EU set to steal guaranteed deposits for bail-in

By Elisa Barwick

Under the dictatorial thumb of the Bank for International Settlements—founded as a supranational banking authority to direct government policy worldwide via central banks—the European Union (EU) has led the way on post-2008 financial system "reform". The so-called reform has hinged on the alleged excision of "moral hazard" from the banking system by making the creditors of banks, rather than taxpayers, pay for bank bailouts. The EU's "bail-in" regime, known as the Bank Recovery and Resolution Directive (BRRD), which confiscates subordinate (junior) bank bonds and deposits above the EU-guaranteed level of €100,000 to save collapsing banks, was implemented in January 2016.

People queue at a Laiki bank branch following a 12-day lockdown in March 2013.
Photo: AFP/Patrick Baz

In practice, however, bail-in has not worked. Italy is a prime example. Bail-ins conducted to rescue at least seven Italian banks since 2015 have had to be accompanied by government bailouts, have left retirees destitute, and have worsened financial conditions. A European Court of Justice ruling made in March this year, found that the European Commission in 2014 *illegally* blocked the government from bailing out regional bank, Tercas, forcing bail-ins of Italian banks, which sparked an avoidable crisis ("Italian banking crisis incubated by EU—another 'bail-in' horror story", *AAS*, 3 Apr. 2019).

Another example is Spain, where the threat of bail-in caused a run on Banco Popular preceding its designation by EU authorities as "failing or likely to fail". Banco Popular was sold to Banco Santander for €1 in June 2017 following the run ("Spain's mission impossible—restoring faith in banks under EU bail-in regime", *AAS*, 7 Mar. 2018). To stop people pre-emptively pulling their money out ahead of a bail-in, Spain has been pushing to expand its Deposit Guarantee Scheme to cover all deposits of institutions and corporations—i.e. including those over €100,000—lobbying the EU to adopt this approach in its revisions to the regime framework.

The EU had different ideas, however. A November 2017 European Central Bank (ECB) report proposed a "pre-resolution moratorium tool" to freeze customer accounts for five days, preventing people from withdrawing their money prior to and during a bank resolution (a bank undergoing bail-in to be recapitalised). This must include guaranteed deposits, argued the ECB, or the moratorium would alert depositors that the institution was in trouble and "covered depositors might still withdraw their funds immediately in order to ensure uninterrupted access or because they have no faith in the guarantee scheme". (See "The big bail-in lie", p. 7.)

The CEC warned of this in a Media Release on 29 November 2017, "Europe to extend 'bail-in' to guaranteed deposits—don't give crisis powers to banking technocrats!"

In April this year the European Commission (EC) announced that the European Parliament had endorsed the proposal, "in order to avoid excessive outflows of liquidity in a bank resolution", i.e. pre-emptive runs on the bank. Part of a broader banking package, for which legislative texts are still being formalised, the proposal was "finalised by global standard setters (i.e. the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB)".

Authorities could already "suspend a bank's payments and/or contractual obligations" for two days, but now the power also extends to *guaranteed deposits*. The power can be deployed by supervisors and resolution authorities, once a bank "is declared 'failing or likely to fail'". The 2017 report had advocated a five-day moratorium. While the timeframe was kept at two days, the ECB report acknowledged that whilst it should only be done in extenuating circumstances, such a freeze could be recurring.

The EC reform package tweaks the BRRD legislation and includes measures to streamline the process of "bank resolution" or "orderly 'bail-in' process", including tightening the rules on the subordination of bail-in instruments, and strengthening bank capital requirements. It is dedicated to helping "stabilise the bank's situation", not to the economy or the welfare of the people.

Case study: Cyprus

The practice of freezing deposits, along with bail-in, had a dry run in Cyprus in 2013.

In March 2013 in the midst of an ongoing EU-wide financial crisis, the largest Cypriot bank, Bank of Cyprus (BoC), was bailed in, and the second-largest Cyprus banking group, Laiki (also known as Cyprus Popular Bank), folded. In conjunction with a bailout from the ECB to stop Cyprus from blowing up the entire Eurozone, the people were robbed to keep banks afloat. Laiki's depositors, along with bondholders, were "classed as creditors for the purposes of a 'haircut'" when the institution was placed into resolution, the 12 August 2019 *Cyprus Mail* reported.

Initially the Troika—IMF, European Central Bank and EU—had demanded Cyprus confiscate 6.75 per cent on accounts under €100,000, and 9.9 per cent on accounts over €100,000. Banks were closed for nearly two weeks while political wrangling went on, and eventually it was decided only to confiscate uninsured deposits. Insured deposits, however, were frozen.

Nearly 40 per cent of uninsured deposits in BoC were converted into shares, and uninsured deposits were transferred over from Laiki and converted into shares, helping to boost required equity levels. The total bail-in was equal to 47.5 per cent of BoC uninsured deposits. Remaining large uninsured deposits in BoC were temporarily frozen, and bank withdrawals were limited to €300 per day. Various capital controls remained in place for two years. All up, an amount equivalent to 25 per cent of the GDP of the country was wiped out.[1]

All but the insured deposits at Laiki bank were taken—all shares, bonds and uninsured deposits—while Laiki's functional operations were absorbed by the Bank of Cyprus. In recent weeks it was revealed that Laiki's depositors will get back five to six cents of every euro they had in the bank over the insured limit of €100,000 when the bank collapsed. Money raised to reimburse stolen deposits, by selling the lender's assets, did little to recoup the losses. Depositors and bondholders slammed delays in asset sales, which resulted in collapsing values and lower compensation. Confiscated credits had totalled €4 billion.

The Cyprus confiscation was implemented, *ad hoc*, as the BRRD was still being negotiated, and provided a model for crisis resolution across Europe. Then-President of the Eurogroup Jeroen Dijsselbloem soon thereafter declared Cyprus the "template" for the entire region.

While the EU has stated that it would never be possible to bail in deposits under EU100,000, the decision to apply the BRRD's moratorium tool to insured deposits to prevent withdrawals from a bank on the cusp of failure is a major step in that direction.

1. "Bank resolution and 'bail-in' in the EU: Selected case studies pre and post BRRD", World Bank.

The big bail-in lie

Authorities lie that "bail-in" of insolvent banks is the surest way to protect bank customers, by keeping banks functioning and the financial system itself from collapsing. Any uninsured deposits that are confiscated would be reimbursed to the extent possible following bank recapitalisation, they claim. At least it wouldn't *all* be wiped out as might occur in a bank collapse or liquidation, we are supposed to think. But, regardless of how we are affected, the financial institution lives on—to continue its gambling, profit gouging and outright thievery—with our money!

New Zealand's Reserve Bank provides the most honest appraisal of the resolution process. In its fact sheet on its bail-in process, known as Open Bank Resolution (OBR), the RBNZ spells out all the "benefits" of bail-in:

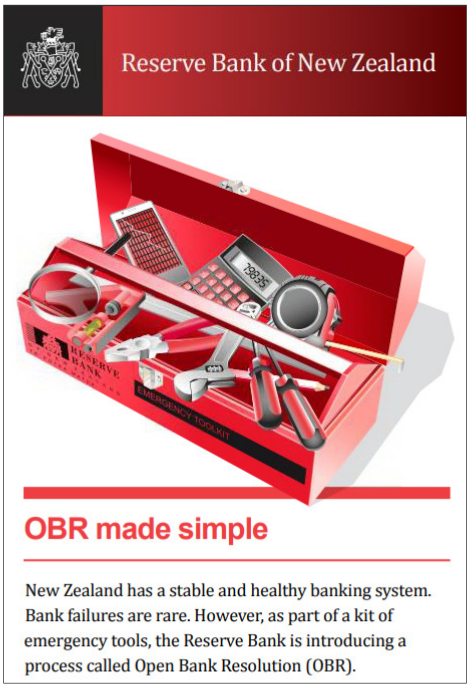
- It provides access to deposits which would not be possible in a normal liquidation. Under liquidation depositors will only receive a portion of what they are owed and it may take years. (It did anyway under the resolution process, as in the Laiki example above.) Under resolution, "customers can access most of their money in their day-to-day accounts", depending on the bank's losses.
- The bank can reopen the next day, when under resolution.
- The bank will not fail, and therefore will not disrupt the entire financial system.

On the other hand, "If losses cannot be covered by shareholders and the bank's available capital, then in addition a proportion of depositors' funds are set aside and frozen for the purpose." Shareholders and owners of subordinated debts (i.e. bail-in bonds) will be wiped out first, then depositors as necessary. "[I]f any money can be returned to depositors after the bank's financial situation has been worked through, it will be", promises the RBNZ.

What's it worth?

RBNZ asserts that any deposits not confiscated would be guaranteed by the government. The IMF, however, has insisted that New Zealand—which only temporarily had a deposit guarantee following the 2008 global financial crisis—implement a permanent deposit-guarantee scheme (DGS).

The IMF pushes this, not to protect the depositors, but because, per the European model, government-guaranteed money is bailed in to restore bank capital, and governments are beholden to repay it to customers. It is just a partial government bail-out in disguise.



But while in this way the banks can effectively take both unsecured and secured deposits, on the proviso that the government will cover it, your reimbursement may not be forthcoming! This is because most DGSs are not adequately funded. 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 schemes. Australia has not set aside any money towards its Financial Claims Scheme (FCS), given that the 2014 Financial System Inquiry recommended "*ex post*" funding, meaning the funds would be recovered from the collapsed bank plus a levy across the banking industry if required, after the FCS were activated.

In any case, in Australia, the FCS would not be activated in the case of a bank resolution, because it only kicks in *once a bank has failed*. A bank in resolution 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."

Auditing firm KPMG admitted this would be true for New Zealand if it goes ahead, as it has promised in principle to do, with a permanent DGS (albeit only to protect a maximum of NZ$30,000). Such "deposit protection regimes require the bank to 'fail' in order for the protection to be activated", KPMG said in its quarterly banking sector review, according to sharechat.co.nz. However, "The OBR, as the core of its purpose, steps in before the bank 'fails'," intervening as soon as a bank becomes "unstable" or "distressed".