Regulatory Competition Between the Deposit Insurer and a Single Financial Regulator—
The Case of Germany

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I. Introduction

In May 2002, after a controversial debate, Germany finally implemented a new single supervisory body for the financial markets, the Bundesanstalt für Finanzdienstleistungsaufsicht (Federal Financial Services Supervisory Body, hereafter referred to under the German acronym, “BaFin”). The new agency, however, became operational largely within the traditional legal and institutional setting. The previously independent functions of the prudential supervision of banks and insurance companies and the market supervision of the securities markets are now exercised from within a common roof, but nonetheless under the old statutory regime, which continues to reflect a functions-based rather than a unified approach to financial regulation as a whole. Particularly with respect to deposit insurance, no effort has been made to alter the existing infrastructure and bring it in line with the concept of substantive integration of the various facets of financial safety nets. As a consequence, the operational independence and important role of the country’s strongest provider of deposit insurance, a fund set up by the association of private banks, was left altogether untouched. A capable scheme with a wide mandate encompassing insolvency prevention, active crisis management, and ultimately, the pay-out of insured deposits, the fund continues to co-exist with the single financial regulator—a good example of a deposit insurer tailored to the needs and peculiarities of the market in which it operates.

This article presents an introduction to the structure of deposit insurance in Germany in light of the market setting in which it operates, as well as an analysis of the co-existence

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of deposit insurers and the single financial services regulator. Specifically, it addresses the impact of regulatory competition on the overall performance of financial supervision.

The text is structured as follows: following a brief description of the German banking system, the article summarizes the 2002 structural changes to the institutional framework for the conduct of banking supervision. Thereafter, it addresses the evolution of the concept of deposit insurance in Germany, both as a result of the notorious Herstatt case in 1974 and of the transposition of the EC Deposit Guarantee and the EC Investor Compensation Directives in 1998. In this context, the focus is on the Deposit Protection Fund set up by the Private Bankers' Association which, compared with the growing body of internationally accepted standards of best practice in this area, continues to be a unique model of a privately organized deposit scheme offering virtually full coverage for insured deposits.

II. A Short Note on the German Banking System

From the 19th century onwards, financial markets within Germany have always been bank-dominated. Traditionally, large banks also exercise significant influence on large corporate enterprises not only as lenders but also as shareholders. Even today, banks occupy a strong position in the financing of Germany's mostly medium-sized, or Mittelstand, businesses while the development of exchange-based capital markets is stagnating. Direct, that is non-intermediary finance by way of the issue of stock or bonds, remains an option almost exclusively open to large corporations.

Again for historical reasons, the retail markets—on which this article inevitably focuses—are divided unevenly between three different types of banking institutions, namely (i) public savings banks (Sparkassen), (ii) cooperative banks (Volks- and Raiffeisenbanks), and (iii) private banks. All of these are, more or less, operating as universal banks. They are, for example engaging in taking of deposits, granting of loans to both private and commercial customers, and providing of payment services and bank accounts, as well as securities services. The difference between the three groups is not therefore one of essentially different business models, but rather one of ownership and legal status.

A. Public savings banks

Public savings banks were first introduced in 1801 in the state of Prussia to provide the general public with basic but affordable banking facilities. From the beginning, the state, or more accurately, local councils, owned and guaranteed public savings banks. Even today, by law, local councils exclusively own the banks and are, in turn, obliged by statute to ensure that the banks are able to meet their obligations at all times (the so-called Anstaltslast, or “maintenance obligation”). In addition, the banks enjoy what has become known as the Gewährträgerhaftung, or “guarantee obligation”—for example, full liability of the local council in the event of default of a savings bank. As a consequence, there have been no open insolvencies of public savings banks in the past, even though these institutions have


3. For recent statistical data, see The German Financial System 71-105 (J.P. Krahnen & R.H. Schmidt eds., Oxford 2004). On the development of organized equity markets, see id., at 139-159. On IPOs and venture capital, see id. at 233-255.
broadened their scope of activities. All cases of financial difficulties have been resolved either by way of recapitalization by the bank's owners or, alternatively, through mergers with other savings banks.\(^4\) Savings banks are closely linked to the Landesbanks, large banking institutions owned by the federal states and acting as commercial banks to these states, as well as head organizations for the savings banks groups. As of December 2000, there were some 550 savings banks operating within the country. This figure subsequently diminished, however, due to the recent trend of consolidation within the savings banks group. Together, savings banks and Landesbanks occupy a significant market share, close to 40 percent in non-bank loans (late 1990s).\(^5\) Under an agreement with the EC commission, the legal privileges of public savings banks are to be phased out gradually, with the unlimited guarantees under Anstaltslast and Gewährträgerhaftung to be abandoned by 2005.\(^6\) In all likelihood, however, insolvency of public savings banks will continue to be rare.

B. COOPERATIVE BANKS

Cooperative banks were founded in the 19th century as a means to facilitate the provision of bank loans to craftsmen and farmers in particular, who were unable to obtain such loans from either private banks or savings banks due to restrictive criteria with regard to the provision of security. Cooperative banks are still mostly owned by local members. Since 1972, all cooperative banks have been united in the German Association of Volks- and Raiffeisenbanks, which—similar to the German Association of Savings Banks—serves as a country-wide link between different banks and two central institutions, WGZ-Bank and DZ-Bank. These banks provide their members with clearing facilities, access to national and international financial markets, liquidity support (if necessary), and centralized back-office facilities. The business of credit cooperatives—some 1,400 as of September 2004—continues to focus on local markets. Only in 1972 have non-members become eligible to receive loans. The combined asset base of the group amounted to 920 billion Euro at the of end 2000, with a customer base of thirty million. This made a market share in the market for banking services of some 13 percent.\(^8\) Due to intensive cooperation and support within the cooperative banking sector, all cases of financial difficulties in the past were resolved by way of bail-outs or mergers with other members of the group, thereby avoiding outright liquidation with consequential losses to depositors.

C. COMMERCIAL BANKS

Commercial banks form the third group of credit institutions active in the retail markets. This group is comprised of four large, internationally active joint stock banks: Dresdner Bank (founded in 1872), Deutsche Bank and Commerzbank (both founded in 1870), and

\(^{4}\) Public savings banks are public law bodies and, pursuant to the applicable laws, prohibited from merging with private commercial banks.

\(^{5}\) For further detail, cf. Krahmen & Schmidt, supra note 3, at 78-82.

\(^{6}\) See generally, E. Wiesel, Sparkassen und Landesbanken auf dem Prüfstand des europäischen Wettbewerbsrechts. Chancen und Risiken für die Sparkassenfinanzgruppe, 2002 Zeitschrift für Bankbetrieb und Bankwirtschaft 288-299.


\(^{8}\) See generally, Krahmen & Schmidt, supra note 3, at 83-85.
since 1998, also Bayerische Hypo- und Vereinsbank, the result of a merger of two large Bavarian banks. These institutions continue to act as "house banks" to Germany's large industrial corporations and form the core of the commercial banking group. Given the dominating influence of public savings and cooperative banks, the four major private commercial banks have not reached a combined market share in bank deposits exceeding fourteen percent (end of 2000). By the end of 2000, they operated 2,873 branches compared to 16,892 branches of the savings bank group and 15,332 branches of the cooperative banking group. The commercial banking group is further comprised of 255 regional banks, other commercial banks, and private bankers, which are usually small institutions with long-standing traditions that often focus on the provision of high-end services. All past cases of bank insolvency occurred in the commercial banking sector, typically affecting small or medium-sized institutions with only regional standing.

D. Summary

In summary, it is worth noting that the problem of bank insolvency in the German banking system has been and continues to be one to which only a fraction of the banking sector as a whole are exposed, namely private banks. This is particularly noteworthy in the context of this article since, although deposit insurance systems have also been created for public savings banks and cooperative banks, only the arrangements available for private institutions are of practical relevance.

III. The Regulatory Framework

A. Overview

Prior to 2002, the responsibility for financial markets regulation in Germany used to be divided between three different federal agencies and several exchange supervisory authorities (Börsenaufsichtsbehörden) in those federal states (Länder) that host stock or commodities exchanges. On May 1, 2002, a new single financial regulator, the Bundesanstalt für Finanzdienstleistungsüberwachung, became operational. The Anstalt is located in both Frankfurt and Bonn—a reflection of the previous situation, partly due to arrangements made with respect to the transfer of the German capital from Bonn to Berlin, in return for which Bonn was guaranteed certain administrative functions.

The new body is responsible for the supervision of banking activities, the licensing of both credit institutions and securities firms, and the on-going supervision of prudential standards concerning those firms formerly within the ambit of the Federal Banking Supervisory Office, (Bundesaufsichtsamt für das Kreditwesen) under the Kreditwesengesetz of 1961 (as amended, the Banking Act). Furthermore, it is in charge of surveillance of the provision of investment services, which used to be performed by the Securities Supervisory Office (Bundesaufsichtsamt für den Wertpapierhandel) under the Wertpapierhandelsgesetz of 1998 (the Securities Trading Act). Lastly, the agency licenses and supervises insurance firms and thus

9. See generally, id. at 75.
10. See the explanatory notes to the Bill, which refer expressly to the "Berlin/Bonn-Gesetz" of 26 April 1994, BGBI 1994-I, p. 918.
11. Gesetz über das Kreditwesen (Kreditwesengesetz) [KWG], v. 9.9.1998 (BGBI. I S.2776).
incorporates the functions of the Federal Insurance Supervisory Office (Bundesaufsichtsamt für das Versicherungswesen) under the Versicherungsaufsichtsgesetz of 1901 (as amended, the Insurance Supervision Act).  

The new agency, in effect the result of a merger of the existing three federal agencies, marks the end of the previous, predominantly functions-based federal structure. It will, however, continue to operate broadly within the existing statutory framework. The reform has been confined to institutional aspects, and there have been no major amendments to the substantive regulatory laws. At the Länder level, the reform leaves untouched the existence of local Exchange Supervisory Bodies (Börsenaufsichtsämter), the listing authorities that supervise the trading process. Similarly, local bodies at the Länder level remain responsible for the supervision of minor insurance firms of only regional relevance.

B. METHODS OF SUPERVISION AND SUPERVISORY CRISIS MANAGEMENT

In principle, the reform has also left untouched the armory of regulatory competencies exercised by the three federal authorities under the respective legal framework. These include wide discretionary powers, generally in the form of the authorization to issue "directions" or "orders" to regulated institutions that are complemented by a range of more specific competencies, inter alia to gather information, and if deemed necessary, to revoke the license of regulated institutions.

In addition, the Banking Act and the Insurance Supervision Act provides detailed competencies with regard to financial crises in regulated institutions, which prescribe a gradual administrative interference with the affairs of troubled institutions. These powers include the imposition of an administrative moratorium on supervised institutions and, to a considerable extent, substitute general insolvency law for that purpose. In practice, once aware of a crisis that requires immediate response, the regulator closes the relevant institution, freezes its assets, and later petitions before the ordinary courts for liquidation in accordance with general insolvency law.

The reform act provides for the harmonization of the current set of administrative sanctions available under the different laws, while the criminal sanctions for contraventions of the regulatory requirements continue to be determined by the relevant statutes.
The new *Bundesanstalt* also continues to enjoy the various rule-making competencies in place under the respective statutes. In accordance with a number of provisions in the Banking Act, the Insurance Supervision Act, and the Exchange Act, the supervisory authority is empowered to issue sub-delegated secondary legislation in the form of *Rechtsverordnungen.*

The agency also retains the right to issue "soft law" instruments such as "guidances" or "principles." An important example of these can be found in Banking Act sections 10 and 11 of the Banking Act, which provide for the issuance of "principles" interpreting the provisions' abstract criteria for capital adequacy and liquidity standards. While these so-called "principles" are not legally binding stricto sensu, particularly not in relation to judicial review before the courts, they indicate how the Supervisory Office will exercise its discretion under the Act, for example, with respect to corrective action under section 45 of the Banking Act. However, under the *Gleichheitsgrundsatz* (Principle of Equality) found in article 3 of the Grundgesetz (the German Constitution), the Supervisory Office is bound to apply these principles to all credit institutions in the same way so that, in effect, they might be characterized as "quasi-binding."

It seems noteworthy that unlike developments in the United Kingdom for example, the desire to improve the regulatory framework specifically with regard to crisis management was never among the primary reasons for reform. Similarly, no attempt has been made to alter the institutional framework for deposit insurance, for example, to increase its links with the new authority.

In principle, the reform does not affect the mechanisms for the coordination of supervisory activities with the *Bundesbank.* Indeed, the *Bundesbank*’s competencies in particular under the Banking Act in particular have become more refined. Consequently, the *Bundesbank* remains an integral part of the conduct of banking supervision in Germany. It continues to be closely involved in the collection of information about market participants, and its local branches remain the supervisory "watchdog" in the regions. When the *Bundesanstalt* decides to order on-site inspections, it may do so through the *Bundesbank* and its local branches.

Specifically with regard to crisis management, it is worth noting that unlike the UK for example, Germany has never had a tradition of "Lender of Last Resort" operations on the part of the Central Bank, other than ordinary liquidity support to the banking sector on a day-to-day basis. Following the crash of *Bankhaus Herstatt* in 1974, however, the *Bundesbank* (as a majority shareholder) and major market participants set up the so-called *Liquiditäts-Konsortialbank* as an institutionalized lender of last resort. This institution is partly financed by the banking sector so that in situations involving banking failure where support is

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23. For further examples, see the powers of the Federal Securities Supervisory Office to issue guidance and guidelines under the Securities Trading Act, e.g. ss. 29(1), 35(6) Securities Trading Act. For further discussion in this respect, see Assmann, fn. 15, nn. 22-28.


25. See Boos, supra note 24.

26. Cf, art. 2, nos. 9 (amendments to s.7 Banking Act), 46 (amendments to s.44 Banking Act) FinDAG.

27. Id.

granting, the financial burden does not lie on the taxpayer alone. Nevertheless, the institution’s limited resources would probably render it almost meaningless in any major insolvency. The successful reorganization of the SMH-Bank in 1983 demonstrates one of the rare applications of this mechanism.

IV. The Evolution of Deposit Insurance Within Germany

A. Overview

Since the transposition of the EC deposit insurance and investor compensation directives, deposit insurance systems exist in a variety of forms. Within the commercial banking group, the Deposit Insurance Fund (Einlagensicherungsfonds) set up by the Private Bankers’ Association (Bundesverband Deutscher Banken) was the first provider of deposit insurance to banking institutions. Indeed, set up by the association and thus essentially by the market participants themselves as early as 1969 (with regional precursors dating back to the immediate aftermath of World War II), the initiative seems to be the very first of its kind in Europe.

As a consequence of the transposition of the above EC directives into German law in 1998, the existing fund was complemented with a mandatory deposit insurance scheme set up so as to comply with the minimum level of depositor protection prescribed by the directives. The key difference between the two systems is that membership with the Deposit Insurance Fund has always been and continues to be voluntary, while all commercial banks are required by statute to contribute to the new mandatory scheme, the Entschädigungseinrichtung Deutscher Banken (Compensation Scheme of German Banks).

As noted above, insolvencies of banks in the past have involved commercial banks—banking institutions in private ownership or listed companies that were competing in the markets without affiliation to public bodies or cooperative structures. Therefore, the following analysis focuses almost completely on the emergence of deposit insurance for commercial banks with relatively few remarks on the structures that have been developed for public savings banks and cooperative banks.

B. Deposit Insurance for Commercial Banks

1. The Deposit Insurance Fund

As noted above, the creation of the Deposit Insurance Fund as a subsidiary of the Private Bankers’ Association dates back to 1969. In the legislative process leading to the enactment of the modern Banking Act in 1961, the legislator contemplated the introduction of a

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30. SMH (an acronym for the merged private banks of Schroeder, Münchmeyer, Hengst & Co.) went into deep waters in 1983. Following informal meetings of the Supervisory Body, the Bundesbank, and the major German banks, the main creditors agreed to provide further liquidity. Formal insolvency proceedings were prevented, and the bank was taken over by a foreign institution. See T. Kramer, Der SMH-Fall. Eine Fallstudie an Hand von Presseveröffentlichungen (1985) (providing an account of the SMH case).

31. See, W. Papenthin, Der Zugang zur Einlagensicherung des privaten Bankgewerbes 14 (Hamburg 1999).


33. See supra, Part III.
statutory deposit insurance system as a corollary to the special status enjoyed by both public savings banks and cooperative banks. A report commissioned by Parliament recommended the introduction of a mandatory fund of at least 200 million D-Marks, while offering coverage in the amount of 10,000.00 D-Marks per depositor to participant institutions.\(^\text{34}\) In order to avoid legislative pressure and retain influence over the fund’s terms and conditions, the Private Bankers Association decided to establish a self-governed but nonetheless formalized and reliable institution in return for the abandonment of the legislative proposals. The legislature agreed, and the Fund was implemented.\(^\text{35}\)

In the aftermath of the notorious failure of the Cologne-based Bankhaus Herstatt in 1974, strong political pressure was exercised on the Fund and its members once again. This pressure was aimed specifically at the perceived level of insufficient protection offered by the fund. Again, interest groups and political parties expressed demands for a mandatory system independent of the Private Bankers’ Association, the market participants’ lobby organization. In order to avoid legislative measures, the Association again agreed to amend the Fund’s terms and conditions, and provided for a comprehensive improvement of depositor protection in the event of bank insolvency.\(^\text{36}\)

Membership with the Fund is voluntary, but all member banks of the Private Bankers’ Association are required to obtain membership.\(^\text{37}\) For competitive reasons, however, most private banks (as opposed to public savings banks and cooperative banks) operating within the country have become participants.\(^\text{38}\)

Membership is subject to restrictive entry criteria. All participant institutions are supervised and audited on an on-going basis by the Auditing Association of German Banks (Prüfungverband deutscher Banken), another subsidiary of the Private Bankers’ Association, pursuant to paragraphs 3, 5(7) and 8 of the statute. The participant institutions are thereby subjected to an additional level of prudential regulation and supervision in addition to the statutory supervision exercised by BaFin under the Banking Act. The de facto coexistence of both seems to have been highly effective in the past. Indeed, it appears that many cases of financial irregularities within participating institutions were discovered by the Fund or the Auditing Association rather than the supervisory authorities.\(^\text{39}\)

The level of coverage offered by the Fund is defined in paragraph six of the statute. As a rule, it encompasses all liabilities of a member institution to non-banks and investment companies and their custodian banks. The coverage also extends to investment fund assets, for each creditor up to a ceiling of 30 percent of the member bank’s liable capital (tier 1). Evidently, this amounts to full coverage of most ordinary bank deposits. The insolvency of Bankhaus Krebs in Freiburg, serves as an example of the very generous protection offered by the Fund. In 1995, the small banking institution became insolvent; individuals who

\(^{34}\) See Bericht der Bundesregierung über die Untersuchung der Wettbewerbsverschiebungen im Kreditgewerbe und über eine Einlagensicherung, Bundestags-Drucksache V/350, 30 June 2004.

\(^{35}\) Cf. PAPENTHIN, supra note 31, at 21.


\(^{37}\) See The Statute, supra note 36, at para. 2a.


\(^{39}\) According to information provided by the Private Bankers’ Association. See Binder, supra note 19, § 12 D. III. 1.
deposited about D-Mark 22 million with the institution were reported to have received D-
Mark 17 million as compensation from the Fund. 40 There is no co-insurance, so deposits are
compensated in full up to the overall ceiling.

The question of whether or not depositors have an individually enforceable right to
protection by the Fund is a matter of lengthy debate in the academic literature. While the
Fund itself tried to exclude such liability in its terms and conditions, strong arguments have
been made that such rights arise under general principles of the German law of obligations,
as a consequence of the Fund’s self-portrayal as guarantor of deposits in the public. Given
that the Fund has not failed to meet its promise in the past, a refusal to pay would appear
imaginable only in exceptional cases. A possible exception might arise in connection with
the insolvency of a very large banking institution; however, in such a case public support
under the “too big to fail” doctrine would in all likelihood be granted anyhow. Hence, the
question of enforceable rights appears to be one of rather academic interest with no practical
relevance. 41

Financing is organized through contributions by the participant banks on a mixed ex-
ante and ex-post basis. 42 Pursuant to paragraph two of the statute, the Fund’s mandate is
defined as follows:

(1) The purpose of the Fund is to give assistance, in the interest of depositors, in the
event of imminent or actual financial difficulties of banks, particularly when the sus-
pension of payments is imminent, in order to prevent the impairment of public con-
fidence in private banks.

(2) All measures apt to be of assistance may be taken in the implementation of the pur-
pose described in subsection (1), in particular payments to individual creditors, . . .
payments to banks, the assumption of guarantees or the assumption of obligations in
connection with action taken under [paragraph] 46a German Banking Act.

It follows from the cited provision that assistance by the Fund in cases of actual or
imminent insolvency can take a variety of forms. After the imposition of a statutory mor-
atorium under paragraph 46a Banking Act, most insolvent banks in the past were simply
liquidated according to the procedures available under general insolvency law. In such cases,
the Fund merely paid the covered deposits. Insofar as it satisfies the claims of depositors,
the claims are then subrogated to the Fund, which will claim the insolvency dividend just
as any other creditor. 43 As a result, the Fund occupies a strong position in the general body
of creditors that commands the key decision-making powers within insolvency procedures.

Alternatively, the Fund may opt for the provision of liquidity or even capital support to
a bank in crisis. It chooses this option if such support appears commercially beneficial in
view of the expected complexity associated with liquidation or after considering the sale of
the insolvent institution’s business to a competitor or other interested investor. The fund
may also provide direct financial support for a merger or merely support the transfer of the
insured deposit base to another bank prior to the winding up of the bank’s business. Re-
cently, the Fund exercised this right in response to the failure of Schmidtbank, a regional

40. See Badische Zeitung 9 September 1995, p. 3.
41. See Binder, supra note 19, at § 12 D. III. 4.
42. See The Statute, supra note 36, at para. 5.
43. See Binder, supra note 19, at § 12 D. III. 6.
bank in Bavaria. Overall, the Fund is empowered to play an active role in the management of imminent crises. In fact, considering the leverage created by its power to provide financial support, its relevance in crisis may even exceed that of the supervisory authority. This is reflected in the legal framework for bank crisis management which provides in paragraph 46a of the Banking Act, that the supervisory authorities may coordinate protective measures with the deposit insurance scheme.

In summary, the Deposit Insurance Fund can aptly be described as a unique combination of virtually unlimited coverage with no co-insurance on one hand and strong elements of peer monitoring and peer pressure on the other. This arguably helps market participants and customers avoid the adverse incentives otherwise ascribed to full-coverage systems. Though far from being in line with internationally accepted best practice in the area, the scheme appears to have worked reasonably well in the past and is likely to continue to do so in the future, unless and until extraordinary payments in connection with a single large scale failure or a series of costly insolvencies in the banking sector exhausts its resources. Particularly noteworthy is the degree to which the fund is integrated into the legal and institutional framework for bank crisis management on a de facto basis, without any formal links to the supervisory authority and without any clear statutory mandate.

2. Mandatory Deposit Protection: The Compensation Scheme of German Banks

As a consequence of the transposition of the EC Deposit Insurance Directive in 1998, the Private Bankers’ Association set up the Compensation Scheme of German Banks (Entschädigungseinrichtung Deutscher Banken). The scheme, established as a private limited company, is a subsidiary of the Association. Like the Deposit Protection Fund, it has no legal or organizational links with supervisory authorities. Membership with the scheme is compulsory for all private commercial banks, irrespective of whether or not they already participate in the Deposit Insurance Fund. The new scheme merely serves as a payout mechanism for the minimum level of protection guaranteed by the directive. If payments are made to depositors of banks that also participate in the Deposit Insurance Fund, the Fund then increases the payment to its own level of protection. Therefore, the Fund remains largely unaffected by the establishment of the new scheme. Given the rather low level of protection provided by the new scheme, the Deposit Insurance Fund continues to be the most important player in the management of banking crises. Consequently, the compensation scheme is of only secondary interest in the context of this article.

C. Deposit Insurance for Other Banking Groups

Within the Savings Banks Group, a similar deposit insurance scheme, the Compensation Scheme of the Federal Association of Public Banks, was established to meet the minimum

44. Id.
45. For example, pursuant to paragraph 46a (1) Banking Act, a moratorium imposed on an insolvent bank may provide for exemptions insofar as the payout of compensation by the deposit insurer is effected via the insolvent bank. See, e.g., Binder, supra note 19, at § 12 D. III. 6.
47. See Binder, supra note 19, at § 12 D. III. 7.
48. See also Deutsche Bundesbank, Deposit protection and investor protection in Germany, Deutsche Bundesbank Monthly Report 29-45 (July 2000).
criteria stipulated by the EC directives. This scheme is, again, a private corporation set up by the Federal Association in its capacity of head organization for public banks. Within the Cooperative Banks Group, existing arrangements for the institutional protection of banks in crisis were reinforced in order to meet the EC law requirements. For the reasons mentioned above, both arrangements are negligible in this article.49

V. Summary and Conclusions

The Deposit Insurance Fund set up by the Private Bankers’ Association continues to be the most important deposit protection scheme in Germany. Its far-reaching functions, with regard to both preventive regulation and the resolution of bank insolvency, remain largely unaffected by both the transposition of the EC Deposit Insurance directive in 1998 and the reform of the institutional framework for banking and financial markets supervision in 2002. The Fund is a private organization with no legal or institutional links with the unified financial services supervisory authority. It is funded exclusively by participant banks and is, in effect, a self-governing body that exercises a strong level of peer monitoring and peer pressure on member banks. While BaFin, the new financial services supervisory authority, retains legal powers for crisis management and formal intervention, the Fund plays a highly significant role by closely monitoring its members’ on-going business, in addition to its capacity as potential provider of financial help during crisis. With virtually unlimited levels of protection and the lack of any co-insurance, the Fund certainly deviates significantly from internationally accepted best practice in the area. Nonetheless, it appears to have been rather successful in the past, without creating adverse incentives that undermine financial stability.

The German example thus indicates that comparative “lessons learned” in the area of deposit insurance may be difficult to reach. The unique structure of the German banking system certainly facilitated the emergence of a strong association of market participants that commanded sufficient influence with the legislator, resulting in the creation of a powerful deposit protection scheme in return for the legislator’s abdication of statutory requirements in this area. The participants’ readiness to provide virtually unlimited coverage to most deposits can be linked to the very restrictive entry and membership criteria that all participant banks must subject themselves to, which operate to minimize risk. Lastly, the Fund’s structure and its terms and conditions are hardly imaginable without the strong influence of large banks, which provide the bulk of the funding but also have strong incentives to use the Fund as a tool to closely monitor and, to some extent, control their smaller competitors.

Consequently, it would appear that when looking for “best practices” as alternatives to existing structures, attention should be given to the question of whether local market structures merit the establishment of individual concepts tailored to local needs, as opposed to implementation of abstract, internationally accepted standards. While the fundamental finding that deposit insurance must reflect market structures is clearly in line with the recommendations concerning deposit insurance issued by the Financial Stability Forum (FSF) in 2001,50 many discrepancies exist between the German model and FSF’s institu-

50. Id. at n. 2.
tional recommendations regarding membership, financing, and coverage. Generally, the success of the German model so far appears to militate some scepticism with regard to these FSF findings.

Finally, the German model indicates that the institutional choice to create a single financial regulator on one hand and to structure a deposit insurance system on the other, are entirely separate issues independent from one another. While deposit insurance is certainly an important cornerstone of the overall regulatory concept, its translation into institutional arrangements can take place more or less without special attention to the supervisory infrastructure as such. Indeed, if the German model provides any answer at all in this context, it might be that some institutional competition between a strong deposit insurer and the banking supervisor is beneficial in maintaining financial stability. This, however, would apply equally to legal systems without a unified financial services supervisor.