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August 2022

TECHNICAL NOTE—CRISIS MANAGEMENT AND FINANCIAL SAFETY NETS

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TECHNICAL NOTE

CRISIS MANAGEMENT AND FINANCIAL SAFETY NETS

Prepared By

Monetary and Capital Markets Department

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at http://www.imf.org/external/np/fsap/fssa.aspx

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Glossary

BaFin	Federal Financial Supervisory Authority
BBk	Deutsche Bundesbank
BCBS	Basel Committee for Banking Supervision
BRRD	Bank Recovery and Resolution Directive
BdB	German Bankers Association
BVR	National Association of German Cooperative Banks
COREP	Common Reporting (ECB)
CRD V	Capital Requirements Directive 2013/36/EU
CRR	Capital Requirements Regulation (EU) No 575/2013 +CRRII
DG	Directorate General
DGS	Deposit Guarantee Scheme
DSGV	German Savings Banks Finance Group
EBA	European Banking Authority
ECB	European Central Bank
ESM	European Stability Mechanism
EU	European Union
FINREP	Financial Reporting (ECB)
FinStabG	Financial Stability Act
FMI	Financial Market Infrastructure
FMSA	Financial Market Stabilization Authority
FOLTF	Failing or likely to fail
FSAP	Financial Sector Assessment Program
FSC	Financial Stability Committee
G-SIB	Global Systemically Important Bank
IFRS	International Financial Reporting Standards
IPS	Institutional Protection Scheme
IRT	Internal Resolution Team
IT	Information Technology
JST	Joint Supervisory Team
KWG	German Banking Act (Kreditwesengesetz – KWG)
LSI	Less significant institutions or banking groups (LSIs)
MoF	Federal Ministry of Finance
NCA	National Competent Authority
NPL	Nonperforming Loan
NRA	National Resolution Authority
RiG	The Act on Risk Reduction and Proportionality in the Banking Sector, December 2020
SAG	Recovery and Resolution Act (Sanierungs- und Abwicklungsgesetz – SAG)
SI	Significant Institution
SRB	Single Resolution Board
SRF	Single Resolution Fund
SRMR	Single Resolution Mechanism Regulation
SSM	Single Supervisory Mechanism
TN	Technical Note

EXECUTIVE SUMMARY

1. **Much progress on resolution planning and preparedness has been achieved since the last FSAP in 2016.** Germany's resolution planning is well advanced, with resolution powers broadly in line with best practice and well-developed internal resolution processes. However, the large weight of Less Significant Institutions (LSIs) in Germany's financial sector calls for further progress on planning for crisis management for smaller banks and the institutional protection schemes (IPSs) of which they are members.

2. **The failures of Wirecard and Greensill, and the recapitalization of NordLB, have highlighted the complexity of Germany's arrangements for bank crisis management.** These incidents have prompted a number of further reform efforts, including changes or proposed changes to BaFin's (Federal Financial Supervisory Authority) banking supervision, EU regulation of fintech groups, Germany's private sector voluntary deposit guarantee scheme (DGS), and the IPS for Landesbanks and savings banks.

3. **The FSAP review focused on the national aspects of Germany's financial sector safety net, which remain critical despite German membership in the Banking Union.** The German authorities have primary operational responsibility for the supervision and resolution of LSIs. Germany accounts for, by far, the largest share of LSIs in the Euro Area—1,324 of about 2,400 total LSIs in the Euro Area, representing 40 percent of Germany's banking sector assets and approximately 55 percent of total Euro Area LSI assets. However, many aspects of crisis management are governed by European Union (EU) law, or the rules and oversight of the European Central Bank (ECB), Single Supervisory Mechanism (SSM), and the Single Resolution Mechanism (SRM). Recommendations for enhancements at the European level—including the introduction of an adequately funded common DGS, a harmonized bank liquidation framework and a finetuning of state aid rules—are outlined in the 2018 Financial System Stability Assessment for the Euro Area (IMF Country Report No. 18/226).

4. **A more systematic and streamlined approach to BaFin's supervisory reporting to the MoF, to ensure BaFin's operational independence, should be considered while maintaining sufficient information flow from BaFin to the MoF.** The detail and frequency of communication between BaFin supervision and the MoF appears to go beyond the necessary oversight and financial stability responsibilities of the MoF, which could be fulfilled through more streamlined reporting and enhanced in-crisis coordination structures.

5. **More proactive use of BaFin's supervisory and early intervention powers for weak banks would help prevent value destruction in distressed banks.** This need for more decisive and timely supervisory action is recognized in BaFin's own reorganization plan as part of a broader workstream on cultural change, and some necessary changes to BaFin's procedures for applying the ladder of early intervention actions have been identified.

6. **BaFin should limit its use of blanket moratoria on the liabilities of weak banks, and in cases where it is used, shorten the moratorium period.** BaFin expects, as the last step of the

supervisory escalation ladder, to apply a blanket moratorium preventing payments, including deposit withdrawals, from a weak bank. Although moratoria are an early intervention measure intended to be applied to going-concern banks, in practice there have been no cases in which a bank subject to a moratorium had successfully returned to viability. Given the typical length of the moratorium, this significantly extends the period for which deposits covered by the DGS may be unavailable,[1] with potentially significant impact on depositors, and more widely on depositor confidence.

7. The most distinctive feature of German bank crisis management is the idiosyncratic, complex, and broad system of depositor and institutional protection. Almost all banks are members of a voluntary DGS or IPS, which offer levels of protection for depositors (and, for the IPSs, other creditors) well above European and international peers. The DGSs and IPSs play a useful role in risk monitoring and routinely handle failure of small institutions; however, recent crisis experience has tested the limits of the current structures. The division into multiple schemes and high levels of protection mean the cost of each failed bank can be high for the scheme of which it is a member. Furthermore, additional financial support from outside the IPS has been necessary in previous cases of distress at Landesbanks.

8. The FSAP recommends a single mandatory DGS, established as a public body. The authorities consider that multiple DGSs are appropriate for the three-pillar structure of the German banking system, and that ongoing reforms will ensure their continuing effectiveness. However, a single scheme would increase risk pooling and diversification across the banking system and be more robust to medium- or large-sized failures. Establishing the DGS as a public body would facilitate this and ameliorate the conflicts of interest arising from the involvement of active bankers in the DGS's governance. In line with international good practice, the DGS should also have access to robust government-backed liquidity lines and not rely solely on market-based borrowing.

9. The authorities should review the systemic implications of maintaining very broad protection for depositors and develop an overall strategy for DGS/IPS reform. The authorities' current work on DGS and IPS issues focuses on their individual supervisory and oversight responsibilities for parts of the system, rather than its overall impact. The authorities should conduct a broader assessment of the impact of high levels of protection offered on financial stability, including through moral hazard and bank funding costs, the allocation of financial assets between deposits and other instruments, and whether they incentivize riskier behavior by new entrants to the German banks market.

10. IPS resolution plans should better align with the most likely failure scenarios and the scope of recovery planning. As the IPSs are strongly committed to providing financial support to their members, the failure of an individual institution is less likely, unless the IPS as a whole is in distress—a possible resolution scenario for BaFin is therefore one where the simultaneous resolution

[1] The EinSiG, in line with the DGSD, requires that DGSs target a payout of covered deposits within seven working days following a determination that compensation is due. BaFin must make this determination no later than five working days after becoming aware that a bank is unable to repay deposits that are due.

of multiple IPS members, or the IPS itself, may be required, and planning should be prepared for such scenarios.

11. The national Financial Stability Committee (FSC) already carries out work on crisis preparation and prevention, but formal arrangements for in-crisis coordination should be strengthened. The FSC has a limited role in-crisis, and coordination between the authorities in crisis cases has occurred mainly through strong and regular—but ad hoc—communication (both bilateral and multilateral). To increase engagement on crisis planning and allow for more systematic coordination of policy responses and communication during an active crisis or near-crisis situation, the authorities should either strengthen the FSC's crisis management role through a sub-committee or establish a parallel crisis management committee. All financial safety net authorities should be included: BaFin, as both supervisory and resolution authority, the central bank, and the MoF. This would not require moving formal decision-making authority—the committee's role would be to ensure that its members' actions are well coordinated and to oversee the preparation and maintenance of national and agency-specific crisis plans. The reformed deposit insurer should also be integrated into crisis coordination arrangements, given the essential role it plays in Germany's financial safety net.

Table 1. Germany: Main Recommendations—Crisis Management and Financial Safety Nets

Recommendation	Priority	Timeframe	Authority
Institutional Arrangements, Coordination, and Cooperation			
1. Streamline the scope and frequency of BaFin's supervisory reporting to the MoF to ensure operational independence (¶22).	H	I	MoF/BaFin
2. Formalize in-crisis coordination arrangements through expanding the FSC's existing crisis management mandate to include a greater operational role in crises, or establishing a parallel committee (¶23–24).	H	I	MoF/BaFin/ BBk
3. Expand the existing program of crisis simulation and testing, with greater involvement of banking supervision departments (¶24).	M	NT	BaFin/BBk
4. Increase coordination with DGSs and IPSs and their involvement in the program of crisis-simulation exercises (¶25).	M	NT	BaFin/BBk
Recovery Planning, Early Intervention, and Triggers			
5. Make earlier use of supervisory powers to increase effectiveness of dealing with problem banks (¶27).	H	NT	BaFin
6. Reduce the use of moratorium powers, shorten moratorium periods, and reduce lags between decisions on moratoria, FOLTF assessments, DGS compensation, and triggering of insolvency (¶28).	M	NT	BaFin
7. Ensure that IPS recovery plans are assessed to the same standards as the most systemically important banks (¶30).	H	I	BaFin

Table 1. Germany: Main Recommendations—Crisis Management and Financial Safety Nets (Concluded)

Recommendation	Priority	Timeframe	Authority
Resolution Regime			
8. Further formalize in-crisis cooperation arrangements between BaFin's resolution and supervisory functions (¶32).	M	I	BaFin
9. Review the national discretion available under the DGSD to increase the cap on DGS contributions to the costs of resolution as a percentage of the target level (¶37).	M	MT	MoF
10. Review implementing the BRRD government stabilization tools (¶36).	M	MT	MoF
11. Continue and expand existing work on bail-in execution, in particular on cross-border issues and timely valuation data (¶35).	M	NT	BaFin
12. Review the application of the public interest assessment methodology to IPS and voluntary DGS members to capture impacts on the stability of these schemes (¶43).	M	MT	
13. Ensure resolution plans for IPS members are appropriate for scenarios where a large share of members of an IPS, or the IPS itself, are in distress, promoting review of EU legislation, if necessary (¶39).	H	I	BaFin/MoF
Resolution Regime			
14. Reassess resourcing for LSI and host institutions resolution planning, given the large number of institutions and increasing size and complexity of some, e.g., of business models post-Brexit (¶21).	H	I	BaFin/MoF
Depositor and Institutional Protection			
15. The authorities should review the systemic implications of maintaining near-universal protection for depositors and develop an overall strategy for DGS/IPS reform (¶47).	H	MT	MoF/BBk/ BaFin
16. Ensure that the mandatory DGSs have access to a robust public sector backstop liquidity line (¶43).	H	NT	MoF
17. Establish a single mandatory DGS as a public body (¶46).	H	NT	MoF
18. Review the suitability of voluntary DGS and IPS arrangements that lack clear legal rights to compensation or support, given the likely impact on depositor confidence of any failure to provide support. (¶48).	M	NT	MoF/ BaFin
Emergency Liquidity Assistance			
19. Test operational arrangements for ELA with the industry (¶53).	M	MT	BBk

Note: H, M, and L stand for high, medium, and low. In terms of timeframe, I, NT, and MT stand for immediate (within one year), near-term (within 2–3 years), and medium-term (within 3–5 years).

INTRODUCTION[2]

A. Context and Scope

12. **This note reviews Germany's financial safety net and crisis management arrangements, including inter-agency coordination arrangements, supervisory early intervention and recovery planning, the resolution regime, emergency liquidity assistance (ELA), and the depositor and institutional protection regimes.** It draws on analysis of legislation and policy documents, the authorities detailed responses to a questionnaire, and discussions with the authorities and market participants during the FSAP mission. The note draws, in places, on international standards—in particular, the Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions and the International Association of Deposit Insurers (IADI) Core Principles for Effective Deposit Insurance Systems—but it does not constitute a detailed assessment of compliance with these standards.

Box 1. Main Findings of the 2018 Euro Area FSAP on Crisis Management

In July 2018, the IMF concluded its first Euro Area FSAP, praising the Euro Area authorities for establishing a considerably strengthened bank resolution framework at the EU-level, while highlighting room for further improvement.

- **The banking union needs a more effective deposit insurance system (DIS)**. Many national DISs are underfunded and lack effective backup funding. A common deposit insurance system for the Euro Area is missing. Greater risk pooling would help avoid disruptions that may overwhelm countries' individual capacities and would help address hosts' risk-sharing concerns.
- **A financial stability exemption is needed to help mitigate critical constraints in the framework.** The SRMR requires bailing in a minimum of 8 percent of total liabilities and own funds prior to access to the Single Resolution Fund or national public funds for loss absorption. Building loss-absorbing capacity and recapitalization capacity beyond capital requirements will take time, and is generally not required for smaller banks expected to be liquidated. Many banks may therefore have no access to funds, even in a system-wide crisis. A financial-stability exception—to be used only in times of Euro Area-wide or country-wide crisis—subject to strict conditions and appropriate governance arrangements—would bring much-needed flexibility
- **Despite the establishment of the SSM and the SRM, fragmentation along national lines persists.** In the EU, resolution requires an assessment against potential outcomes under significantly heterogeneous national insolvency regimes. This is exacerbated by diverging national supervisory powers and securities regulation practices, various national discretions in the directives for bank resolution and deposit insurance, and SRB decisions being executed by national resolution authorities under diverging national laws (e.g., administrative and labor laws). Heterogeneous national (bank) insolvency regimes, with more generous public-funding options and less stringent loss-sharing requirements under EU state aid rules than in the SRM, deliver substantially different outcomes for bank creditors, and strongly incentivize national solutions.

[2] This Technical Note was prepared by Mark Adams (IMF). The FSAP team would like to thank the authorities and other counterparts for their support. The German and EU authorities, market participants, and analysts provided extensive access to information and open discussion of their views, which greatly enriched this report. The logistical support of the authorities is especially appreciated, given the additional challenges of a partially hybrid mission.

Box 1. Main Findings of the 2018 Euro Area FSAP on Crisis Management (Concluded)

- **Many banking union countries have not availed themselves of essential powers available under EU directives.** For example, most countries have not established powers for public equity support and temporary public ownership (i.e., "government stabilization tools"); almost two-thirds of the countries have not authorized the use of deposit insurance funds in liquidation proceedings, preventing the use of time-tested and cost-effective purchase and assumption ("sale of business") transactions in liquidations.
- **A more unified resolution framework for small and large banks should include an administrative bank liquidation tool.** This would allow the National Resolution Authority (NRA) to appoint a liquidator and commence proceedings. The NRA would be authorized to apply this tool to all banks within its remit—irrespective of whether the public interest test is met. A liquidation tool would help reduce destruction of value, level the playing field for creditors, and reduce the risk of member states "gaming" the system.

13. As Germany is part of the European Union and the Euro Area, the management of distressed financial institutions takes place within a European framework. For all parts of the financial safety net, many aspects of the legal regime are set by European law or regulatory guidelines. The ECB, as part of the SSM, has the direct responsibility for the supervision of Germany's largest institutions (Significant Institutions (SIs)) while BaFin and the Deutsche Bundesbank (BBk) are responsible, under the oversight of the ECB, for the supervision of other smaller banks (LSIs). Similarly, the Single Resolution Board (SRB) has primary responsibility for decisions relating to the resolution of larger and cross-border institutions. BaFin is responsible, under the SRB's oversight, for the resolution of other smaller banks. Any provision of ELA is the BBk's responsibility, but it must act within a framework set by the ECB.[3] IMF recommendations relating to the European framework are set out in the 2018 Financial System Stability Assessment for the Euro Area (IMF Country Report No. 18/226) and summarized in Box 1 above. This note will focus on national aspects of the regime.

B. Market Structure and Recent Experience of Financial Distress

14. Germany's financial system is bank-centric, with the banking sector traditionally seen as split into three pillars. Credit institutions, with assets equivalent to 270 percent of GDP, account for about 60 percent of financial sector assets. Germany accounts for 25 percent of total Euro Area bank assets and about 55 percent of total Euro Area LSIs by both number and assets. The first "pillar" consists of a diverse group of private commercial banks, which account for about 48 percent of banking sector assets, and includes 1 German global systemically important bank (G-SIB), 12 other SIs, and a large number of smaller banks. This pillar has recently grown due to the transfer of some wholesale banking activity from the United Kingdom after Brexit, and now includes multiple large capital markets-focused subsidiaries of non-EU G-SIBs, with the total assets of non-EU groups having grown more than ten-fold in the last four years. The second pillar (~32 percent of bank assets) consists of the 376 publicly owned Sparkasse (savings banks) and associated financial institutions, including the 5 Landesbanks, which provide wholesale financial services to the

[3] The BBk is not legally required to provide ELA in any specific case. However, should the BBk decide to grant ELA, the ECB Governing Council may object, under Art. 14.4 of the Statute of the ESCB and the ECB.

Sparkassen.[4] Lastly, the cooperative banks (~20 percent of bank assets) include 1 large central institution, DZ Bank, and more than 800 individual cooperative banks.

15. Institutions in the savings bank and cooperative bank pillars do not operate wholly independently, but as part of networks that include IPSs recognized under EU law—failure of individual small banks in these pillars is therefore unlikely, unless the financial strength of the pillar as a whole is at risk. These networks play an important role in both day-to-day operations (e.g., coordinating marketing and IT) and, acting as IPSs, in crisis management for these banks. Of the 1,324 German LSIs, almost 1,200 are members of an IPS, as are 8 of the 21 SIs. The IPSs seek to detect distressed members early, have powers to intervene in their management, and provide financial support to prevent their failure (see Box 2). The IPS for savings banks and Landesbanks is operated by the Deutsche Sparkassen-und-Giroverband (DSGV), and includes 11 regional sub-funds as well as sub-funds for Landesbanks and for regional building societies (Bausparkassen); the IPS for cooperative banks is operated by the Bundesverband der Deutschen Volksbanken (BVR) and organized on a central level.

16. There have been three significant cases of bank distress or failure since the 2016 FSAP. These involved one Landesbank, NordLB, and two German bank subsidiaries of international financial services groups, Wirecard and Greensill. In addition, the restructuring of former Landesbank HSH Nordbank was completed in 2018, resulting in its conversion into a private-law bank (Hamburg Commercial Bank), following the transfer of a large portfolio of non-performing loans to the former regional government shareholders. The liquidation of Maple Bank, a Canadian-owned bank which failed in 2016, has been almost completed. Other banking sector support measures put in place during and after the global financial crisis—which included public sector guarantees of bank funding, a blanket government guarantee of deposits, and the public sector recapitalization or full nationalization of several banks—have mostly come to an end. However, the wind-down of bad banks established for Hypo Real Estate and WestLB continues under the supervision of FMSA, the former national resolution authority.

[4] Other members include DekaBank, which provides asset management services, 8 regional building societies (Landesbausparkassen), and a range of other financial and nonfinancial companies.

Box 2. Institutional Protection Schemes in the European Union

In EU financial regulation, an IPS is a mutual support arrangement between banks, which commits to provide financial support to ensure the liquidity and solvency of its members. If an IPS meets certain criteria set out in the Capital Requirements Regulation (CRR), its members gain some of the same regulatory benefits as institutions that are members of a single consolidated group. Members can apply for supervisory permission to (i) apply a zero percent risk weight to most exposures to other members of the same IPS; (ii) exempt these exposures from large exposure limits; (iii) exempt exposures to the capital of other IPS members from being deducted from their own capital; and (iv) waive individual institution liquidity requirements and apply more favorable inflow and outflow percentages for the calculation of the liquidity coverage ratio.

As both German IPSs include both SIs and LSIs, the SSM and BaFin cooperate on the assessment of whether they meet these criteria. Banks must apply to their supervisor (either BaFin or the SSM) for recognition of any IPS they are members of. The SSM has published guidelines on how it and national supervisors will assess compliance with these criteria.[1] Neither BaFin nor the SSM has direct prudential regulatory authority over IPSs under the CRR. However, both German IPSs are recognized by BaFin as DGSs, and must meet the requirements of the EinSiG (which transposes into German law the Deposit Guarantee Scheme Directive (DGSD)), and BaFin can intervene in the event of violations.

The CRR criteria for recognition require the IPSs to have systems to monitor and influence their members' riskiness, and to be able to grant support from funds readily available to it. The SSM guidelines further specify, among other requirements, that governance structures must allow timely decisions on support measures; that there should be a clear commitment to provide support; and that there should be an ex ante fund (although there are no guidelines on the size of the fund).

The two German IPSs are by far the largest in the Euro Area. Other Euro Area IPSs exist in Austria, Italy, and Spain. Apart from the German schemes, only the two Austrian IPSs, one of which is wholly consolidated into a single banking group supervised on a consolidated basis as an SI, form a large part of their national banking system.

Most other large EU cooperative bank networks (e.g., in France, Italy, and the Netherlands) are now supervised as consolidated groups. These cooperative bank networks share many features with IPSs and retain some decentralized decision making.

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[1] SSM "Guide on the approach for the recognition of institutional protection schemes (IPS) for prudential purposes".

Box 3. Recent Cases of Bank Distress

NordLB, a public Landesbank owned by two regional federal states and regional savings banks associations, required recapitalization in 2019[1] . The capital shortfall was the result of losses on its shipping loan portfolio and restructuring costs, and followed an earlier round of recapitalization in 2011-12. Following an attempted private sale process and informal discussions with stakeholders, formal discussion of support from the DSGV IPS began on 19 January, and concluded with an agreement between the DSGV and NordLB's shareholders on 21 June. During this period there were extensive negotiations on burden-sharing between the regional governments, the regional savings bank associations, and the DSGV IPS and its sub-funds. The final support package consists of both asset guarantees from the federal states and direct capital injections and investments of €3.1 billion (65 percent from the federal states, 12 percent from three regional savings bank associations, 24 percent from the DSGV IPS)[2].

Wirecard Bank AG is the bank subsidiary of Wirecard AG, a German payments group which failed in June 2020 following revelations of accounting fraud. Wirecard Bank provided payment, deposit, and lending services in support of the broader group's business. At the point when Wirecard AG entered insolvency, Wirecard Bank held significant intragroup deposits which, under German insolvency law, would be subordinated to other claims. Thanks to the presence of this buffer, which provides protection against loss to non-intragroup creditors, Wirecard Bank has been able to enter a solvent wind-down process with deposits remaining available and intragroup liabilities ring-fenced by BaFin, rather than resolution or insolvency. As described in the accompanying Technical Note on LSI Regulation and Supervision, the failure of the Wirecard Group has prompted changes to a number of aspects of German prudential and conduct supervision.

Greensill Bank AG was the German bank subsidiary of Greensill Capital, an international financial services company focused on supply chain finance, which entered insolvency in March 2021 following the revelation of highly concentrated lending against inadequate collateral and the withdrawal of insurance coverage. Greensill Bank was acquired by Greensill Capital in 2014. The bank grew very rapidly in 2019, with a fivefold increase in total assets in one year, in part by attracting a large volume of deposits through online deposit brokers. BaFin imposed a moratorium on Greensill Bank on March 3, preventing all payments including the withdrawal of deposits, and subsequently petitioned the courts to open insolvency proceeding against the bank and declared that DGS compensation would be paid on March 16. Compensation of around €3.1 billion was paid, by both the mandatory DGS and the voluntary DGS operated by the German Bankers Association (BdB).

[1] This followed earlier restructuring aid to NordLB in 2012-2015 – see Annex II of the 2016 Germany FSAP Technical Note on Crisis Preparedness, Bank Resolution, and Crisis Management Frameworks (IMF Country Report No. 16/194).

[2] All figures are from the public version of the European Commission State Aid Decision Letter: 283125_2123117_150_5.pdf (europa.eu).

INSTITUTIONAL FRAMEWORK

17. Germany's institutional arrangements for financial crisis management are complex, with important roles for German public authorities, European institutions, and multiple industry-run DGSs and IPSs.[5] The safety net participants have well-established lines of communication and interaction, and the national FSC has a mandate that includes work on crisis management. In practice, the coordination arrangements between authorities in a live crisis situation

[5] The institutional arrangements for involvement of the European authorities in crisis management (ECB, SSM, SRB, and European Commission) follow the structures described in the Euro Area FSAP and are not set out in full here.

remain somewhat informal, and none of the DGSs or IPSs are formally embedded in the arrangements for institutional coordination.

18. The MoF is responsible for the overall safety net framework and for the legal and technical oversight of BaFin. It chairs the FSC, participates as a member in resolution colleges, and represents Germany in the event that the European Council is asked to approve or object to a resolution scheme proposed by the SRB.[6] Any use of public funds would require the MoF to seek authority from the German parliament.

19. BaFin is the financial sector supervisor and national competent authority (NCA) for both prudential and conduct issues for banks, capital market firms, insurers, pension funds, and financial market infrastructures (FMIs). As the prudential NCA for credit institutions, it participates in the European SSM. It has the lead responsibility for supervision of LSIs under the SSM's oversight and participates in SSM-led Joint Supervisory Teams (JSTs) for SIs. The ECB SSM retains responsibility for some specific decisions, even for LSIs, including the removal of banking licenses (in general, based on a proposal from BaFin, but potentially on the SSM's own initiative). In this role, BaFin's crisis-related responsibilities include review of banks' recovery plans, identification of and early intervention in problem institutions, the recognition of IPSs (jointly with the SSM), and several decisions related to bank failure (declaration of DGS compensation events, determination of whether a bank is failing or likely to fail, initiating insolvency of a bank, and proposing the withdrawal of a banking license to the SSM). About 550 of BaFin's 2,720 staff work in banking supervision. Following a reorganization in the wake of the NordLB case, a specialized directorate (Directorate R) covers most crisis management issues, including the policy areas listed above (apart from DGS issues) and the intensified supervision of weak banks.

20. BaFin also took over as Germany's NRA in 2018, absorbing most of the responsibilities and staff of the Financial Market Stabilization Authority (FMSA)—the previous NRA; some scope remains to improve cooperation between the NRA and banking supervision. In this role, it participates in the European SRM, with lead responsibility for resolution planning and resolution of LSIs, FMIs, and investment firms, and as part of Single Resolution Board-led Internal Resolution Teams (IRTs) for SIs and cross-border LSIs. The responsibilities of the resolution directorates in BaFin include running crisis-simulation exercises (most recently in September 2020[7]), preparation of resolution plans and the assessment of resolvability, chairing BaFin's internal Core and Extended Crisis Committees, which coordinate BaFin's work on live resolution cases, determining whether a bank meets the conditions for resolution, and executing any resolution. These internal crisis committees and the simulation exercises do not yet include bank supervision staff (from either BaFin or BBk; doing so would help to ensure clear understanding of the roles of each directorate in crisis situations. BaFin's NRA functions are carried out by three resolution directorates, which report to the Chief Executive Director of the resolution sector of BaFin, a sector independent from the supervisory

[6] See the Euro Area FSAP, Technical Note on Crisis Management.

[7] BaFin´s Resolution Directorate has also conducted a "Stress Test Exercise" in 2019 with all German DGSs. The exercise followed a short playbook intended to test major crisis procedures/milestones and the pathway to resolution.

sector in order to avoid conflicts of interest with prudential supervision, and has about 100 staff. Staff resources may be stretched in the teams responsible for resolution planning for LSIs and host institutions, which cover a large number of institutions with diverse business models, some of which are highly complex and have grown following Brexit (e.g., G-SIB subsidiaries). The FMSA remains responsible for overseeing the wind-down of two bad banks, as well as the operations of Portigon AG (which assumed the continuing business of WestLB, a former distressed Landesbank).

21. The BBk plays a key role in banking supervision and financial stability analysis and may grant ELA in cases of need. About 1,500 BBk staff are directly involved in the supervision of banks and CCPs and have operational responsibility for most on- and offsite supervision tasks, although BaFin is responsible for supervisory decisions based on the BBk staff's work. BBk staff does not have direct involvement in bank resolution. Consistent with the Eurosystem agreement on emergency liquidity, the BBk is responsible for any decision to grant ELA and would assume the credit risk associated with any ELA, but it requires the ECB's non-objection for larger ELA operations.

22. The authorities should take a more systematic and streamlined approach to BaFin's supervisory reporting to the MoF to ensure BaFin's operational independence, with a sub-committee within FSC or a parallel body, taking a greater operational role in crisis management. The detail and frequency of communication between BaFin and the MoF in a number of cases appears to go beyond the necessary oversight and financial stability responsibilities of the MoF. All microprudential developments of material importance are reported to the MoF, as well as most decisions about the internal organization of BaFin and changes to regulations and guidance. Reporting is done at divisional and directorate levels, as well as more senior levels. Although the MoF rarely provides explicit directions to BaFin, this extensive level of supervisory reporting, including on individual cases, may affect the actual and perceived independence of BaFin. Sufficient information flow from BaFin to the MoF can be ensured with less granular reporting, such as the quarterly reporting from the BaFin Resolution section.

23. The national FSC already carries out some work on crisis preparation. Formal arrangements for in-crisis coordination could be strengthened, either within or outside the FSC's structure. The FSC, comprising the MoF (as chair), BaFin, and the BBk, is the central body responsible for coordinating official sector work on financial stability and macroprudential issues. It has a statutory mandate for work on crisis management, with the Financial Stability Act giving it responsibility to strengthen the cooperation of its member institutions in the event of a financial crisis. The FSC's crisis management role has focused on pre-emptive work, such as loss-absorbing capacity and the preparation of a handbook of in-crisis tools available to its members. Hence, the FSC has a very limited role in-crisis, other than a requirement for BaFin (as NRA) to notify it if a bank is failing, or likely to fail. Instead, coordination between the authorities in crisis cases has occurred mainly through strong and regular, but ad hoc, bilateral and multilateral communication. To formalize the coordination of in-crisis policy responses and communications, the authorities could establish a sub-committee within the FSC or create a separate body parallel to the FSC.

24. Germany has a uniquely complex system of depositor and institutional protection, which divided into multiple subschemes that have historically developed separately for each pillar of the banking system and are operated by industry bodies. All of the DGS and IPS schemes have limited involvement in formal crisis coordination arrangements. European legislation requires all banks to be members of a DGS covering €100,000 per depositor. Germany, uniquely, has three separate mandatory schemes—one for each pillar[8]—to meet this mandate. In addition, most private banks are members of the voluntary DGS operated by the BdB, which provides much higher levels of protection—15 percent of the member bank's eligible capital *per depositor*.[9] As noted above, all savings banks, Landesbanks, and cooperative banks are members of an IPS,[10] which provide financial support to prevent the failure of members, effectively protecting all depositors and other liability holders. Both the voluntary private sector DGS and the two IPSs have extensive powers under their membership agreements to inspect their members, intervene in the operations of distressed members, and provide financial support to avoid default. These powers, as well as the need of the mandatory DGSs to prepare for possible payouts, make the DGSs and IPSs crucial actors in managing distressed banks. However, in part due to their status as industry bodies (which carry out some public law tasks in their role as mandatory DGSs) rather than public authorities, their engagement with the authorities' crisis management preparation and coordination work is limited.[11] This could allow for misunderstandings, divergent communication to the public, and delays in decision making in a crisis situation. To mitigate this and improve crisis preparedness, the authorities should revise the crisis coordination arrangements to increase coordination with the DGSs and IPSs, and to also involve them in the program of crisis-simulation exercises.

EARLY INTERVENTION AND RECOVERY PLANNING

25. Early use of supervisory and early intervention measures to decisively address problems at weak banks is typically the best way to minimize losses and reduce the risk of contagion; BaFin has a broad toolkit of powers for this. Powers for supervisory and early intervention measures by BaFin bank supervision in Germany are provided in both the Recovery and Resolution Act (SAG) and the Banking Act (KWG). These supervisory powers follow those provided for in European legislation under the BRRD and Article 104 of the CRD and include powers to develop a restructuring plan; limit lending, deposit growth, or other business activities; require implementation of recovery plan options; and dismiss management. BaFin may also appoint special representatives to a weak bank—most often these have responsibility to monitor the

[8] A fourth mandatory scheme covering five public promotional banks merged with the private sector scheme on October 1, 2021. A separate voluntary scheme for these banks remains in place.

[9] For example, the announced protection limit for Greensill bank was ~€75 million. See the FAQ of the voluntary DGS for more details: https://einlagensicherungsfonds.de/faq/fragen-zur-greensill-bank-ag/.

[10] For savings banks and Landesbanks, the IPS also acts as the mandatory DGS fund; for cooperative banks the IPS and the mandatory DGS fund are legally separated but both are operated by the BVR.

[11] The mandatory DGSs are subject to BaFin oversight and required to conduct DGS stress tests, as described below.

implementation of supervisory measures,[12] but BaFin can also provide “strong” special representatives who take over some or all of the bank’s decision-taking responsibilities.

26. BaFin should make earlier use of its supervisory powers for weak banks. Discussions with supervisors indicated that, in some cases of weak banks, supervisors issued multiple warning letters, or asked for multiple valuation or audit reports, before taking more proactive formal supervisory measures. This need for more decisive and timely supervisory action is recognized in BaFin’s own reorganization plan, as part of a broader workstream on cultural change, and some necessary changes to BaFin’s documented procedures for applying the ladder of early intervention reaction have been identified, including reducing excessive reliance on lagging quantitative indicators and integrating early intervention decisions more into the supervisory process.

27. BaFin should reduce its use of blanket moratoria on the liabilities of weak banks and shorten moratorium periods. Discussions with supervisors indicated that BaFin would routinely expect, as the last step of the supervisory escalation ladder, to apply a blanket moratorium preventing payments, including deposit withdrawals, from a weak bank. Moratoria have been applied three times since 2015 and can be applied for up to six weeks before BaFin declares a DGS compensation event, although discussions with supervisors and experience from recent cases indicated that 1–2 weeks is more typical. Although moratoria are intended to be applied to going-concern banks, BaFin was not aware of any cases in which a bank subject to a moratorium had successfully returned to viability; moratoria led to closure and/or DGS payouts. Given the typical length of the moratorium, this significantly extends the period for which deposits covered by the DGS may be unavailable,[13] with potentially significant impact on depositors and on wider deposit confidence in the system if their main transactional deposit accounts were affected. BaFin’s ability to provide partial exceptions from the moratorium can mitigate this to an extent, but if broadly applied, it would allow large liquidity outflows. BaFin should therefore review its processes to ensure that it does not need a long moratorium period and is prepared to make decisions about the likely next steps (declaration of a DGS compensation event, proposing the withdrawal of authorization, and application for insolvency), for weak banks promptly when a moratorium decision is being considered.

28. Recovery planning is well established for SIs and potentially systemically relevant LSIs, but is at an early stage for most IPS members and smaller banks. Recovery planning policy is the responsibly of Directorate R in BaFin’s banking supervisory area. For LSIs, BaFin assesses recovery plans in coordination with the BBk, and for SIs, BaFin and BBk participate in the SSM JSTs that are responsible for recovery plan assessment. Larger German banks have been subject to recovery planning obligations for 7–8 years, since before the establishment of the SSM. For LSIs, an assessment is made of whether they are “potentially systemically relevant;” those that are, have now been required to submit recovery plans with similar scope to those for large banks for four years.

[12] In this case, the special representatives are often BBk staff. BBk staff cannot be appointed as “strong” special representatives.

[13] The EinSiG, in line with the DGSD, requires that DGSs target a payout of covered deposits within seven working days following a determination that compensation is due. BaFin must make this determination no later than five working days after becoming aware that a bank is unable to repay deposits that are due.

For these two groups of banks, earlier rounds of recovery plan submissions identified common issues similar to those seen in peer countries, including governance weaknesses, overly optimistic valuation or scenario assumptions, and incomplete sets of triggers or recovery options. These have been addressed through iterative supervisory feedback. For the large remaining population of banks, BaFin has, so far, limited experience of recovery planning. Smaller private sector banks are eligible to submit simplified recovery plans (in alignment with the BRRD). BaFin received the first round of these between end-2020 and October 2021, and early analysis suggests they had similar shortcomings to early submissions from larger banks.

29. The first joint IPS recovery plans have only recently been submitted—given the importance of the IPSs to the German banking system, their recovery plans will need to be held to a high standard. As permitted under the BRRD, BaFin has opted to grant waivers of the obligation for IPS member banks which are LSIs to submit recovery plans. A condition of this waiver is that the IPSs must submit joint recovery plans. At the time of the FSAP mission, submission of the first round of recovery plans for the two IPSs was due in the next few months, and BaFin did not yet have clear sight of their content. Given the size and importance of the two IPSs to the German financial system, BaFin should expect these recovery plans to meet suitably high standards, similar to the largest banks. The description of recovery options should clearly set out how financial support from the IPSs would be provided, including clear descriptions of the governance arrangements required to implement them and the speed with which action could be taken. The recovery plans should also include in-depth consideration of scenarios where the IPS as a whole is in financial distress, and recovery options that might be available in this situation, as is required for European cooperative bank networks, which are supervised as consolidated groups.

RESOLUTION REGIME

30. Most aspects of the German bank resolution regime are broadly in line with global and European good practice, although the use of the regime could be extended further for LSIs. The legal framework for the resolution regime is set out clearly in a combination of German and European law. The SAG implements the BRRD in Germany and sets out BaFin's powers, tools, and objectives as the German NRA. The SRM Regulation sets out the powers of the SRB and the framework for coordination between the SRB and NRAs in the resolution of banks in the Banking Union.

31. The process for triggering resolution is well planned and sufficiently flexible, but internal coordination with banking supervision and the BaFin President's office could be more formalized. The resolution directorates' Core Crisis Committee (CCC) is responsible for managing the process, supported by the Crisis Management Division (AM3) and the relevant Resolution Planning Unit. The CCC includes the senior management of the resolution directorates and can also meet in extended format, including the heads of other relevant BaFin divisions (e.g., legal, communications). However, to avoid conflicts of interest and to maintain operational separation of the resolution authority, it does not include representatives from banking supervision (either BaFin or BBk) or the BaFin President's office; AM3 division is responsible for coordinating with these areas of BaFin. The CCC meets regularly, not only in crisis situations. To trigger resolution, according to EU

law three conditions must be met. The first condition is whether a bank is "failing or likely to fail" (FOLTF)—this assessment is carried out by BaFin banking supervision (usually Directorate R), in consultation with the NRA and with notification to the SRB. This assessment may be conducted when a moratorium is already in place—as part of reviewing options to reduce the use of moratoria, BaFin should consider how to ensure FOLTF assessments are carried out before this point. The second condition, whether there is a reasonable prospect that alternative private sector measures to address the bank's problems will succeed, is also led by banking supervision. In particular, the intensified supervision team is responsible for discussing with the relevant voluntary DGS/IPS on whether they will provide financial support; resolution will not be triggered until the DGS/IPS confirms that it is not willing to step in, which sometimes requires several rounds of discussion.

32. The SAG provides BaFin with a broad set of resolution powers and tools that are consistent with the FSB KAs. Once resolution is triggered, BaFin can apply several resolution tools: a bail-in of own funds and liabilities, or transfer assets and liabilities to a private sector purchaser, temporary bridge bank, or asset management company. Supplementary powers are available to replace management, require affiliates to continue providing essential services, apply a temporary stay of early termination rights, or impose a short moratorium. Safeguards on the use of powers include the requirement that no creditor should incur greater losses in resolution than in insolvency without compensation (the "no creditor worse off" principle), and protection for rights of set-off and collateral. BaFin has developed extensive internal documentation to support the application of these powers, including a comprehensive resolution manual, critical paths for implementing each resolution tool, and information tools to support decision making during a resolution weekend. BaFin staff have appropriate protection against individual legal liability for resolution decisions taken in good faith and courts can require compensation, but not reverse resolution decisions. BaFin has appointed panels of technical advisors (valuation experts, advisors on implementation of tools, and transactional advisors).

33. BaFin has focused in particular on ensuring adequate loss-absorbing capacity and enabling the execution of bail-in, which is the most likely resolution tool for many German banks. Most German banks already meet applicable requirements to issue liabilities that are able to absorb losses in resolution with few impediments; for G-SIBs, the FSB TLAC standard was implemented in the CRR, and for all banks the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) was implemented in the BRRD and SRMR, set on an individual bank basis by BaFin (for LSIs) or the SRB (for SIs). In general, banks' final MREL targets are set for 2024. Due to ongoing issuance of new TLAC/MREL instruments (including since the beginning of the COVID-19 pandemic) and the statutory subordination of legacy senior unsecured debt instruments, shortfalls against the final 2024 TLAC/MREL requirements are already very rare, even as of today. BaFin has also implemented additional requirements for banks to support the quick execution of a bail-in of these liabilities. Banks are required to be able to deliver specified data on liabilities to BaFin within 24 hours of a request in a crisis. Information is provided at a granular level (individual ISINs and subordinated deposits) in a format which can be provided directly to BaFin. BaFin has standardized processes and automated calculation tools in place to perform the required calculations at instrument level for bail-in and automatically prepare information for the implementing legal instrument and the central securities depositories (CSDs), who would operationally freeze, cancel,

and exchange bailed-in securities. BaFin has conducted dry runs to test these capabilities. Further work is planned by BaFin on bail-in execution of international securities, including on legal issues and data requirements for international CSDs; this will help drive progress on this critical operational issue at both national and Banking Union levels. BaFin should also continue to engage with valuation experts on whether they can deliver information required for the bail-in calculation (e.g., information on structured instruments, derivatives) on a similar timescale.

34. Germany should consider implementing the BRRD government financial stabilization tools, if legally possible. European legislation on bank resolution includes optional provision for the use of government guarantees and public equity support in exceptional circumstances where government support is needed to maintain financial stability.[14] Germany has not implemented these tools, although it applied similar measures during the global financial crisis, and federal state governments have provided equity support and guarantees to several Landesbanks since. The authorities should consider implementing these optional tools to provide a more structured framework for the use of these tools as a last resort, subject to determining that other resolution tools would not maintain financial stability and protect the public interest.[15]

35. Resolution funding arrangements have been established but have a number of potential limitations in their use. Funding in resolution may be required for a number of purposes: to provide additional capital for a bridge bank, to support a transfer to a private sector purchaser where the offered price for a package of assets and liabilities is negative, to compensate creditors for losses in excess of the NCWO safeguard, and to provide temporary working capital or liquidity to institutions under resolution. As a member of the Banking Union, Germany participates in the European Single Resolution Fund (SRF), which raises levies from the banking industry to meet costs of these kinds, and will, in the future, have access to backstop funding from the European Stability Mechanism (ESM) once ongoing ESM reforms are completed. The SRF has a target level of 1 percent of covered deposits; under transitional arrangements for its introduction, until 2023 part of the costs of resolution of a German bank would be met from a German "national compartment." As discussed in the Euro Area FSAP, there are a number of legal and operational obstacles in practice to the use of SRF funds in resolution.[16] In addition, the statutory DGS schemes (including the DSGV IPS) can be required by BaFin to contribute to resolution costs, but this is capped at half of their target level of ex ante funding (0.8 percent of covered deposits).[17] The relevant legislators should consider removing this limit, as the DGSs are adequately protected by the NCWO safeguard, which limits their contributions to the losses they would have incurred had the bank entered insolvency (likely to be low, as the statutory DGS would be a preferred creditor). The level of access to additional

[14] As noted in the Euro Area FSAP Technical Note on Crisis Management, almost half of EA countries have established powers for public equity support and temporary public ownership, which may be used after exploiting the other resolution tools to the maximum extent. However, the position expressed by the European Council Legal Service was that the government's financial stabilization tools provided for in the BRRD are currently available only for use outside of the SRM (for example, by non-EA member states).

[15] See also recommendation 19 in the IMF Euro Area FSAP Technical Note on Crisis Management.

[16] See in particular recommendations 3 and 18 in the IMF Euro Area FSAP Technical Note on Crisis Management.

[17] The cap of 50 percent of the target level of ex ante funding is set in BRRD Article 109; however, this article also allows national Member States to set a percentage higher than 50 percent.

resolution funds that may be required for liquidity purposes is reduced by the ability, in principle, of banks which have undergone resolution to access emergency liquidity from the BBk, subject to appropriate safeguards (see paragraphs 48-52 below).

36. Resolution planning is well advanced for SIs and larger LSIs. Resolution planning began under the FMSA for the four largest German banks and expanded to all SIs under the SRB. The most recent annual round of resolution planning also extended to banks for which BaFin expects it may need to use resolution tools in a systemic crisis. BaFin has a multiannual work program until 2024 for future resolution planning, based on the SRB's guidance for banks on expectations for resolvability. Areas of focus will include developing BaFin's assessment of resolution tools, which are more likely to be used for medium- and small-banks; in particular, for transfer to a private sector purchaser, banks' capabilities to predict their liquidity needs in resolution, and resolution planning for capital-markets focused investment firms and non-EU groups. Common potential impediments to resolvability—which BaFin has identified are similar to those in other EU member states—for example, availability of data, governance, liquidity in resolution, and communications planning. So far, BaFin has sought to address these issues through issuing guidance and dialogue with banks (and other RAs for cross-border institutions). BaFin could also address impediments through use of formal powers requiring action to address impediments.

37. Given the importance of LSIs and IPSs in Germany, thresholds for the third condition, the public interest assessment, and for triggering resolution should take adequate account of broader systemic risks. The assessment of whether resolution is necessary in the public interest is carried out by the resolution directorates in line with guidance from the SRB. BaFin has recently reviewed its application of the public interest assessment and identified a number of LSIs, whose resolution they would likely not have assessed as being in the public interest in an idiosyncratic failure, but would potentially be in a systemic stress scenario, these LSIs are now subject to additional resolution planning. There is scope to further extend this approach; in particular, to consider the impact on the relevant voluntary DGS/IPSs and, therefore, on confidence in the associated banking pillar since, given the very high levels of protection these offer to creditors, the failure of any medium-sized bank could result in a significant loss for the scheme. While the approach to public interest assessment is, to a large extent, harmonized at the level of the SRM, given the unique importance of IPSs and the voluntary private sector DGS in the German banking system, BaFin should take the lead in ensuring the approach to PIA and resolution planning for IPS and voluntary DGS members is fit for purpose.

38. BaFin should ensure resolution plans for IPS members are appropriate for scenarios where a large share of IPS members, or the IPS itself, are in financial distress, promoting review of EU rules, if necessary, to achieve this. Unlike for recovery plans, EU legislation does not permit a waiver of resolution planning requirements for individual institutions that are members of an IPS, conditional upon the preparation of a joint resolution plan. As the IPSs are strongly committed to providing financial support to their members,[18] the failure of an individual institution is less likely, unless the IPS as a whole is in distress; a possible resolution scenario for BaFin is

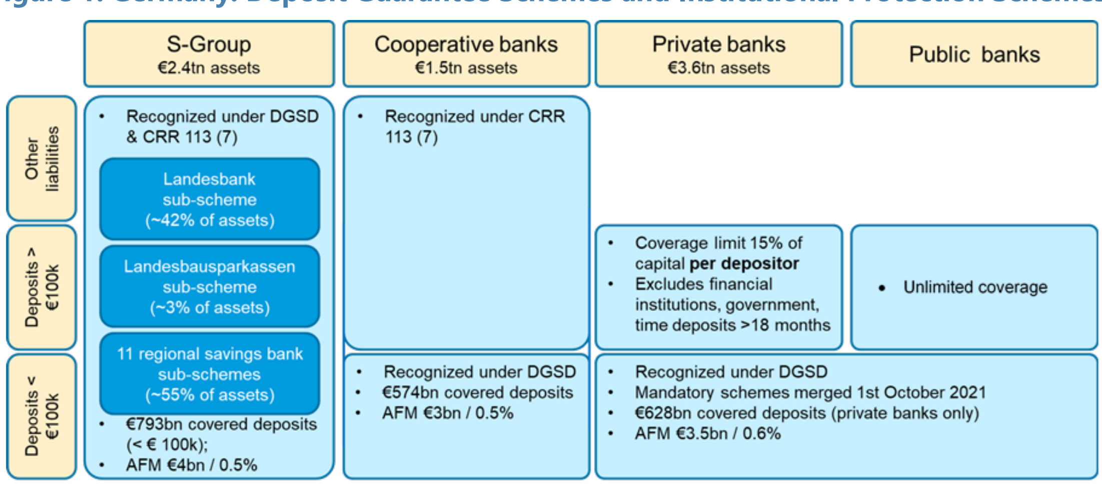
[18] Although not legally required to do so—see discussion in paragraph 47.

therefore one where the simultaneous resolution of multiple IPS members, or the IPS itself, may be required. While BaFin has conducted some initial modelling of contagion within the IPSs, it does not currently have resolution plans that address this scenario, in part due to the lack of a clear legal basis to conduct resolution planning at the level of the IPSs as a whole.

DEPOSIT GUARANTEE AND INSTITUTIONAL PROTECTION SCHEMES

39. Germany has a uniquely complex system of depositor protection, which nearly provides universal coverage to deposits and many other bank liabilities. The system consists of (at least) five schemes, some divided into multiple subschemes, as summarized in Figure 1. Deposits up to €100,000 per depositor are protected by statutory DGSs, which all banks are required to join. There are separate schemes for private sector banks and cooperative banks, operated by their respective industry associations. For savings banks, Landesbanks, and related institutions, the statutory DGS is merged with the IPS. The statutory funds cover close to €2 trillion in deposits, about 50 percent of all nonbank domestic deposits. In addition to this, all savings and cooperative banks and most private banks (~130 out of 180 members of the statutory scheme) are voluntary members of either an IPS or a voluntary "top-up" DGS. These protect deposits above the €100,000 limit—in the case of the private bank voluntary scheme, by providing additional coverage—currently up to a limit of 15 percent of the capital of the bank per depositor—for the largest banks, meaning coverage levels are in billions of euros. In the case of the IPSs, the schemes seek to avoid payout by providing financial support to distressed members; mandatory DGS funds may be used for these failure-prevention measures, as well as other sources of funding. The publicly owned savings banks and Landesbanks formerly benefited from explicit guarantees by local and regional governments, which were abolished in 2006. However, the two IPSs and the voluntary DGS continue to provide high levels of protection to depositors and (in the IPSs) other investors.

Figure 1. Germany: Deposit Guarantee Schemes and Institutional Protection Schemes[1]



Sources: DGS/IPS annual reports; responses to FSAP questionnaire. S-Group refers to the Sparkasse Finance Group, the IPS operated by the DSGV.

[1] AFM: available financial means, reported as €bn and as a percentage of covered deposits.

40. Both the voluntary DGS and the IPSs aim to identify distressed members and prevent their failure. Each scheme seeks first to identify vulnerable members early and intervene to prevent serious distress. They require members to provide extensive access to information to allow the schemes to monitor and identify risk. For the private sector scheme, their affiliated audit association is responsible for annual risk audits of members, with cases of vulnerable banks escalated to the scheme's steering committee. For the cooperative banks and savings banks, members submit information to the IPS's central body. Each has agreements with members permitting the onward sharing of information with BaFin and BBk to share supervisory information with the scheme. The schemes aim to identify vulnerable members at an early stage and, in practice, often initially flag problem institutions to supervisors. Once a problem member is identified, all three schemes have extensive powers to intervene in their management. For private banks, the bylaws of the voluntary scheme provide broadly specified powers to intervene in members' business, e.g., to cap the growth of their deposits. For cooperatives, tools available to the scheme include increased reporting requirements for weak banks or requiring a restructuring plan that must meet criteria set by the BVR; for savings banks, similar tools are available to each regional subscheme. See the accompanying Technical Note on LSI Regulation and Supervision for a discussion of synergies between these risk-monitoring practices and bank supervision.

41. In practice, payouts by the statutory DGSs are rare, as the voluntary DGS and IPSs can and do provide financial support to prevent the failure of distressed members. There have been three payout cases (including Maple Bank and Greensill Bank) for the private statutory scheme since the last FSAP,[19] and none for the IPS statutory schemes, consistent with the aim of the IPSs to avoid member failures. BaFin's Directorate R will typically seek confirmation from the schemes whether they are willing to provide financial support to prevent failure before imposing a moratorium, or before resolution is triggered by BaFin's resolution function. For private banks, financial support decisions require a majority vote of the voluntary DGS's executive board (consisting of member representatives); there have been three cases in the last 10 years where the scheme took over member banks. For cooperatives, support from the central scheme would typically take the form of a guarantee of credit risk to support a restructuring or merger with another cooperative.[20] For savings banks and Landesbanks, the governance and risk sharing for financial support decisions is more complex. Available support measures again include guarantees and capital injections but are decided at the level of the relevant subscheme; if the amount of support needed exceeds the subscheme's resources, the national scheme may provide additional resources. Resolving burden-sharing between subschemes and public sector shareholders is especially complex for Landesbanks, whose subscheme has highly concentrated exposure to just six members, which may operate in multiple regions and may have regional savings bank associations as shareholders.

42. The financial resources available to the schemes are relatively limited, given that none has access to a robust liquidity backstop; the authorities should put in place a public sector liquidity backstop for at least the statutory schemes. The statutory schemes have a target ex

[19] The private sector voluntary DGS provided financial support to avoid member failures in a number of cases between the Global Financial Crisis and the 2016 FSAP.

[20] Or, occasionally, a full payout from the voluntary IPS fund when no credible restructuring plan is possible.

ante fund level of 0.8 percent of covered deposits, to be reached by July 2024, and can raise additional levies (normally not exceeding 0.5 percent of covered deposits per year) if the fund is depleted. The private voluntary fund and cooperative IPS have additional ex ante funds but do not publicly disclose their size. The DSGV IPS has no additional ex ante fund (although some subschemes do). The voluntary schemes may also seek to borrow from their members but do not have committed credit lines. Potential losses to the statutory schemes and the voluntary private DGS in a payout are limited by the fact that Germany has tiered depositor preference—all deposits are preferred to other senior unsecured creditors in insolvency, and statutory scheme covered deposits are preferred to other deposits. Financial support from the IPSs is provided with the aim of avoiding failure and could expose the IPSs to losses on guarantees or capital provided to distressed members. The ability to recover losses from member contributions in the medium term is also potentially constrained by the relatively similar business models of the members of each scheme, which increases the likelihood that they will face correlated shocks and members may not be able to pay high levies to rebuild the fund in the wake of a significant failure. In the event of a medium or large bank failure, or if any scheme needs to meet the full liquidity needs of a payout, even for a relatively small bank, their financial resources could be severely strained in the near term, even if ultimate losses are limited and/or can be recovered from member levies. The liquidity needs of a deposit payout for one or more medium-sized LSIs would be large enough that committed, robust private sector liquidity lines would be difficult to obtain. For this reason, many other DGSs maintain liquidity lines from their national governments.[21]

43. Following the failure of Greensill Bank, the private banks voluntary DGS has adopted reforms to gradually reduce the scope of protection offered, although deposit protection levels will remain well above those available in peer countries. From 2023, the scheme will change from offering protection levels calculated as a percentage of the capital of the failed bank to offering fixed coverage levels. For natural persons, this limit will fall from €5 million initially to €1 million by 2030, and for corporations from €50 million to €10 million. Deposits in foreign branches, public corporations, and financial institutions will cease to be covered. These changes will eliminate the extremely high coverage levels offered to customers of larger banks, but will remain very high in international comparison, with coverage for individuals remaining 10 times the harmonized EU level once the transition period is complete.

44. In the wake of the NordLB case, the SSM and BaFin requested a number of changes to the DSGV IPS to enable faster action in future crises. The planned changes have yet to be finalized but are expected to include: i) the establishment of a relatively small ex ante fund (target level 0.5 percent of DSGV aggregate risk-weighted assets); ii) streamlining of governance procedures for escalation of cases to the national IPS; and iii) enhancements to data and risk monitoring procedures.

45. Structural changes to the statutory DGSs should also be considered, including a merger of the three schemes into a single body, which should also be established in the public

[21] As noted in paragraph 16 and Box 3, public sector resources have been provided in several cases to support crisis management (in the form of a temporary blanket guarantee of deposits during the Global Financial Crisis, guarantees and other State Aid measures, and public sector shareholders' participation in Landesbank recapitalizations).

sector. This would increase risk pooling and diversification across the schemes, helping to mitigate the limited access to funding. If established as a public sector body, it would be more straightforward to provide it with a robust public sector liquidity line. Merging the three schemes would also remove a potential obstacle to German participation in a single European deposit insurance scheme, as recommended in the Euro Area FSAP, although models have been proposed to allow the existing structure of multiple national schemes to be maintained even after the introduction of an EDIS.[22] As an interim measure, loss-sharing and liquidity provision arrangements could be adopted between the three pillars within Germany. Establishing the DGS as a public body would facilitate these changes and ameliorate the conflicts of interest arising from the involvement of active bankers in the DGS's governance.

46. The broad coverage of the schemes also poses potential systemic risks; the authorities should review the systemic implications of maintaining near-universal protection for depositors and develop an overall strategy for DGS/IPS reform. The high levels of protection offered by the system may have significant effects on moral hazard and bank funding costs, allocation of financial assets between deposits and other instruments, and the behavior and risk appetite of new entrants to the German market. The authorities' current work focuses mainly on their supervisory and oversight responsibilities for parts of the system, rather than its overall impact.

47. The private sector voluntary DGS does not provide depositors with any legal right to compensation, and IPS members similarly have no right to financial support. There is a potential systemic risk in a scenario where these schemes did not, in fact, provide support when called upon; the authorities should review requiring stronger legal commitments from the schemes. Neither the voluntary private DGS nor the IPSs provide a legal commitment to support or compensation above €100,000; voluntary DGS compensation could, in principle, not be paid in specific cases, and IPSs could allow members to fail without providing any financial support. All three schemes, however, in both their public communications and descriptions of past behaviour, stress the reliability of their support.[23] Depositor behavior is likely to assume support will always be provided. If, in an individual case, a scheme did not, this could jeopardize depositor confidence across all members of the scheme. The lack of legal commitment also means that, in the event resolution of a scheme member is required, it is not clear to what extent costs of resolution could be shared with the scheme.

EMERGENCY LIQUIDITY ASSISTANCE

48. The BBk may decide to grant ELA, subject to non-objection of the ECB Governing Council. Decisions on ELA are taken by the BBk, which also bears their credit risk, but the non-objection of the ECB Governing Council is required for larger ELA operations. In order to obtain non-objection, ELA provided by the BBk should meet requirements set out in ELA agreement. In line with

[22] See, for example, proposals by Nicolas Veron and Isabel Schnabel: https://voxeu.org/article/breaking-stalemate-european-deposit-insurance.

[23] See, for example, the following statement from the DSGV "In practice, the group-wide mutual protection of all member banks makes insolvencies virtually impossible. Depositors, therefore, have all their money protected by the institutional scheme." Source: DSGV "Glossary on the state of the Banking Union."

the ELA agreement, the BBk would provide ELA only to solvent institutions, defined as meeting all Pillar 1 capital requirements (or being credibly able to restore compliance within a 24-week window). This assessment could be extended to include a more forward-looking assessment of bank viability (building, for example, on supervisory assessments of business models) and restoration of compliance with capital buffers.

49. Although the BBk has not provided ELA since the end of the Global Financial Crisis, it has considerable experience in adapting to a changing Eurosystem collateral framework and other terms for monetary policy lending. The wide range of monetary policy operations adopted by the Eurosystem over the last decade helps to mitigate the lack of recent operational experience of granting ELA, as many of the operational, legal, and technical requirements are similar, and all major German banks are monetary policy counterparties.

50. Banks that have been subject to resolution are not excluded from ELA. Given the resolution process is designed to ensure the restoration of solvency, BaFin—as the NRA—should ensure it liaises with the BBk to confirm any bank post-resolution meets the solvency requirements

51. Nonbank financial institutions could also receive ELA; the BBk should define internal standards for lending to CCPs in particular. At present, German CCPs are authorized as credit institutions according to the Kreditwesengesetz (German Banking Act). The one major CCP is additionally authorized as a credit institution according to the CRR. Decisions regarding the provision of ELA to CCPs would follow, in principle, the same process applicable to any other relevant credit institutions, or financial institutions, in the event of uncovered liquidity needs. Specific planning for CCP ELA would help to future-proof this, given that German CCPs are growing in scale following Brexit, and ensure the BBk is prepared to manage the types of liquidity needs and collateral likely to be sought by CCPs.

52. Given the lack of recent operational experience of ELA for both the BBk and German banks, the BBk should test its operational arrangements for ELA with the industry. This would help to identify any remaining gaps in banks' ability to provide information on, e.g., solvency, collateral availability, transfer of non-standard collateral, despite the availability of much information through supervisory data, the Security Holdings Statistics, and AnaCredit loan reporting.

Annex I. Progress on 2016 FSAP Recommendations

Recommendation[1/]	Responsible Authority	Status
Crisis preparedness		
Define a coordination mechanism, including the SRB, ECB, and MoF in a system-wide crisis.	German authorities/SRB /ECB	For coordination within Germany, see discussion in ¶24–25 in main text. For ECB/SRB coordination, see Euro Area FSAP.
Develop contingency plans for a systemic wide crisis and test plans via a simulation exercise.	German authorities/SRB	**Implemented.** See ¶21/33 above.
Streamline and simplify SSM decision-making procedures.	German authorities/ SSM	See Euro Area FSAP.
Review efficiency of SRM decision making on SRB resolution decisions.	German authorities/SRB	See Euro Area FSAP.
Resolution planning		
Deepen planning to ensure temporary liquidity funding needed to support the orderly resolution of banks (i.e., private funds and public backstops).	German authorities	**Partially implemented.** See discussion of SRF in ¶37 above, ELA in resolution cases in ¶51, and DGS/IPS funding in ¶43.
Continue efforts to identify and remedy operational impediments to expeditious implementation of resolution tools, and ensure ability to maintain control during this implementation period.	German authorities	**Implemented.** See discussion on resolution tools in ¶34–35 in main text.
Resolution funding		
Lead EU-level discussion to establish a common permanent backstop for SRF.	German authorities/ SRM	**Implemented.** See discussion of SRF in ¶37 in main text.

[1/] NB the 2016 Germany FSAP preceded the 2018 Euro Area FSAP and included some recommendations addressed to European authorities as well as the German authorities. This table only provides updates on actions of the German authorities. Progress on crisis management issues at the European level is discussed in the Euro Area FSAP Technical Note on Crisis Management (IMF Country Report No. 18/232).

Annex II. Financial Soundness Indicators

Germany: Financial Soundness Indicators for Banks, 2015–2020

(Percent)

	2015	2016	2017	2018	2019	2020
Capital adequacy						
Regulatory capital to risk-weighted assets	18.3	18.8	19.4	18.9	18.6	19.2
Commercial banks	17.3	17.9	18.8	18.1	18.3	19.8
Landesbanken	19.4	21.4	22.3	20.2	20.0	19.9
Savings banks	16.7	16.9	17.4	17.6	17.3	17.6
Credit cooperatives	17.6	17.7	17.6	17.5	17.1	17.2
Regulatory Tier I capital to risk-weighted assets	15.7	16.3	16.9	16.6	16.5	17.2
Commercial banks	15.5	16.0	16.7	16.0	16.4	17.6
Landesbanken	15.6	16.6	17.5	15.6	15.7	15.8
Savings banks	14.8	15.2	15.8	16.2	16.1	16.4
Credit cooperatives	14.1	14.5	14.8	15.0	14.9	15.4
Asset composition and quality						
Sectoral distribution of loans to total loans						
Loan to households	29.0	28.5	28.6	29.1	29.5	28.4
Commercial banks	22.2	20.9	20.8	21.4	22.2	21.1
Landesbanken	5.5	5.4	5.0	4.2	4.0	3.8
Savings banks	58.2	57.8	57.1	55.3	54.5	51.6
Credit cooperatives	68.8	68.2	67.0	66.0	64.7	61.5
Loans to non-financial corporations	15.2	14.9	15.1	15.7	16.1	15.4
Commercial banks	12.0	11.0	11.4	12.6	13.1	11.9
Landesbanken	23.5	24.1	23.3	22.2	21.9	20.9
Savings banks	22.4	23.1	24.0	25.1	25.2	24.2
Credit cooperatives	16.8	17.4	18.3	19.0	19.6	19.6
NPLs to gross loans	2.0	1.7	1.5	1.2	1.1	1.7
Commercial banks	1.2	1.2	1.1	1.1	1.0	2.1
Landesbanken	4.5	3.6	3.2	1.7	0.9	0.9
Savings banks	1.9	1.6	1.3	1.2	1.1	1.5
Credit cooperatives	2.0	1.8	1.6	1.4	1.2	1.7
NPLs net of provisions to capital	17.4	14.7	11.9	9.1	6.8	6.2
Commercial banks	6.9	9.2	5.5	6.1	3.0	9.3
Landesbanken	42.2	30.7	30.1	10.6	4.9	5.9
Savings banks	19.7	16.3	13.6	11.9	10.4	3.0
Credit cooperatives	19.5	17.3	15.9	14.4	12.5	5.2

Germany: Financial Soundness Indicators for Banks, 2015–2020 (Concluded)
(Percent)

	2015	2016	2017	2018	2019	2020
Earnings and profitability						
Return on average assets (after-tax)	0.2	0.2	0.2	0.2	0.0	...
Commercial banks	0.1	0.1	0.1	0.1	-0.5	...
Landesbanken	0.1	-0.1	0.1	-0.2	0.1	...
Savings banks	0.5	0.6	0.6	0.4	0.4	...
Credit cooperatives	0.6	0.7	0.6	0.5	0.6	...
Return on average equity (after-tax)	4.0	4.3	4.1	2.4	-0.4	...
Commercial banks	2.2	3.2	2.8	1.5	-9.0	...
Landesbanken	1.9	-2.0	1.0	-3.9	1.6	...
Savings banks	6.5	7.4	6.7	4.8	4.8	...
Credit cooperatives	7.4	8.4	7.1	5.5	6.6	...
Interest margin to gross income	75.0	71.2	69.5	72.3	69.5	...
Commercial banks	67.0	63.4	60.7	67.8	61.8	...
Landesbanken	82.5	74.9	73.9	74.2	73.0	...
Savings banks	78.2	76.4	73.9	71.7	71.4	...
Credit cooperatives	78.4	76.5	75.3	74.6	73.5	...
Trading income to gross income	2.9	2.4	4.5	2.9	2.1	...
Commercial banks	5.3	2.6	8.0	4.9	3.2	...
Landesbanken	5.4	10.2	11.5	8.8	6.4	...
Savings banks	0.0	0.0	0.0	0.0	0.0	...
Credit cooperatives	0.0	0.0	0.0	0.0	0.0	...
Noninterest expenses to gross income	70.4	69.3	71.9	73.1	76.0	...
Commercial banks	75.6	74.3	79.4	79.3	84.9	...
Landesbanken	69.1	63.6	72.5	76.6	78.5	...
Savings banks	68.9	67.8	67.1	68.3	71.4	...
Credit cooperatives	66.6	66.6	65.7	66.2	67.2	...
Liquidity						
Liquid assets to total short-term liabilities	146.5	146.6	151.3	151.7	161.2	169.6
Commercial banks	128.4	127.9	131.4	140.3	147.4	157.4
Landesbanken	139.2	146.4	150.8	126.0	152.6	178.4
Savings banks	246.3	253.7	263.6	198.6	186.0	187.2
Credit cooperatives	241.7	246.9	242.2	162.2	169.9	158.6
Sensitivity to market risk						
Net open positions in FX to capital	4.6	4.0	3.7	3.2	3.7	3.4
Commercial banks	1.8	1.9	2.1	2.2	2.6	2.4
Landesbanken	10.6	6.4	4.0	3.1	2.6	3.2
Savings banks	4.8	4.4	4.3	3.5	4.0	3.6
Credit cooperatives	7.9	7.9	8.2	7.4	7.6	7.4

Source: Deutsche Bundesbank. The authorities provide annual data only and disseminate them once a year.