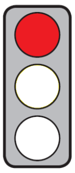
EUROPEAN DEPOSIT INSURANCE SCHEME

cep**PolicyBrief** No. 2016-05

KEY ISSUES

Objective of the Regulation: The Commission wants to introduce a common deposit insurance scheme for the eurozone.

Affected parties: All banks in the eurozone and their depositors.



Pro: –

Contra: (1) The Regulation cannot be based on the internal market competence (Art. 114 TFEU) but at best on the flexibility clause (Art. 352 TFEU).

(2) Neither the lack of confidence in the resilience of some national deposit guarantee schemes nor differences in credit rating between eurozone countries make a common deposit guarantee scheme absolutely necessary.

(3) It is doubtful whether EDIS will promote financial stability. It may even have the opposite effect.

CONTENT

Title

Proposal COM(2015) 586 of 24 November 2015 for a **Regulation** of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to **establish a European Deposit Insurance Scheme**

Brief Summary

► **Context and Objective**

– In reaction to the financial crisis, the EU created the "Banking Union" for the eurozone. Until now, the Banking Union has been composed of two pillars,
  - the common banking supervision by the European Central Bank (ECB) [Single Supervisory Mechanism, SSM, Regulation (EU) 1024/2013, see cep**PolicyBrief**] and
  - the common mechanism for bank resolution [Single Resolution Mechanism, SRM, Regulation (EU) 806/2014, see cep**PolicyBrief**].

– Now, as the third pillar, the Commission wants to bring in a common deposit insurance scheme primarily for the eurozone ("European Deposit Insurance Scheme, EDIS").

– EDIS will be introduced gradually in three phases and, by July 2024, will largely replace the national deposit guarantee schemes (DGSs):
  - 2017 – 2020 ("Reinsurance Phase"): EDIS provides reinsurance for the existing national DGSs (Art. 41a (1)).
  - 2020 – 2024 ("Co-insurance Phase"): EDIS provides co-insurance alongside the existing national DGSs (Art. 41d (1)).
  - From July 2024 ("Full Insurance Phase"): EDIS provides full insurance (Art. 41h (1)).

– EDIS will (Explanatory Memorandum p. 3)
  - protect deposits irrespective of their geographical location,
  - ensure that banks are not penalised because their head office is located in a specific Member State, and
  - push ahead with reducing bank/sovereign links in order to maintain financial stability.

► **Scope**

– EDIS applies to all officially recognised national DGSs and all banks affiliated to these DGSs
  - in eurozone countries (Art. 2 (2) a) and b)) and
  - in non-eurozone countries participating voluntarily in the Banking Union [Art. 2 (2) in conjunction with Art. 2 SSM Regulation [(EU) 1024/2013, see cep**PolicyBrief**]].

► **Joint Deposit Insurance Fund (DIF)**

– Within the framework of EDIS, a joint Deposit Insurance Fund (DIF) will be set up to which all participating banks must pay mandatory contributions (Art. 74a (1)).

– The DIF will be administered by the Single Resolution Board (SRB) (Art. 1 (2)).

– Neither the EU nor the Member States are liable for expenses or losses of the DIF (Art. 74a (2)).

– The DIF's financial means must reach (Art. 74b (1) and (2))
  - 0.071% of the covered deposits at the end of the re-insurance phase; that would be approx. € 3.8 billion;
  - 0.8% of the covered deposits at the end of the co-insurance phase; that would be approx. € 43 billion;

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- The collection of contributions will be "spread out in time as evenly as possible". The Commission shall set out the criteria, for spreading out the time of the contributions to the DIF, in a delegated act. (Art. 74b (5))
- The mandatory contributions will be invoiced by the respective national DGS and paid directly to the Board (Art. 74a (1) and Art. 74c (1) and (2)).
- The mandatory contributions of each bank to the DIF depend on the level of the bank's covered deposits and on its risk profile. The risk profile of each bank is measured (Art. 74c (1), (2) and (5))
  - up to the end of the re-insurance phase in relation to the other banks in the same Member State and
  - from the beginning of the co-insurance phase in relation to all banks in the eurozone.

  The Commission will issue a delegated act, for each of the two phases, specifying the method of calculating the contributions (Art. 74c (5)).
- If, at the end of the re-insurance phase, the financial means of the DIF is not sufficient to cover expenses, the Board will collect extraordinary contributions from the banks. These contributions must correspond in principle to the shortfall in financing but must not exceed a specific share of the covered deposits of all the banks. The Commission will specify this share in a delegated act. (Art. 74d (1))
- The Resolution Board may (Art. 74f and Art. 74g)
  - take out loans or "other forms of support" for the DIF with institutions, financial institutions or "other third parties" at the "most appropriate time" and
  - lend to other DGSs in non-eurozone countries and apply to these DGSs for loans.

► **Relationship between the DIF and the national DGSs**

- Under the Deposit Guarantee Directive (2014/49/EU; see cep**PolicyBrief**) the national DGSs must have funds of at least 0.8% of the covered deposits by 2024. As the contributions made by banks into the DIF count towards the minimum target level of the respective national DGSs (Art. 74c in conjunction with Art. 41j (1)) the minimum target level of the national DGS is de facto reduced to:

2017	2018	2019	2020	2021	2022	2023	2024
0.14%	0.21%	0.28%	0.28%	0.26%	0.20%	0.11%	0.00%

- Support for a national DGS from the DIF is only allowed if the DGS has this level of financial means (Art. 41j (1)).
- With regard to the funding levels of the national DGSs, the Commission can approve temporary exceptions, e.g. for reasons linked to the business cycle (Art. 41j (2)).
- Member States can allow their deposit insurance schemes to take account of DIF contributions from banks when determining their DGS contributions or reimburse contributions which exceed the amount stipulated on the relevant date (Art. 74c (4)).

► **Re-insurance phase: Liquidity shortfall assistance and excess loss cover by the DIF**

- In the case of a pay-out event, the DIF assumes, for all national DGSs, during the re-insurance phase, (Art. 41a (2) and (3))
  - 20% of the liquidity shortfall of the DGS as a loan and
  - 20% of the excess loss of the DGS as a subsidy.
- The liquidity shortfall is calculated as the compensation to be paid by the national DGS in excess of the stipulated financial means of the DGS less extraordinary amounts paid by banks to the DGS which it can collect within three days (Art. 41b (2)).
- The excess loss is calculated as the total amount repaid by the national DGS to depositors which exceeds the prescribed financial means of the DGS less the revenue which the DGS can generate in winding-up proceedings by subrogating the rights of depositors and less the extraordinary bank contributions collected within one year by the DGS (Art. 41c (1)).
- The level of DIF assistance is limited: Liquidity shortfall assistance and excess loss cover each amounts to a maximum of 20% of the financial means of the DIF stipulated for the end of the re-insurance phase or 8% of the covered deposits of the banks in the respective national DGS, whichever is lower (Art. 41a (4)).
- The national DGS must repay the liquidity shortfall assistance to the DIF (Art. 41a (3)).

► **As from the co-insurance phase: Liquidity assistance and loss cover by the DIF**

- For all national DGSs during the co-insurance and full-insurance phase, in the event of a pay-out event, the DIF covers the liquidity need as a loan and the loss as a subsidy, up to the following level in each case (Art. 41d (2) and (3), 41e, 41f (1), 41g (1), and 41h (2) and (3)):

2020	2021	2022	2023	2024
20%	40%	60%	80%	100 %

- The liquidity need arises from the total compensation payable by the national DGS (Art. 41f (1)).
- The loss arises from the total compensation paid by the national DGS less the revenue which the DGS can generate in winding-up proceedings by subrogating the rights of depositors (Art. 41g (1)).
- The national DGS must repay the liquidity assistance to the DIF (Art. 41d (3)).

Statement on Subsidiarity by the Commission

According to the Commission, national DGSs are vulnerable to "large local shocks". This undermines the homogeneity of protection for deposits contributing to a lack of confidence among depositors. It can also be detrimental to the internal market. Only EU action can ensure appropriate deposit insurance across the internal market and weaken the "link" between national DGSs and the "financial position" of the respective Member State.

Policy Context

The Deposit Guarantee Directive 2014/49/EU was passed in 2014. Its transposition deadline expired on 3 July 2015. Transposition has not yet taken place in six Member States (as of 1 March 2016). In their Five Presidents' Report (see cep**PolicyBrief**) in June 2015, Jean-Claude Juncker, Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz prompted the idea of creating a European deposit guarantee scheme.

Legislative Procedure

24 November 2015	Adoption by the Commission
Open	Adoption by the European Parliament and the Council, publication in the Official Journal of the European Union, entry into force

Options for Influencing the Political Process

Leading Directorate General:	DG Financial Stability, Financial Services and Capital Markets Union
Leading Committee of the EP:	Economic and Monetary Affairs, Rapporteur: De Lange (EVP-Group, NL)
Leading Federal Ministry:	Ministry of Finance
Leading Committee of the BT:	Finance
Decision-making mode in the Council:	Qualified majority (55% of Member States making up 65% of the EU population)

Formalities

Legislative competence:	Art. 114 TFEU
Form of legislative competence:	Shared competence (Art. 4 (2) TFEU)
Legislative procedure:	Art. 294 TFEU (Ordinary legislative procedure)

ASSESSMENT

Economic Impact Assessment

A common deposit insurance scheme for the eurozone (EDIS) will not necessarily provide added value. Two of the Commission's three motives for the joint Deposit Insurance Fund are unconvincing and not all the requirements have been met for the third one.

Firstly, the protection of bank deposits will no longer depend on their geographical location. Thus the Commission implicitly assumes that the target funding level of 0.8% of the covered deposits is insufficient for some national DGSs. **Confidence in the resilience of some national DGSs can also be created,** however, **by scaling up their target funding level – instead of using the EDIS.**

Secondly, with EDIS, the Commission wants to ensure that banks are not penalised because their head office is located in a specific Member State. Thus the Commission alludes to the fact that it is not the funding level of the DGS but the varying credit ratings of the home state that can be crucial for the credibility of the DGS. Whether this really constitutes a problem of any relevance to competition between banks, is doubtful: only 3% of EU citizens have opened a bank account outside the EU. Banks from Member States with a high credit rating therefore hardly ever compete with banks from Member States with a low credit rating. **Differences in credit rating between eurozone countries do not** therefore **justify an EDIS** either.

Not only is every bank at liberty to set up a branch in a Member State with a high credit rating but also every eurozone country has access to the funds of the European Stability Mechanism (ESM). As a result, the relevance of the differences in credit ratings between the eurozone countries diminishes. Ultimately, effectively de-coupling depositor protection from the bank's country of domicile, in particular requires banks to back their investments in government bonds with own funds. The Commission shies away from this, however, because it would make borrowing more expensive for Member States with a low credit rating. The efforts of the Commission are thus one-sided: some banks will be able to "import" the financial power of other DGSs or other Member States cheaply, without weak DGSs and Member States having to improve their credit rating above the level of the existing Deposit Guarantee Directive.

Thirdly, **it is doubtful whether EDIS will in fact "promote" financial stability.** Although a joint Deposit Insurance Fund could improve the diversification of risk due to the larger pool of insured risks and strengthen the resilience of the deposit guarantee scheme and thus also financial stability, the proposal fails to meet two prerequisites for this, or at least fails to meet them to a sufficient degree (see cep**Input**).

First prerequisite: **The EDIS Regulation should stipulate that the mandatory contribution of every bank to the DIF has to correspond immediately** – and not just from the co-insurance phase – **to their risk profile in the whole eurozone and that this also applies to the DGS contributions still to be paid.** Otherwise banks with low-risk profiles would be subsidising the risky activities of other banks. That would not only distort competition but would also jeopardise financial stability because every bank would have the incentive to take higher risks. The logical consequence of this view is that variations would have to be possible in the required level of the available financial means of national DGSs. The EDIS Regulation does not provide for this either, and in fact even allows the funds of the DGSs to fall continuously from 2022. **Whether this will result in the whole deposit insurance scheme** of DIF and DGS becoming underfunded and thereby **in fact jeopardising financial stability will largely depend on the Commission's delegated act on how the collection of DIF contributions is to be spread over time.**

Second prerequisite: **Banks should have to back investments in government bonds with own funds** otherwise, if EDIS really does increase investor confidence, banks with a low own funds ratio in particular would have an incentive to invest massively in government bonds. That would, however, run counter to the efforts of the Banking Union to break the bank/sovereign link.

Finally, EDIS itself could be the very cause of a risk to financial stability. Deposit insurance schemes should be able to absorb small and medium-sized bank insolvencies but they are not designed for large bank insolvencies. EDIS could trigger new expectations in this regard because a target funding level of € 43 billion means that a large bank insolvency could theoretically also be financed by EDIS funds. Whether this will calm investors or, instead, cause investors in other Member States to fear a major drain on the DIF thereby undermining investor confidence in the resilience of the EDIS, is not easy to predict. In the latter case, there is a risk of contagion and local banking crises could spread across several Member States.

Legal Assessment

Legislative Competency

The Regulation cannot be based on the internal market competence (Art. 114 TFEU) **but at best on the flexibility clause** (Art. 352 TFEU). The Council must then decide unanimously. (See in this regard cep**Input** 02|2016).

Subsidiarity and Proportionality with Respect to Member States

Unproblematic in view of the high level of integration that exists in the EU banking sector.

Compatibility with EU Law in other respects

Unproblematic.

Impact on German Law

The Deposit Guarantee Act (EinSiG) transposing the Deposit Guarantee Directive in Germany basically remains in place. Although the Regulation has direct effect (Art. 288 TFEU), the rules of the EinSiG on contributions must be adapted on grounds of legal certainty.

The Bundestag cannot "without prior constitutive consent, transfer its budgetary responsibilities by way of vague budgetary authorisations to other bodies" particularly if this "may lead to unmanageable burdens with significant budgetary-policy consequences" (BVerfG, 2 BvR 987/10 of 7 September 2011). Since the Regulation clarifies that "under no circumstances" can budgetary means of the Member States be used for expenses or losses, this requirement has been met.

Conclusion

The Regulation cannot be based on the internal market competence (Art. 114 TFEU) but at best on the flexibility clause (Art. 352 TFEU). Confidence in the resilience of some national DGSs can also be created by scaling up their target funding level – instead of using the EDIS. Differences in credit rating between eurozone countries do not justify an EDIS. It is doubtful whether EDIS will in fact "promote" financial stability. For this, the Regulation would have to stipulate that the mandatory contribution of every bank to the DIF has to correspond immediately to their risk profile in the whole eurozone and that this also has to apply to the DGS contributions still to be paid. Whether this will result in the whole deposit insurance scheme in fact jeopardising financial stability will largely depend on the Commission's delegated act on how the collection of DIF contributions is to be spread over time. Banks should have to back investments in government bonds with own funds.