

Note: The normalized standard deviation was calculated as the standard deviation of interest rates on outstanding amounts across Eurozone countries in a given year divided by the German interest rate in the same year.

Source: ECB Statistical Data Warehouse, Bank interest rates deposits from non-financial corporations and households (on outstanding amounts)

There is a further important reason why European deposit insurance is advisable in a monetary union: it is about the ability to manage sovereign crisis. The ESM is the main instrument to deal with a sovereign debt crisis. Its treaty explicitly allows to provide bail-outs only to solvent countries. In case a country is not solvent, however, ESM resources cannot be provided to the country. At least conceptually, a bail-in of sovereign bond holders is then required. This gives rise to two difficulties:

The first one is that is such a situation depositors are likely to panic and since they are in a monetary union they can



In particular, it would be easier to bail-in sovereign bond holders, thereby providing more fiscal breathing space to governments. Bail-in of sovereign debt will never be easy. It cannot be a standard instrument but it is rather a measure of last resort. However, in certain extreme circumstances, such a bail-in is preferable to financial assistance programmes that would require self-defeating austerity. Full banking union with deposit insurance is arguably a necessary prerequisite for rendering soft bail-in in case of ESM programme possible

How could a European deposit insurance system be designed? Does it require full insurance or only a re-insurance? This question is discussed in Schoenmaker and Wolff (2016) and the below summarizes the piece. To achieve a full decoupling of banks from sovereigns, a full insurance needed. Re-insurance can achieve that only partially.

There are currently many country specificities such as special treatments of which deposits are covered under what circumstances. Another country specificity in Germany is how cooperative banks and savings banks have created their own special deposit insurances (pillar-based deposit insurance system). Such country specificities are difficult to sustain in a full-insurance model.

A full European deposit insurance is only advisable when sovereign debt exposure of banks is being diversified and country specificities as regards depositor treatments are harmonized. Otherwise, the deposit insurance may have to cover losses resulting from national fiscal policies. Conversely, reducing