a claim against the residual bank or entity.

5 Available financial means

- As currently, the "available financial means" of a DGS must, by 3 July 2024, at least reach a target level of 0,8% of the amount of the covered deposits of its members [Art. 10 (2)].
- Currently, it is not specified which "financial means" can be taken into account when determining whether a DGS has reached the target level. In future, it is specified that for calculating the available financial means [new Art. 10 (2)],
  - funds directly contributed by, or recovered from, members to the DGS, including investment income derived from funds contributed by the members, can be considered, while
  - administrative fees and charges, repayments not claimed by eligible depositors during payout procedures and loans between DGSs cannot be considered.
- Currently, DGSs must ensure that contributions are collected such that the target level is reached within six years where the available financial means have been reduced to below two-thirds of the target level [Art. 10 (2)]. In future, it is clarified that this rule will only apply where the drop in financial means is related to DGSs interventions, i.e. deposit payouts, preventive, resolution or alternative measures [new Art. 10 (2)].
- Currently, Member States may allow certain fully collateralized payment commitments of a bank towards a DGS to be regarded as "available financial means" to be taken into account in reaching the target level [Art. 10 (3) in connection with Art. 2 (1) (13)]. In future, only payment commitments that are also "irrevocable" can be taken into account [new Art. 10 (3) in connection with new Art. 2 (1) (13)].

6 Timeline for repayments

- Currently, Member States may decide, in the case of beneficiary accounts, to extend the standard repayment period – 7 days – to up to three months from the date the deposits become unavailable [Art. 8 (3)]. In future, Member States must allow DGSs an extended repayment period of up to 20 working days from the date those DGSs received documents from depositors to examine the claims. The extended repayment period must apply not only to beneficiary accounts but also to temporary high balances and client funds deposits. [new Art. 8 (3)]
- Currently, Member States are allowed to limit the time for depositors to claim the repayment of their deposits that were not repaid within the applicable deadline [Art. 9 (3)]. In future, Member States must ensure that depositors can claim such repayments within a period of 5 years [new Art. 9 (3)].

7 Depositor information and the right to withdraw deposits

- As currently, banks must inform depositors about the DGSs of which the bank and its branches are members [Art. 16 (1)]. In future, this has to be done using a harmonized information sheet, which includes, inter alia, information about the [new Art. 16 (1), Art. 16 (1a)]
  - protection of deposits,
  - banks' contact details,
  - coverage level,
  - applicable exclusions from DGS protection, and
  - identity of DGS responsible for protecting a deposit.

  The information sheet must be provided to depositors before they enter into a deposit-taking contract and, afterwards, annually. Depositors must acknowledge its receipt. [new Art. 16 (2)] The European Banking Authority (EBA) must develop draft implementing technical standards on its content and format [Art. 16 (9)].
- As currently, banks must, as a rule, inform depositors in the case of a merger, conversion of subsidiaries into branches or similar operations, at least one month in advance. In future, they must, additionally, explain the impact of the operation on the depositors' protection. [new Art. 16 (6)]

- Currently, depositors have a right to withdraw their eligible deposits or transfer them to another bank without incurring a penalty in the case of a merger, conversion of subsidiaries into branches or similar operations within a three-month period. This applies to eligible deposits exceeding the coverage level [Art. 16 (6)]. In future, this will apply to eligible deposits equal to the lost coverage due to the operation, and banks must explicitly notify their depositors about such rights, where the operation leads to reduced depositor protection [new Art. 16 (6)].

8 Tackling anti money laundering (AML) concerns

- Currently, DGSs may repay depositors, inter alia, via cash or electronic transfers [Recital 12]. In future, DGSs must, where repayments exceed € 10,000, reimburse depositors via credit transfers [new Art. 8a].
- As currently, deposits, arising out of transactions in connection with which there has been a criminal conviction for money laundering, must be excluded from repayments by DGSs [new Art. 5 (1) (c)]. DGSs must, in particular, suspend repayments to depositors who have been charged with a money laundering offence, pending judgment of the court [old Art. 8 (8), new Art. 8c (2)].
- In future, designated authorities – i.e. bodies administering or public authorities supervising DGSs – must inform a DGS within 24 hours about the outcome of customer due diligence measures, which a bank must perform, under the oversight of supervisors, at the moment it is failing or is likely to fail [new Art. 8c (1)].
- In future, DGSs must suspend repayment for a period of up to 15 calendar days, where they are informed by a Financial Intelligence Unit (FIU) – i.e. entities that a Member State must establish to prevent, detect and effectively combat money laundering – that that FIU has decided, due to suspicion of money laundering, to suspend a transaction, withhold consent to proceed with the transaction, or suspend a bank or a payment account [new Art. 8c (3)]. For any measures taken due to such FIU notifications, DGSs should not be held liable [new Art. 8c (4)].

9 Treatment of branches

- In future, the DGSD will not only apply to banks established in the EU that are affiliated to a DGS, but also to EU-based branches of banks established in third countries [new [Art. 1 (2) (d)].
- Currently, Member States must check whether a branch of a third-country bank located within their territory provides protection equivalent to that provided for under the DGSD. If not, they may force such a bank to join a DGS within their territory [Art. 15 (1)]. In future, those branches will, in any case, be required to join a DGS in the Member State where they want to perform deposit taking activities [Recital 35, new. Art. 15 (1)].
- In future, if a member bank of a DGS has set up a branch in a non-EU third country, the DGS will not have to cover depositors of that branch. Such coverage will only be possible, upon approval by the designated authority, if the DGS raises specific contributions from such a bank. [new Art. 15a]

10 Cooperation between DGSs in home and host Member States

- As currently, DGSs must cover the depositors at branches in other Member States set up by their member banks. In future, they will also have to cover depositors located in Member States where member banks exercise the freedom to provide services ("passported services"), i.e. they do without an establishment in the other Member State. [new Art. 14 (1)]
- As currently, depositors at branches set up by banks in another Member State must be repaid by a DGS in the host Member State on behalf of the DGS in the home Member State. In future, however, a DGS in the home Member State may decide to take over the task, if [new Art. 14 (2)]
  - the administrative burden and the costs are lower, and
  - depositors are not worse off compared to a repayment by the DGS of the host Member State.
- In future, a DGS of a host Member State may operate as a point of contact for depositors of banks that exercise the freedom to provide services, if agreed upon with the DGS of the home Member State [new Art. 14 (2a)].
- In future, Member States must ensure that DGSs of home and host Member States agree on payout terms and conditions, on the cost compensation that home DGSs must make to host DGSs, on the point of contact for depositors, as well as on the timeline and the payment method [new Art. 14 (2b)].

11 Investment policy

- Currently, DGSs must invest the available financial means "in a low-risk and sufficiently diversified manner" [Art. 10 (7)]. In future, Member States must ensure that the investment strategy is set by DGSs, designated authorities or competent authorities, and complies with those same principles [new Art. 10 (7)]. The EBA must develop guidelines with regard to the investment strategy [new Art. 10 (13)].
- In future, DGSs may also place all or part of the available financial means with their national central bank or national treasury on segregated accounts [new Art. 10 (7a)].

12 Alternative funding arrangements

- As currently, DGSs may require their member banks to pay extraordinary contributions not exceeding 0.5% of their covered deposits per calendar year, if their available financial means are insufficient to repay depositors. Furthermore, DGSs must have "alternative funding arrangements" in place that give them access to short-term funding [Art. 10 (8) und (9)].
- In future, DGSs should specifically be allowed to use funds originating from such "alternative funding arrangements" prior to using their available financial means and prior to raising extraordinary contributions. However, such "alternative funding arrangements" should not include funds financed through public funds. "Alternative funding arrangements" financed through public funds should only be used as a last resort [new Art. 10 (11)]

13 Improved information exchange

- As currently, a DGS must be able to receive, at any time and upon the DGS's request, information from their member banks necessary to prepare for a deposit payout [deleted Art. 4 (8), new Art. 16a (1)].
- In future, member banks must also provide information about depositors of their branches and depositors who receive services based on the freedom to provide services [new Art. 16a (2)]
- In future, DGSs must inform the EBA each year about [new Art. 16a (3)]
  - the amount of covered deposits in their Member State,
  - the amount of available financial means.
- In future, designated authorities must inform the EBA about [new Art. 16a (4)]
  - any determination of the unavailability of funds,
  - any use by a DGS of resolution financing or alternative and preventive measures, the funds used for those interventions, the amount recovered, the costs for the DGS and the duration of the recovery process, and
  - the availability and use of alternative funding arrangements.

  The EBA must publish the information [new Art. 16a (5)].
- In future, resolution authorities must provide DGSs, upon their request, with a summary of the resolution plans of the member banks of those DGSs but only where the DGSs and their designated authorities need such information for DGS interventions other than a depositor's payout. [new Art. 16a (6)]

14 Transposition of the amended Directive

- Member States must transpose the amended Directive and apply its provisions by 24 months after its date of entry into force .
- However, the new rules on preventive measures (see chapter 3.4) must apply
  - after 48 months, or
  - after 72 months, if a Member State so wishes, and only with respect to IPSs.

  The longer transposition period for IPSs takes account of the need to set up a fund that is segregated from deposit insurance funds and only for IPS purposes, as agreed upon between the IPSs, the ECB and competent authorities [Recital 45].

B. Legal and political context

1 Status of legislative procedure

18.04.2023	Adoption by the Commission
Open	Adoption by the European Parliament and the Council, publication in the Official Journal of the European Union, entry into force

2 Options for exerting political influence

Directorates General:	DG Financial Stability, Financial Services and Capital Markets Union
Committees of the European Parliament:	Economic and Monetary Affairs, Rapporteur: Ernest Urtasun (Greens/EFA group, ES)
Federal Ministries:	Economy (leading)
Committees of the German Bundestag:	Economy (leading)
Decision-making mode in the Council:	Qualified majority (acceptance by 55% of Member States which make up 65% of the EU population)

3 Formalities

Basis for legislative competence:	Art. 53 (1) TFEU (Freedom of Establishment)
Form of legislative competence:	Shared competence (Art. 4 (2) TFEU)
Procedure:	Art. 294 TFEU (ordinary legislative procedure)

C. Assessment

1 Economic Impact Assessment

1.1 Public authorities

By granting depositor protection for the bank deposits of public authorities up to a coverage amount of € 100,000, the Commission is changing course. Until now, these have generally not benefited from depositor protection. Only a few Member States have made use of the option enshrined in the DGSD to grant such protection to local authorities with a budget of no more than € 500,000. The reason usually given for not protecting public authorities as depositors is that they should be able to assess the risk profile of a bank themselves and can therefore be considered "professional" depositors. With its change of course, the Commission is ultimately denying the professionalism of these authorities and declaring them to be "in need of protection". However, this change of course is double-edged. On the one hand, it may remove existing administrative hurdles and reduce the legal uncertainties associated with the option for Member States. These stem in particular from the open questions of when an authority is considered "local", how to deal with budgets that fluctuate around the € 500,000 threshold, or problems with the rapid identification of protected local authorities in the event of a crisis. In this sense, the notified legal amendment is therefore appropriate. In addition, the inclusion of all public authorities can be seen as a pragmatic decision, since a targeted and case-by-case classification of these authorities as professional (rather than non-protected) vs. non-professional (rather than protected) depositors would be impractical. On the other hand, however, the change of course, , has some negative repercussions. For example, it may encourage avoidable disincentives by reducing the need for public authorities to adequately assess the risk profiles of different banks. Instead of the taxpayer, other depositors are increasingly liable for any wrong decisions made by a respective government authority. The argument that "most" of these authorities are not sophisticated depositors is also unconvincing. And even if this is the case, it should be the primary task of the legislature to ensure that they become savvy depositors, since they generally handle taxpayers' funds. In any case, the inclusion of public authorities must be adequately reflected in the contributions to deposit insurance schemes, as their risk profile will change noticeably as a result of the measure.

1.2 Treatment of client funds

A wide variety of alternative financial and payment services have emerged in recent years. Numerous fintech companies have established themselves on the market and stimulated competition. In the process, they are also increasingly managing client funds and are also required by regulatory requirements - e.g. the 2nd Payment Services Directive (EU) 2015/2366 - to park these in separate accounts at banks. However, the current DGSD is not clear on the issue of whether or not funds held by these financial institutions – investment firms, payment institutions and e-money institutions – at banks, on behalf of their clients, are covered by deposit protection. Some Member States have opted in, but others have not. That such client funds should now be covered uniformly is appropriate. First, consumers are often unaware that such deposits may not be protected. Secondly, they generally have no influence on the choice of bank in which their deposits are or will be stored. They are therefore dependent on the decision of the financial institution and cannot necessarily rely on it choosing, for example, a "low-risk" bank in their interest. And thirdly, any losses they may have to bear in the course of a bank failure will weaken their confidence not only in the failing bank holding the deposits or in the banking system as a whole, but also in the financial institution not responsible for the crisis situation. There is thus a danger that risks actually located in the banking sector will be transferred to the sectors in which these financial institutions operate. However, two things should be borne in mind. First, the additional protection of client funds requires an increase in resources for the DGSs and thus the levying of additional contributions. And secondly, it must be ensured that the compensation of "clients" can also succeed in the event of an emergency. To do this, however, the DGSs or their member banks must have sufficient information about the identity of the clients. This is currently not the case on a regular basis, so regulations are needed in this regard.

1.3 Treatment of temporary high balances

In the event of real estate transactions in connection with private residential properties, it may be the case that a depositor's holdings of deposits at a bank swell temporarily and the deposits exceed the € 100,000 threshold. This also applies to certain life events, such as marriage, retirement or insurance payouts. The DGSD also provides depositor protection for such temporary deposit inflows. In doing so, the DGSD currently gives Member States wide latitude on the questions of how extensive this protection can be – potentially unlimited – and how long it can be granted – between three and 12 months. The specification of a minimum amount of 500,000 euros and a maximum duration of six months, now being proposed, does contribute to a standardization ("harmonization") and thus to a simplification of the requirements and therefore reduces the overall administrative burden for DGSs. However, the case for the Commission to create regulations at all is not very compelling. Firstly, there are large differences in income and wealth in the Member States, which would also justify different levels of depositor protection with regard to temporary high deposits. Secondly, the amendment unnecessarily leads to a lowering of the promised level of protection in some Member States. Even though the safeguard is of little practical relevance , it could potentially weaken depositor confidence. Thirdly, harmonization is problematic in that it limits competition for "adequate" depositor protection. For example, it removes the discretion of Member States to allow their banks and DGSs to target depositors who, for example, want protection for temporary funds flowing in as a result of real estate transactions.

1.4 Treatment of liabilities that have fallen due

The abolition of the option for Member States to specify that liabilities fallen due are also to be considered when paying compensation to depositors, simplifies and accelerates the compensation process, reduces the administrative burden on DGSs and is therefore appropriate. This is particularly true since the practical relevance of this legal amendment is low and unlikely to have any significant impact on the general confidence of depositors in the protection promised by the deposit guarantee scheme.

1.5 DGS interventions

DGSs primarily serve as a protective shield for depositors in the event of a bank failure; their primary task is therefore usually to compensate depositors. However, the DGSD, in addition to its other mandatory task of supporting the funding of resolution measures[1], specifies two further tasks for the schemes, namely the funding of (1) preventive measures to avoid the failure of a bank and (2) alternative measures to ensure depositors' access to their covered deposits in the event of bank failure. However, it is up to the Member States to decide whether the DGSs may be used for these two tasks (national right of choice). According to the ECB, the use of preventive measures by deposit guarantee schemes is possible in nine Member States, and that of alternative

[1] Note: This cep**PolicyBrief** does not specifically address the important role of deposit guarantee schemes in resolution financing.

measures in eleven Member States (as of 2020).[2] The Commission now wants to revise the requirements for the use of preventive and alternative measures. In particular, it aims to create greater legal clarity and certainty with regard to the use of these measures, to standardize the conditions for their use and to ensure more efficient recourse to the available financial means of the DGSs. In the following, we will first briefly outline and then evaluate the main reasons expressed by the Commission for the planned regulatory steps:

The Commission sees preventive measures as a task for DGSs in the EU on the basis of two considerations in particular. First, the costs to schemes associated with preventive measures may be lower than the costs that would be incurred if a bank failure occurred and depositors had to be compensated. In this sense, preventive measures not only serve to support the bank at risk of failure, but they also protect DGSs from potentially higher losses. And second, they can help to safeguard the confidence of depositors in the protection of their deposits and, indirectly, financial stability. Preventive measures, however, are not without problems from an ordoliberal perspective. This stems from the fact that they are measures aimed at preventing a bank failure under which the costs are borne not by the responsible owners and creditors of the bank at risk of default, as would actually be appropriate, but primarily by the other member banks, which provide the financial underpinning for such measures with their contributions to the DGS. Preventive measures therefore regularly violate the liability principle that is central to ordoliberal policy. Moreover, they could give rise to moral hazard risks. If banks can count on being supported by preventive measures in an emergency, this may encourage them to choose riskier business models than they would have chosen if they had no access to the financial means of the DGSs. Concerns also arise because distortions of competition cannot be ruled out on a regular basis. It cannot be ruled out, for example, that distressed banks in similarly acute situations will be supported in different ways and, possibly, in a way that keeps one bank alive but sends another into insolvency. Finally, if preventive measures are implemented, there is a risk that banks whose exit from the market would be compelling from an economic perspective, for example due to unsustainable business models, will be bolstered. Enabling preventive measures is therefore more than double-edged and should only be possible within narrow limits, if at all. The aforementioned problematic effects of their use must be contained as far as possible. However, to a certain extent, the regulations on preventive measures envisaged in the Commission proposal fail in this regard:

Although the Commission emphasizes in its proposal that preventive measures can "significantly improve the protection of depositors"; that it attaches importance to ensuring a level playing field and that it highlights the measures as a key instrument for strengthening depositor confidence and financial stability, it does not, interestingly enough, abandon the Member States' right to choose. As a consequence, all Member States that allow preventive measures will have to implement them according to more uniform requirements in the future, e.g. on the basis of the harmonized least cost tests (see next section). However, since the measures do not become mandatory DGS tasks, Member States can continue to limit themselves to the two mandatory DGS tasks – depositor compensation and resolution financing. This approach is incomprehensible and demonstrates a lack of confidence in the necessity and importance of the measures. If it considers preventive measures to be necessary as a DGS task, they should be included as a mandatory measure in the DGS toolbox. This is the only way to avoid distortions of competition among banks in the EU.

One major change relates to the introduction of harmonized least cost tests. In particular, these tests are intended to ensure that preventive measures can only be used where they are more favorable than having to compensate depositors in the event of bank insolvency. Currently, according to the Commission, Member States have taken different approaches to this balancing act which has led to inconsistencies and a lack of predictability in the rules. The least cost tests are intended to counteract this. The basic idea behind such harmonized audits is logical. First, they prevent the excessive use of DGS funds and thus the risk of a shortage of these funds in the medium term. Second, they reduce the risk of distortions of competition resulting from competitive advantages enjoyed by a bank that is a member of a particular DGS or located in a particular Member State in which it is more likely to have a preventive measure applied to support it than other DGSs or Member States. Third, such checks reduce moral hazard risks because they signal to markets that preventive measures may not be used in every case. And fourth, for supervisors, resolution authorities, affected DGSs and banks, cost optimization audits improve legal clarity and reduce regulatory arbitrage across Member States. Nevertheless, the fact that such tests are ultimately only auxiliary constructs, which have numerous weaknesses, should not be underestimated. First, the costs that would be incurred by DGSs in the event of bank resolution or insolvency can, by their very nature, only be estimated. They are not actually observable either when the test is carried out or at a later date. The cost calculation therefore depends on numerous assumptions as well as on the depth of the analysis carried

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[2] Eule, J., Kastelein, W., & Sala, E. (2022). Protecting depositors and saving money: Why deposit guarantee schemes in the EU should be able to support transfers of assets and liabilities when a bank fails. ECB Occasional Paper, (2022/308), p. 5.

out in the event of a crisis and, in particular, on the question of which types of costs are taken into account at all, i.e. whether indirect costs (e.g. contagion risks for other banks in the event of a bank failure) are also included. This means that, even if the DGSD sets out precise requirements for implementing least cost tests, the results can never be exact. On the contrary, they are often imprecise and to some extent arbitrary. Second, the prescription of harmonized least cost tests could ultimately narrow the view because other factors beyond the pure cost comparison of DGS measures, that would argue for or against the use of preventive measures, are left out. For example, a preventive measure may make sense according to the results of the test because it "presumptively" imposes costs on the DGS that are initially lower than any potential depositor compensation. However, if this only postpones a potential bank failure, and thus the compensation of depositors, because the DGS provides funding to a bank without a viable long-term business model, little is gained. If this scenario becomes reality, there is a risk that the DGS will even be called upon several times, which is inefficient from an economic point of view. Therefore, in addition to the important cost comparison, other factors should always play an important role in the decision-making process. For example, it would be important to ensure that only banks not expected to default within a certain period, irrespective of the support provided, should be allowed to benefit from preventive measures. To this end, additional provisions in the Directive that go even further than the aforementioned obligations for banks receiving assistance, would be desirable – e.g. the obligation to guarantee access to deposits or commit to measures to comply with prudential requirements. Third, the administrative burden of conducting mandatory least cost tests must be kept in mind. It should not lead to detrimental and potentially grievous delays in a decision for or against the implementation of preventive measures. On this point, the legislators should provide the European Banking Authority (EBA) with specific instructions regarding preparation of the technical details of the least cost tests. Fourth, and already briefly touched upon above, is the question of whether indirect costs should also be included when estimating the costs of depositor compensation - i.e., inter alia, potential cost of contagion effects, disruption in financial markets, or, for member banks of a DGS, costs arising from the need to replenish the DGS. The answer to this is not without consequence. On the one hand, inclusion of all these indirect costs is certainly warranted from a macroeconomic perspective. Not taking them into account would distort the results to the detriment of preventive measures. Nevertheless, their determination is extremely difficult and thus prone to error. Therefore, while legislators should advocate the inclusion of as many indirect costs as possible, this should be additionally flanked by procedures for their determination that are as precise, sound and uniform as possible and, if necessary, by establishing upper limits to prevent a potential overestimation of these costs. The Commission's exclusive focus on potential replenishment and additional funding costs for the deposit insurance system should therefore be abandoned and, as a matter of principle, appropriate consideration should also be given to system-wide external effects.

Currently, preventive measures are possible as long as the resolution authority has not yet determined the resolution case. According to the Commission, this has led to DGSs being able to support banks with preventive measures even when they were on the verge of collapse. In the Commission's view, however, only banks whose failure is not imminent should be supported with preventive measures. In the future, therefore, their use should be limited to at an earlier point in time than was previously the case. This is the purpose of the amendment limiting the implementation of preventive measures by a DGS to cases where the resolution authority, in consultation with the competent authority, has not yet concluded that the bank is failing or likely to fail ("failing or likely to fail, FOLF"). The adjustment of this precondition for triggering preventive measures is appropriate. It strengthens the important liability principle already mentioned above and reduces moral hazard risks by sending a signal to banks that they cannot expect support in all cases and at all times. The adjustment thus reduces the risk of DGS funds being "wasted" and mainly used to avoid a liquidation or insolvency that is actually unavoidable and sometimes necessary in a market economy.

The obligation now being envisaged, for banks to prepare a note accompanying the preventive measures, is intended to ensure that banks supported by these measures also commit to steps that promise to strengthen their capital and liquidity position again. Making such commitments to take necessary efforts is essential. This is because, if deemed credible, they mitigate the risk to DGSs in deploying preventive measures and ultimately also strengthen the confidence of other member banks and depositors in the careful and prudent use of the DGSs' available financial means. The endorsements thus have an important raison d'être. The same applies to the new requirements for supervisors to monitor compliance with the commitments set out in a note, which are intended in particular to prevent banks that have already been supported from being supported again. This could reduce the risk of DGS funds flowing into a potential "bottomless pit".

Currently, where a preventive measure is taken by a DGS, it can be classified as "extraordinary public financial support" and thus deemed to be state aid. If this is the case, and the risk exists in particular for public DGSs, the

consequence is that the bank concerned must be classified as failing or likely to fail ("FOLF") under the current Bank Recovery and Resolution Directive (BRRD). The inevitable result of this determination, however, is that the bank must be resolved unless alternative private sector or supervisory measures can prevent the bank's failure within a reasonable period of time. And the need to wind down the bank in turn precludes the use of DGS funds for preventive measures. The changes now envisaged are intended to break this vicious circle, which has so far made the use of preventive measures more difficult or regularly raised doubts as to whether such measures can be implemented in a legally secure manner, and aim to ensure that even the classification of a preventive measure as state aid does not automatically have to result in resolution of the bank. The adjustments that have now been made are therefore ultimately necessary to ensure that preventive measures can be applied in a more legally secure manner, and to make their application possible in practice. Whether they are expedient from an ordoliberal perspective is another matter, as explained above.

Covered deposits of depositors and claims of DGSs currently benefit from a "super preference" in insolvency proceedings. They rank above uncovered preferential deposits and the claims of ordinary unsecured creditors. The Commission views such a super preference as a barrier to the use of preventive and alternative measures. This is because it leads DGSs to regularly expect a large recovery when they compensate depositors.[3] This in turn means that the calculated costs of depositor payouts are often lower than those of recourse to preventive or alternative measures.[4] The least cost test thus regularly turns out to be in favor of depositor compensation. Therefore, by making depositor compensation relatively more expensive for DGSs, the abolition of the "super preference" is now intended to improve, among other things, the relative attractiveness of preventive and alternative measures. Initially, this strategy seems reasonable. After all, it may, at least in the short term, improve the situation of depositors and boost their confidence, since the use of preventive and alternative measures preserves access to their deposits. The use of these measures can then also reduce financial stability risks and ensure that it is primarily the banking sector, rather than the taxpayer, that pays for costs associated with the measures. However, the strategy also entails veritable medium- and long-term risks. First, it increases the likelihood that DGS funds will be increasingly called upon in the future. It is therefore likely that the DGSs will have to be replenished more frequently than in the past, which will place an additional burden on the member banks of the funds concerned. If they have to make these additional contributions in difficult market situations, this may in turn have procyclical effects, give rise to contagion risks and thus jeopardize financial stability. And second, it increases the losses that DGSs have to bear, including for depositor compensation, should a bank failure nevertheless occur. The more frequent use of deposit insurance schemes combined with higher costs in the event of compensation cases could thus have the effect of gradually undermining depositor confidence in the performance of DGSs. Whether this outweighs the potential short-term benefits associated with the adjustment is certainly debatable.

The changes in preventive measures are also particularly relevant for institutional protection schemes (IPSs) that exist in some Member States, including Germany and Austria.[5] If an IPS meets the requirements of the DGSD and some specific requirements of the Capital Requirements Regulation (CRR), Member States may recognize it as a DGS. The available financial means within this deposit guarantee scheme may also then be used - to a limited extent - for preventive (institution-protecting) measures.[6] These measures are often of crucial importance to member banks, in particular as an important argument when competing with other banks; for reasons of preserving their reputation, and also to protect their respective brand. The Commission's proposals now have the effect of making it more difficult for recognized IPSs to take institution-protecting measures using available financial means from the DGSs. They will be allowed to carry out such measures in the future and the possibility for IPSs to be recognized as deposit guarantee schemes will be preserved. However, the requirements for their implementation have been tightened.[7] At the same time, they are being urged to carry out these measures to a greater extent in the future, with money fed from a fund which they may (but do not have to) build up separately. Institution-protecting measures via the DGSs will thus be made more difficult. This step is misguided. After all, if preventive measures to protect institutions are (in the medium term) to be financed primarily via separate and voluntary funds, it will be easier to Europeanize the national DGSs, which are primarily responsible for

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[3] See also Mecatti, I. (2020). Deposit guarantee schemes and bank crisis management: legal challenges arising from the actual EU legal framework, p.11

[4] This also applies in a particular way to measures taken by deposit insurance schemes to support the funding of resolution, which is also a stated objective of the Commission in the CMDI review but will not be explored in depth here.

[5] These include the institutional protection schemes of the cooperative banks (BVR Institutssicherung GmbH) and the savings banks (Sicherungseinrichtung des Deutschen Sparkassen und Giroverbands).

[6] This only applies if the relevant Member State has made use of the option to allow preventive measures in the first place.

[7] This is demonstrated, among other things, by the challenging conditions in the context of the least cost tests or the impossibility of preventive intervention in the event of a risk of failure.

compensating depositors and financing resolution. Thus, the adjustments ultimately create a basis for the creation of a Single European Deposit Insurance Scheme (EDIS), which the EU Commission has long been advocating, a project which it (and also the ECB) has been pushing for several years, but for which it has so far - for good reasons - failed to obtain a political majority (see also cep**PolicyBrief** No. 5/2016). This is because essential prerequisites for the practicability of this daring project have still not been met.[8] Any steps to create a basis for such a profound change of course are therefore premature as long as no progress is made in meeting the prerequisites.

Notwithstanding the question of whether or not the restrictions on the use of preventive measures for recognized IPSs are appropriate, the Commission's proposal is also accompanied by veritable legal uncertainties. To be sure, the Commission emphasizes that the amended conditions on the use of available financial means for preventive measures are intended to be without prejudice to the question of whether an IPS meets the criteria set forth in the Capital Requirements Regulation (CRR).[9] Nevertheless, it is questionable whether this will stand up in practice. After all, as an IPS authorized under the CRR, its function under the Regulation is to safeguard member banks and, in order to avoid bankruptcy, to ensure their liquidity and solvency if necessary. In addition, there must be no significant factual or legal impediments to transferring equity to the bank or repaying liabilities to the bank.[10] However, if this can no longer be considered to be the case due to the changed requirements for preventive, institution-protecting measures, compliance with the criteria set out in the CRR will also be in question. In order to ensure legal certainty here, legislators should therefore clarify the interplay between the new requirements for preventive measures under the revised DGSD and the requirements for IPSs enshrined in the CRR. A simple recital is not sufficient for this purpose.

1.6 Available financial means

DGSs must achieve a target level of 0.8% of the covered deposits of their member banks by July 2024. However, there is currently a lack of legal clarity as to which financial means may be used to achieve the target in addition to the banks' mandatory contribution payments. Under the proposed clarifications, loans between the various DGSs in the EU, and even management fees, cannot be considered as financial resources to be counted as "available financial means" or used for achieving the target level. Such clarifications are logical and strengthen legal certainty. They create a welcome convergence of practices across Member States and prevent DGSs from relying on less consistent inflows of funds, which would also be detrimental to the credibility of their performance in the event of a crisis.

1.7 Timeline for repayments

In the case of beneficiary accounts, client funds, and temporarily high balances, compensating depositors promptly and in a timely manner within seven days is a major challenge for DGSs. In the first two cases, identifying claimants takes time, and in the case of temporarily high balances, determining eligibility for benefits is also time consuming. Allowing DGSs more time than the standard seven days to compensate depositors in these cases is therefore understandable. It also ensures that, in the event of a crisis, resources do not have to be used for these identification and determination processes unnecessarily, excessively or hastily. At the same time, the 20-day deadline now provided for, which takes effect from the time the systems have sufficient information about an entitlement, creates the necessary pressure to ensure that these depositors do not have to wait an excessively long time for compensation either. This maintains confidence in depositor protection. In addition, the new regulation strengthens legal certainty because the current three-month period begins at a time when the unavailability of a bank's deposits is established and forces the DGS to pay out within this period, even if it may lack the necessary information to establish a claim for compensation. This difficulty is now being avoided.

1.8 Depositor information

According to the DGSD, depositors must be adequately informed about the depositor protection granted. Such an obligation to provide information is also appropriate in principle as an essential element in strengthening depositor confidence. Uniform requirements on the content and design of the relevant documents that must be provided to depositors are also expedient as they strengthen in particular the readability, comprehensibility and comparability of the information on the part of those depositors who have accounts at banks that are members

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[8] This includes, for example, that banks still do not have to back investments in government bonds with equity capital (see also cep**Input** 4/2017).

[9] See Recital 25.

[10] See Art. 113 (6) and (7), CRR.

of different DGSs. However, it is questionable whether it is appropriate to inform depositors about deposit protection every year, rather than just when they sign a deposit-taking agreement. First, depositors are unlikely to misinterpret a lack of regular information on deposit protection as indicating that it is no longer granted. Second, "pushy" reminders of such protection may also make depositors inclined to doubt the stability of their bank, as they would not otherwise expect such information. And third, the annual information requirement entails unnecessary costs that can easily be avoided. An information requirement at the time of conclusion of the contract, in the event of compensation, or even if the scope of deposit protection were to be adjusted would be perfectly sufficient. The Commission also fails to explain why the depositor must actively confirm receipt of the information each time. Such active intervention seems superfluous and excessive, also because it remains unclear what the consequences of non-confirmation would be.

In the course of mergers among banks, conversions of bank subsidiaries into branches or similar measures, the scope of deposit protection for depositors at the banks concerned may change. In particular, such measures may also result in a reduction of depositor protection.[11] Even though depositors already have the right to withdraw deposits or transfer them to another bank in such a case, many depositors are often not aware that mergers, conversions and similar measures may be accompanied by limitations with respect to depositor protection. The fact that they will have to be explicitly informed of this in the future therefore promotes depositor confidence without overburdening the deposit guarantee schemes, especially since the information obligation does not apply if the measure keeps depositor protection stable or improves it.

1.9 Tackling anti money laundering (AML) concerns

DGSs thrive on depositor confidence. If, in the event of compensation, excessive payouts were made to persons suspected of or convicted of money laundering, this would undermine the confidence of honest depositors and call into question the long-term viability of the systems. Policy efforts to ensure that money launderers are not afforded depositor protection are therefore warranted. However, the Commission's proposalis somewhat misguided. This is because it obliges banks – in conjunction with the planned new money laundering requirements[12] – to carry out special money-laundering-related due diligence at precisely the moment when they fail or threaten to fail, and to share the findings with their designated supervisory authority, which in turn has to enter into an exchange with the DGS concerned in this regard. However, the implementation of stringent due diligence requirements is likely to tie up resources at the very time when seamless and prompt compensation of eligible depositors is also important. The fulfillment of due diligence obligations should in no way obstruct this ambition, as delayed payouts can also cost trust in DGSs. It would therefore be more appropriate if thorough money laundering checks were carried out earlier than at the time of a bank's (imminent) failure and if an efficient exchange of information between the relevant actors, i.e. in particular between the bank, the DGS scheme, the designated supervisory authority and the authorities responsible for combating money laundering, were ensured.

On the positive side, the requirement that depositors who receive more than EUR 10,000 in the event of compensation must be compulsorily compensated by means of a transfer is appropriate. Although this amount is ultimately chosen arbitrarily, the provision enables better traceability of disbursed funds and follows, at least to some extent, a risk-oriented approach.

DGSs currently face legal uncertainties regarding their ability to (temporarily) suspend payouts to depositors in cases of suspected money laundering which, even in these cases, can result in their having to pay out funds quickly, i.e. within the mandatory 7-day period. The creation of a clear rule allowing for a temporary suspension of a payout in cases of suspected money laundering, provided that the DGS has been informed of such cases by a Financial Intelligence Unit (FIU), gives the schemes the necessary time buffer to examine the facts in consultation with the relevant authorities, and to avert unwanted payouts if necessary.

1.10 Treatment of branches

The regulatory approach now envisaged, means that uniform deposit protection will apply to all deposit-taking business occurring within the EU but will not be granted if an EU bank offers the business through a branch in a

[11] If, for example, a depositor has deposits of € 250,000 at Bank A and € 350,000 at Bank B, € 100,000 would be covered by the deposit protection scheme in the event of the simultaneous failure of Bank A and Bank B, i.e. a total of € 200,000 (out of a total of € 600,000 in deposits). If Bank A and Bank B merged, the depositor would have deposits with the merged Bank AB totaling € 600,000, but only € 100,000 of these would be protected. His depositor protection is therefore reduced as a result of the merger.

[12] See also Recital 38 and Art. 15 (4) of Proposal for a Regulation of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing [COM (2021) 420].

third country. This simplifies the existing legal framework and ensures a uniform EU-wide approach to the treatment of branches. Most branches established by third-country banks in the EU are already members of a DGS in a Member State.[13] The equivalence checks laid down in the DGSD, which apply in the case of non-membership, apply only rarely. The general obligation for membership now being planned is therefore only a small step but is particularly appropriate and pragmatic because it may reduce the extent to which supervisory authorities have to use their administrative resources for time-consuming equivalence tests. Furthermore, these tests can lead to different findings on the equivalence of the legal systems in the third countries under review and thus to different treatment of branches which distorts competition.

1.11 Cooperation between DGSs in home and host Member States

If a bank has a branch in another EU Member State, primary responsibility for compensating the branch's depositors has so far been borne by the DGS of that other Member State (host Member State), which assumes this task on behalf of the scheme in the bank's home Member State. This also makes sense, in principle, since in the event of a crisis depositors usually turn to the DGS in their own country. This is partly due to language barriers, which often make it difficult to communicate with the scheme in a bank's home Member State. Nevertheless, the increased involvement of home Member State DGSs now envisaged is appropriate. Firstly, in the event that the DGS in the host Member State is overburdened with payments, such as where it is simultaneously confronted with other compensation cases, support by the system in the home Member State may relieve this burden and help to ensure orderly compensation. Secondly, coordination expenditure may be reduced if the support service leads to less burdensome and time-consuming coordination processes between the DGS in the home Member State and that of the host Member State. At the same time, responsibility should not be transferred to the DGS in the home Member State for all cases, but - as envisaged - only in narrowly defined cases. Otherwise, there is a risk that these systems will be overburdened because they would then have to prepare ex ante and at least organizationally for compensation cases in potentially many different Member States and, for example, build up language skills in order to be able to enter into a dialog with depositors in various other Member States.

With increasing digitalization and the progressive use of mobile banking, there has also been a growing willingness on the part of banks in recent years to engage in cross-border deposit business without, however, establishing a branch in another Member State ("passporting").[14] In such cases, the DSGD currently provides that the DGS of the bank's home Member State is responsible in the event of compensation and not, as in the case of a branch, the DGS in the host Member State. This means that, in the event of compensation, depositors must turn to the DGS in another Member State and not to the one in which they are domiciled. However, if they use a branch, they can turn instead to the scheme in their Member State of residence. This difference in treatment depending on whether a depositor uses a branch or enters into a transaction through passporting is, firstly, confusing and, secondly, likely to be unfamiliar to the individual depositor. Thirdly, depositors will not usually know whether they are using a branch or passporting. In the future, for reasons of depositor protection, it is therefore appropriate that the DGS of the host Member State should also act as the primary contact point regarding compensation in the case of passporting, thus ensuring a uniform approach.

1.12 Alternative funding arrangements

If a DGS is needed for one of the four intervention measures – compensation of depositors, funding of resolution measures, preventive measures and alternative measures – it can currently draw either on its available financial means, on ex-post contributions to be collected from member banks at short notice, or on alternative funding arrangements (e.g. loans, issuance of debt securities). The Commission's proposal explicitly allowing DGSs to resort to the latter alternative funding arrangements first, before using the other means, is double-edged. On the one hand, this sequence of steps could mitigate the risks of a "bank run" because, if the available financial means of the DGSs are used first, any risk of a rapid loss of confidence in the performance of the DGSs as a whole is naturally constrained due to their limited resources. And if, in the event of a crisis, ex-post contributions are levied early on member banks, including the failing bank, this could have a procyclical effect and encourage additional contagion risks. On the other hand, early recourse to alternative funding arrangements contradicts key ordoliberal principles. This is because the failing bank would regularly be exempt from making or having to have made a contribution of its own. As the originator of the use of the DGS, it has participated in the buildup of the financial means of the DGS just as it has regularly participated in the replenishment of the funds via ex-post

[13] See also EBA (2019), Opinion of the European Banking Authority on the eligibility of deposits, coverage level and cooperation between deposit guarantee schemes, EBA-Op-2019-10, 8 August 2019, p. 93.

[14] A depositor in Member State B therefore has, for example, a deposit account at a bank in Member State A.

contributions. However, the costs of using alternative funding arrangements are borne in particular by the other member banks of a DGS or, if the state serves as a source, also often by the taxpayer. This, however, gives rise to misaligned incentives, the principle of action and liability is undermined and the original insurance idea of DGSs is lost. Legislators should not therefore explicitly push the early use of alternative funding arrangements. Any use of these alternative means - no matter at what point in time - should be subject to strict conditions that minimize the aforementioned risks. However, the Commission's proposal fails to provide such conditions.

2 Legal Assessment

2.1 Competence

The legal basis of the proposed legislation to amend the Deposit Guarantee Schemes Directive (DGSD) is the freedom of establishment in the internal market [Art. 53(1) TFEU]. Considering the principle of free movement of services in the financial services sector, the rules on deposit protection also play a significant role. Art. 53 TFEU enables the European Parliament and the Council of the European Union to adopt directives to coordinate provisions in the area of financial services. In essence, the amendments contained in the proposal adapt existing EU law. Thus, the provisions of the proposal concern areas in which the EU has already exercised its powers.[15] Since the act merely amends the original Directive, its reliance on the same legal basis is justified. Against this background, competence is unproblematic.

2.2 Subsidiarity

Under the subsidiarity principle, an action at the supranational level is legitimised when the objectives of such action cannot be sufficiently achieved by the Member States due to the scale or effects of the action. Measures at the EU level to regulate the deposit insurance protection are more effective than alternative actions at the national level. Member States are not in a position to adopt measures relating to the rules on deposit guarantee schemes as would be sufficient to achieve the objectives of the Directive. Only a single EU-wide rulebook on deposit guarantee schemes can ensure a level playing field across the EU. Diverging national rules on deposit protection, on the other hand, would lead to unjustified competitive advantages between banks in different EU Member States. In turn, that creates incentives for regulatory arbitrage across the EU Member States.

Furthermore, the taking of deposits often occurs on a cross-border basis. Different requirements for banks operating in various EU Member States would lead to imperfect supervision, unfair competition and lack of consumer trust in deposit protection mechanisms. A supranational action is therefore justified to avoid identified inconsistencies and a lack of predictability in the implementation of the rules. The reviewed requirements for the establishment of a harmonized approach to the rules on deposit protection across the EU contribute to greater legal clarity and certainty regarding their application. Currently, there is no harmonised approach when it comes to interpreting the conditions for using DGS funds other than where they are used for the payout of covered deposits among Member States. Thus, the introduction of the harmonised least cost test and targeted amendments to the provisions on preventive measures are more appropriate for the achieving the desired aim of harmonisation than any other possible solution. However, it is debatable whether a simple cost comparison is an adequate and fit-for-purpose mechanism for deciding whether preventive measures are permissible. In other areas, the proposed changes to harmonise legislation are less controversial. Thus, a high level of national discretion regarding the treatment of the deposits of public authorities, dormant accounts and client funds deposits creates an inconsistent level of deposit protection throughout the EU and may lead to market distortions. Indeed, the clarification of those rules will help to strengthen consumer confidence and achieve the objectives of the Directive to a greater degree. The proposed rules, e.g. on the treatment of public entities or accounts with temporarily high balances, seek, therefore, to ensure the additional level of harmonisation needed to consistently achieve the objectives set by the DGSD. Regulatory intervention at EU level is unavoidable to remove the legal uncertainties and inconsistencies. Therefore, the amendments to the DGSD are in line with the principle of subsidiarity.

[15] European case law has established a principle which states that if a legislative act merely supplements the original legislative act without changing its original aim, the EU legislature is entitled to use the same legal basis as for the first act. See Judgment of the Court (Second Chamber) of 21 June 2018, Republic of Poland v European Parliament and Council of the European Union, C-5/16, EU:C:2018:483, p. 49, p. 69.

2.3 Proportionality vis à vis Member States

Different national laws as well as existing legal gaps in the area of deposit protection create legal uncertainties. National regulation here would constitute an unnecessary obstacle to the functioning of the internal market. The proposed amendments to the DGSD are suitable and necessary to achieve the desired aims of the Commission. Any other action taken at national, regional, or local level would be less effective than the amendments to the DGSD when it comes to harmonising the rules on deposit protection across the whole internal market. The principle of proportionality vis-à-vis the Member States is therefore not violated.

2.4 Compatibility with EU law in other respects

Further points regarding compatibility with other EU laws arise:

Compatibility of using DGSs for preventive measures with State aid law

The question of whether the use of preventive measures by DGSs may conflict with State aid rules within the meaning of Article 107(1) TFEU has often arisen in the past. The Article states that *"[…], any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market*". Furthermore, the Banking Communication[16] specifies that, while "*interventions by deposit guarantee funds to reimburse depositors […] do not constitute State aid, the use of those or similar funds to assist in the restructuring of credit institutions may constitute State aid*" and those funds may even "*constitute aid to the extent that they come within the control of the State and the decision as to the funds' application is imputable to the State*" when they "*derive from the private sector*"[17].

The answer to the question of whether a preventive measure by a DGS constitutes state aid is not obvious. However, a preventive measure that tries to preserve the financial soundness and long-term viability of a bank, may constitute an intervention that risks to "distort or threatens to distort competition". Furthermore, as specified in the Banking Communication, if the DGSs funds are "within the control of the State" and the decisions of a DGS with regard to the funds' application are "imputable to the State", financial assistance via preventive measures may constitute state aid. Thus, the rules on state aid undoubtedly apply when the preventive measure is provided directly by the state or by public or private bodies established or appointed by the state.[18] Furthermore, although DGSs are not financed by the state, they are imposed by EU law, and their function is to provide financial support to ailing banks and deposit protection, which are closely connected to public functions. However, as decided by the General Court, if a DGS is a private legal entity[19] and "its decision to intervene [is] in no way attributable to a decision of a State authority", preventive measures may not constitute state aid.[20,21] Consequently, the Commission must provide evidence that the measure was actually taken under the influence or control of public authorities. Only then can the measure be classified as state aid and be imputable to the state. However, although Art. 107(1) TFEU, the Banking Communication and court decisions somewhat clarify the conditions for the (non)compliance of a preventive measure with state aid law, the existing state aid framework still constitutes an obstacle to the implementation of those measures by DGSs and is insufficiently clear. Since the legislative framework for state aid is closely interconnected with the crisis management and deposit insurance (CMDI) framework, it is necessary to ensure coherence between the provisions in both areas. Thus, as envisaged by the Commission[22], it should amend the state aid rules for banks as stipulated in the Banking Communication in order to achieve coherence and to provide even more clarity thereby ensuring legal certainty. As the provisions of the Communication can be amended quickly and may take effect immediately, the

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[16] Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication')

[17] Banking Communication, No. 63.

[18] See Judgment of the Court (First Chamber) of 15 July 2004, Pearle BV, Hans Prijs Optiek Franchise BV and Rinck Opticiëns BV v Hoofdbedrijfschap Ambachten, para. 34.

[19] This means that public DGSs may not perform preventive measures.

[20] Morra, C. B., Pozzolo, A. F., & Vardi, N. (2023). Completing the Banking Union, The case of crisis management of small-and medium-sized banks.

[21] See also Judgement of the General Court, 19 March 2019, Tercas Italian Republic and Others v. European Commission, T-98/16, T-196/16 and T-198/16, ECLI:EU:T:2019:167 and Judgement of the Court (Grand Chamber), 2 March 2021, Case C-425/19 P Commission v Italy, Fondo interbancario di tutela dei depositi, Banca d'Italia et Banca Popolare di Bari SCpA, ECLI:EU:C:2021:154.

[22] The Commission wants to review the legal framework for state aid for banks. An evaluation of the state aid rules for banks in difficulty ran from 17.03.2022 to 15.07.2022. The results of the consultation have not been published yet. They will be available on the Commission's webpage here.

Commission should change the Communication in a timely manner as that would help to avoid any delay in adopting the new CMDI framework.

In one aspect, which is closely related to the question of whether a preventive measure may be considered state aid, the Commission achieves a welcome clarification. Currently, if an intervention of a DGS, including preventive measures, qualifies as state aid, this may force resolution authorities, under the BRRD, to determine that a bank is failing or likely to fail (FOLF). In this case, the bank concerned must be resolved or put into insolvency procedures and the preventive measures of a DGS will not be permitted. Now, the proposed amendments to Art. 32 (1) (d) and Art. 32c (1) (b) BRRD establish criteria for determining when preventive measures cannot be considered as extraordinary public financial support. This will be the case when the measure aims to secure the financial soundness and viability of the bank in the long run, the requirements for using the preventive measures are met, and when a bank is not declared as FOLF. This enhances legal certainty. However, as stipulated above, the new rules must be complemented with additional clarifications in the state aid framework to ensure full coherence.

Controversial regulations on money laundering prevention

The rules on money laundering prevention foreseen in the proposed Directive are, at least partially, inadequate because the DGSs lack powers to access the necessary information. The new regulations aim to prevent the repayment of covered deposits to depositors suspected of money laundering or terrorist financing. Although this effort is to be welcomed, there are nevertheless gaps in the implementation of those measures in practice. Ensuring a smooth exchange of information between the judiciaries, Financial Intelligence Units (FIU), designated authorities and DGSs s is currently not feasible. In several Member States, the public prosecution authorities are not obliged to inform the bank, the DGS or the supervisory authorities about the commencement of investigations.[23] DGSs and supervisory authorities are also not informed about the submission of a suspicious activity report to an FIU. There could be reporting obligations on the national level. By way of illustration, German anti-money laundering legislation obliges banks to report to the national FIU on any transaction or asset stemming from a criminal offense that is allegedly related to money laundering or terrorist financing.[24] The national FIU evaluates these reports and related suspicious facts. This does not necessarily lead to legal consequences. Only if the FIU detects the violation of anti-money laundering legislation, does it disclose information to domestic public authorities and transfer the case to the law enforcement authorities to initiate prosecution. In addition, a suspicious activity report sent to an FIU, or a criminal complaint filed with the prosecution authority, may be considered unfounded in terms of content.

Conflict of laws with Art. 113(7) CRR

The proposed changes with respect to the ability of DGSs to finance preventive measures may be interpreted as a limitation of the mandate of institutional protection schemes (IPSs) as laid down in the Capital Requirements Regulation (CRR). According to Art. 113(7) of the CRR, an IPS is a contractual or statutory liability arrangement that protects its member banks. IPSs must ensure, in particular, that they have the liquidity and solvency needed to avoid bankruptcy when necessary, and that there are no practical or legal impediments to transferring own funds or to the repayment of liabilities to member banks. However, although the Commission stipulates that the amended conditions for the use of available financial means for preventive measures should be without prejudice to the question of whether an IPS fulfils the criteria of the CRR mentioned above[25], the new conditions for preventive measures in the DGSD conflict with the CRR criteria in several respects. For instance, the proposed harmonised least cost test may, in practice, inhibit those IPSs that are recognized as DGSs to ensure the solvency and liquidity of a member bank. Against this background, even though Recital 25 of the proposed Directive states that the amendments take into account the peculiarities of the specific business model of the IPS, it is unclear whether a IPS may still be able to fulfil the conditions of Art. 113(7) CRR and be able to pursue preventive measures as an IPS recognized as a DGS. In practice, there is the real risk that an IPSs may lose their status as a recognized DGS. Altogether, this can be interpreted as a hidden prohibition or at least as a declaration that the IPS business model is undesirable. This represents a legal uncertainty that requires additional clarification by the legislators.

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[23] At least in Germany, France and Italy, see German Code of Criminal Procedure (Strafprozeßordnung – StPO), The French Criminal Code of Procedure, The Italian Code of Criminal Procedure.

[24] German Money Laundering Act (Geldwäschegesetz – GwG), Section 43 (1).

[25] See Recital 25.

D. Conclusion

In the wake of the global financial crisis, the European legislators adopted the DGSD in order to enhance the protection and confidence of depositors. In the meantime, the Commission has identified several shortcomings with respect to a number of DGSD provisions, in particular with respect to the scope of depositor protection, the conditions for the use of DGSs' funds, the operational effectiveness of DGSs and the wide latitude for Member States to interpret the rules. The proposed revision of the DGSD aiming to tackle all these issues, has both strengths and weaknesses. First, the inclusion of public authorities in the scope of deposit protection is double-edged. On the one hand, it may remove existing administrative hurdles and reduce several legal uncertainties. On the other, it may encourage inadequate assessment of the risk profiles of different banks by public authorities. Second, the proposed specification of a minimum amount of € 500,000 and a maximum duration of six months for temporary high balances contributes to a standardization of the requirements and reduces the administrative burden for DGSs. However, differences in income and wealth in the Member States may justify different levels of depositor protection and limit competition for "adequate" depositor protection. Third, allowing DGSs to finance preventive measures, in addition to depositor compensations and resolution measures, may give rise to moral hazard risks. If banks can count on being supported by preventive measures when they are in crisis, this may encourage them to choose riskier business models. Furthermore, distortions of competition cannot be ruled out and there is always a risk that banks whose exit from the market would be compelling from an economic perspective will be bolstered. Thus, such measures should not be promoted. Fourth, the harmonized least cost tests that DGSs must perform to compare the estimated costs of a depositors' payout vis-à-vis the estimated costs of resolution financing, alternative measures or preventive measures may prevent excessive use of DGS funds , reduce the risk of distortions of competition and also moral hazard risks because they signal to markets that such measures are not enacted in every case. However, the costs can often only be estimated and depend on numerous assumptions, and other factors beyond the pure cost comparison are not considered in an appropriate manner. Fifth, policy efforts to ensure that money launderers are not afforded depositor protection are warranted to uphold the trust of honest depositors in deposit protection. However, stringent due diligence requirements will tie up resources at the very time when seamless and prompt compensation of eligible depositors is important. Furthermore, there are legal obstacles relating to DGSs or supervisory authorities not being notified about the commencement of investigations. And sixth, early recourse to alternative funding arrangements contradicts key ordoliberal principles. This is because the failing bank would regularly be exempt from making or having to have made a contribution of its own. The costs of referring to alternative funding arrangements are borne, in particular, by the other member banks of a DGS or, if the state serves as a source, also by the taxpayer. This, however, gives rise to misaligned incentives. Legislators should not explicitly push the early use of alternative funding arrangements.