Leibniz Institute for Financial Research SAFE
Sustainable Architecture for Finance in Europe

SAFE Finance Blog

27 MAY 2021

More European, more uniform

Thomas Huertas: The euro area crisis management and deposit insurance framework is currently more likely to trigger new crises than prevent them. That is why a reset is needed, and why a reset may be feasible

The crisis management and deposit insurance (CMDI) framework in the euro area requires a reset. At this stage, the framework is far more likely to manufacture a crisis rather than enable the authorities to manage one. Specifically, the current framework could trigger the doom loop between weak banks and weak governments rather than terminate or untie it. Nor does the CMDI necessarily protect deposits. There is no guarantee that a euro in covered deposits will remain a euro, if the bank in which the deposit is held fails, and/or the Member State in which the failing bank is headquartered defaults.

The CMDI framework aims to enhance financial stability, limit recourse to taxpayer money, promote competition, and protect depositors. These policy objectives remain valid. What needs to change is the method that authorities use to achieve those objectives.

Changing the approach

First, the approach needs to integrate micro- and macro-aspects of crisis management. In particular, the approach needs to take account of the prospective roles of the European Stability Mechanism. It will not only provide credit to Member States but it will also act as a guarantor of the Single Resolution Fund. Second, the approach needs to encompass the European Central Bank (ECB) as a provider of liquidity to banks individually and to the market, both currently and prospectively.

Finally, the approach needs to recognize that by the time any reform proposed as a result of this review would become effective, the transition to the BRRD will be complete and significant institutions in the euro area will have become fully resolvable via bail-in. This affords the euro area the opportunity to reset expectations about resolution.

A reset could complete the European banking union

The euro area should take this opportunity to make the crisis management and deposit insurance framework more European and more uniform. Specifically, there should be a single presumptive path for dealing with failed banks: the use of bail-in to facilitate orderly liquidation under a solvent wind-down strategy. This will protect deposits and set the stage for the transformation of the Single Resolution Fund into the Single Deposit Guarantee Scheme with a backstop from the European Stability Mechanism.

In addition, measures should be taken to avoid forbearance, including the transfer of responsibility for emergency liquidity assistance from national central banks to the ECB to create a single lender of last resort. Finally, national deposit guarantee schemes should become investors of last resort in the gone-concern capital of the failing bank. This will ensure that the orderly liquidation approach extends to all banks, including those without access to capital markets. Together, these measures would complete the banking union, promote market discipline, avoid imposing additional burdens on taxpayers, help untie the doom loop between weak banks and weak governments, strengthen the euro, and enhance financial stability.

Thomas Huertas is a Senior Policy Fellow at SAFE and Senior Fellow at the Center for Financial Studies.

This blog post is based on the SAFE White Paper No. 85 "Reset required: The euro area crisis management and deposit insurance framework", which was submitted to the targeted consultation on CMDI framework by the European Commission.

BACK

NEWS & LATEST

All News

SAFE Finance Blog

Events

Videos

Distribution List

In this Section:

FOLLOW US

CONTACT

Leibniz Institute for Financial Research SAFE

Theodor-W.-Adorno-Platz 3
60323 Frankfurt am Main

Phone: +49 69 798 30080
Fax: +49 69 798 30077
Email: info@safe-frankfurt.de