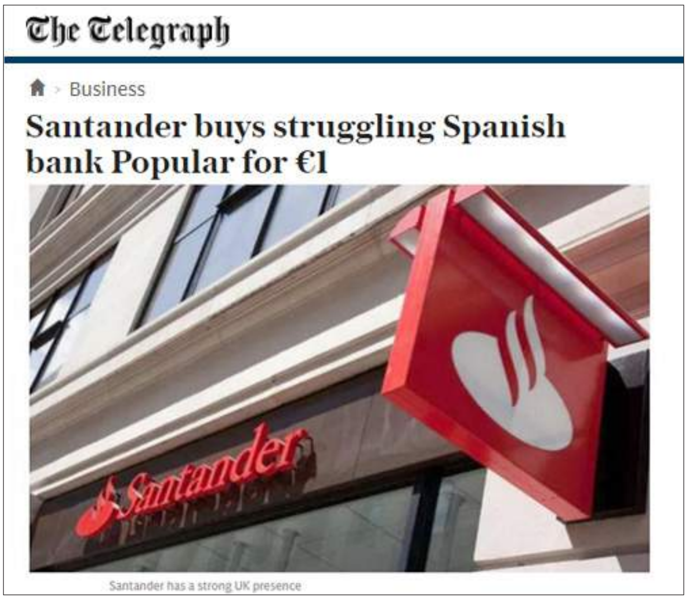
Spain's mission impossible—restoring faith in banks under EU bail-in regime

By *Elisa Barwick*

The government of Spain is pushing to expand its deposit guarantee, despite it being drastically underfunded already. Spanish Prime Minister Mariano Rajoy, supported by big banks, corporations and Spain's Fund for Orderly Bank Restructuring, wants to expand the Deposit Guarantee Fund to cover *unlimited* deposits of institutions such as local councils, large companies and small- to medium-size enterprises (SMEs). Currently a maximum of €100,000 is guaranteed for all institutions, as for private citizens.

On the face of it this proposal sounds reasonable, even good, but it is a move which would more firmly entrench the European Union banking resolution framework, the Bank for International Settlements' Bank Recovery and Resolution Directive (BRRD), as the model for "bail-in" to replace bailouts around the world. As well as in Spain, bail-ins—the expropriation of bonds, shares and other credits to recapitalise collapsing banks—have been conducted in Cyprus, Portugal, Austria, Denmark, Greece, the Netherlands, Slovenia, the UK and on several occasions in Italy.

Spanish authorities claim the change would prevent more bank crashes like that of Banco Popular, which collapsed last year. They blame the mass withdrawal of cash by big corporations for the panic which concluded with the rushed sale of Banco Popular to Banco Santander for €1 last June. Over €14,250 million flowed out of the bank from April through June 2017, 30 per cent of which was withdrawn by public institutions. Were the proposed guarantees in place at that time, the argument goes, a more propitious sale may have been arranged, and bond- and shareholders may not have been wiped out. The suggestion is ironic because at the time the treatment of Banco Popular was hailed as a major success for the bail-in regime, which until then had for political reasons often been stymied or resulted in partial bail-ins accompanied by bailouts.



The Telegraph

Business

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Coverage of the "resolution" of Banco Popular in June 2017. Shares, junior bonds and deposits over €100,000 were confiscated, but Spain's deposit guarantee fund was not invoked as the bank and its remaining assets were absorbed by Santander. Former shareholders are now seeking compensation. Photo: Screenshot

According to Spanish financial daily *Cinco Dias*, the changes being drafted in Spain would reassure large depositors that their money would not be wiped out to save the banks. There's a simpler way to do this—junk the bail-in laws! The forest Spanish leaders are missing for the trees is that it is the threat of bail-in hanging over the banks which drove big business to withdraw its money. In November 2017 the same flawed logic was visible in a European Central Bank proposal to amend the BRRD to include a "pre-resolution moratorium tool" which would allow deposits in banks considered "failing or likely to fail" to be frozen for

Backing for Australian deposit guarantee? Zero!

Australia's Financial Claim Scheme (FCS) has even less backing that Spain's. The Bank for International Settlements' Financial Stability Board (FSB) admitted in a 2011 Peer Review of Australia that "The limit of $20b per ADI [Authorised Deposit-taking Institution] would not be sufficient to cover the protected deposits of any of the four major banks". The total deposits in the Big Four banks alone are over $1.6 trillion, around $400 billion apiece.

In 2009 a meeting of Australia's Council of Financial Regulators revealed: "APRA noted that a pre-funded deposit insurance scheme in Australia would not be insurance in the true sense, as failure by one of the four largest institutions would be likely to exceed the scheme's resources." In any case, Australia has not adopted a pre-funded scheme.

Australia has made no provision for "ex ante" funding of the FCS. While the Labor Government in 2013 had suggested a fund be built up to 0.5 per cent of protected deposits over time, this decision, along with proposed bail-in powers for APRA, was put on hold pending the findings of the 2014 Financial System Inquiry. The FSI recommended the government stick with an "ex post" funding model for the FCS, meaning the funds would be recovered from the collapsed bank plus a levy on the banking industry as a whole if required, after the FCS were activated. The Inquiry's report noted that its other recommendations, including bail-in powers for APRA, would reduce the risk of bank failures, and consequently the demands upon the FCS.

The FSB's 2011 Peer Review also noted that some banks will not be put through the process of liquidation because they are deemed Too Big To Fail. All of this affirms the purpose of bail-in—which is to keep TBTF banks afloat at all costs, with the people's money. A bank in resolution (i.e. undergoing bail-in) is technically not a "failed" bank, and according to the FCS website, "The FCS can only come into effect if it is activated by the Australian Government when an institution fails."

five days, repeatedly if necessary. The freeze would prevent a run on the bank, providing bank regulators more time to determine if an institution must be put into resolution, and to begin the process if warranted.

Only trashing the BRRD and replacing it with Glass-Steagall banking separation, thereby preventing banks engaging in the speculative activity which is driving their insolvency, would restore confidence in them. These banks are collapsing for a reason. Banco Popular was riddled with toxic real-estate debt, for instance, so only outlawing those speculative practices (which are no doubt encouraged by the regulators, as in Australia) addresses the actual problem.

Not funded

If it gets legs domestically, the Spanish plan would still have to be approved by the EU authorities which administer the BRRD. A 27 February Wolf Street article, "A New Cunning Plan to Allay Banking Jitters is Hatched in Spain", reports that EU banking authorities have been refining bail-in rules following the "quickfire resolution" of Banco Popular.

Whatever is decided, in reality the new proposal is a pipe dream, as even the current scheme is drastically underfunded. According to data from the European Banking Authority, some European countries have set aside only the equivalent of 0.1 per cent of the value of deposits covered by their deposit-guarantee schemes. Spain holds 0.2 per cent. Under EU rules member states must hold at least 0.8 per cent, generally raised by a levy on banks. Spain's available cash was a mere €1.6 billion at the end of 2016 and is likely much less today. There is no way it could guarantee deposits of major Spanish banks like BBCA or Caixabank.