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TF DGS/VH/TM

EACB Comments on the Commission Proposal on European Deposit Insurance Scheme

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The **European Association of Co-operative Banks (EACB)** is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 31 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4,200 locally operating banks and 68,000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 205 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 78 million members and 860,000 employees and have a total average market share of about 20%.

For further details, please visit www.eacb.coop



Background

The “Five Presidents’ Report”, published on 22 June 2015, outlines plans to strengthen economic and monetary union through closer integration of the euro area, including besides all the introduction of a European Deposit Insurance Scheme (“EDIS”). It states that while establishing a fully-fledged EDIS might take time, as a first step, EDIS could be devised as a re-insurance system at the European level for the national deposit guarantee schemes. This has given a strong impetus to the European Commission and in compliance with the path set by the Five Presidents, the Commission came up with a legislative proposal for a Regulation amending Regulation (EU) 806/2014 in order to establish European Deposit Insurance Scheme (“Commission proposal on EDIS”) in late November.

According to the Commission EDIS should be understood as the third pillar of the Banking Union, thus it should have the same scope as the SSM and the SRM. EDIS will be set up in three phases: a re-insurance phase (from 2017), a co-insurance phase (from 2020), followed by a full insurance phase (after 2024). While initially the role of the EDIS would be rather complementary, in the second phase it would progressively increase its support to national DGSs in case of liquidity needs, until in 2024 a common deposit guarantee scheme on EU level becomes operational on a full scale. Thus in a 8-year period the mutualization mechanism should be completely up and running.

Management Summary

The EACB Members are of the opinion that EDIS is an initiative which time has not come – not yet and not in the way the Commission proposes.

The EACB Members support the objectives of establishing an effective Banking Union and reinforcing public confidence in deposit insurance. Still, we are concerned about the Commission proposal on EDIS since at this point in time national schemes are not yet harmonized and funded equivalently according to their target level. Furthermore, there are no sound risk control measures in place to justify a mutualization mechanism which entails a cross-border responsibility. In such environment, if risks are excessively mutualized, EDIS may rather create disincentives for the building up of stringent and solid national DGSs, thus leading to unfair allocation of burden and moral hazard. On top of it, use and consumption of the financial basis of national protection schemes as a consequence of outside shocks will sharply compromise the confidence of citizens in places where it has already been built.

Against this background, we find the Commission proposal on EDIS, especially on the last two stages (co-insurance and full mutualization), as premature and concerning. We believe that the move towards any common deposit insurance mechanism should only be done in consideration of a number of prerequisites in a strict order of priorities.



The timescale is crucial. The DGSD (Directive 2014/49/EU) requires a report on the progress of cooperation among DGSs through a European scheme by 2019 before any new steps are initiated. In fact, we believe that a profound analysis and an impact assessment are necessary before any new measures are considered.

In meanwhile, the already adopted measures should be fully implemented and the continued harmonization thereunder should be set as a priority. Only once the Banking Union rules and the single rulebook have been sufficiently implemented and harmonized, a common insurance mechanism can be considered in earnest.

Furthermore, the efforts should be focused on measures ensuring risk reduction. To test the effects of the already adopted measures, while ensuring a level playing field, the financial health of all the banks in the European Union, except those which were already subject to the ECB's AQR and stress test back in 2014, has to be checked before the introduction of any EDIS-like mechanism.

The discussion on the evolutionary design of EDIS must be held only in consideration of the elements above. Moreover, if ultimately introduced, the EDIS should be i) devised solely as a reinsurance mechanism, provided with robust moral hazard safeguards, ii) cost neutral for the industry in order to let banks be able to finance any potential growth of the economy; iii) financed through risk-based contributions and designed in a way that ensures level-playing field within the entire EU (e.g. keep the possibility to have a 0.5% target level) without prejudice to the variety of business models.

EACB Reflections on EDIS

Timing and context

We have serious doubts about the envisaged timing of the Commission proposal on EDIS. The DGSD requires a report on DGSs cooperation through a European scheme by 2019 and the legislator should stick to this time plan. There should be no hasty moves. Therefore, if the analysis behind such a report indicates a reasonable necessity of a common scheme, any possible amendments on the DGSD should be discussed at that point of time.

At the same time, we note that the DGSs are merely a component of the financial safety net and there are other components, along them, such as SSM and SRM/SRF/BRRD, which together determine the conditions for the functioning of the DGSs. Going on a more unified level with the DGSs, without having made the other components fully operational, could harm the entire safety architecture agreed just a few years ago.



Full implementation and further harmonization of the relevant legal environment

Not only should the already adopted measures be implemented, but the harmonization has to be even further strengthened. Among others, that would include that **the target level set forth by the DGSD (0.8% or 0.5% where applicable of covered deposits) is effectively reached in all EU Member States**. Running EDIS, while the funding level of the DGSs within the Banking Union and in the EU in general varies significantly, spurs competition concerns and may compromise the functioning of the internal market.

All participating banks in all countries must step up and adequately fund the respective schemes to which they belong. EDIS should not be seen as an excuse for not building up stringent and solid national DGS. Without the harmonization precaution in place, the Member States may easily be incentivized to rely on external help, rather than to establish well capitalized, steady and effectively working DGS on national level. Before this backdrop, we have concerns regarding the credibility of the concept.

Additionally, more convergence in insolvency law and restructuring proceedings across Member States is necessary to allow uniformity in management of credit risk and resolution action and ensure equality of access to EDIS.

Risk reduction measures

The EACB members note that achieving a solid ground for EDIS would require a viable risk reduction strategy to be set as a priority. Recent developments in certain Member States as well as need for the recapitalization of banks in others seem to confirm that **reducing excessive risk-taking in the financial sector should precede any risk sharing**. In environment of vast divergences, where some banking sectors are still fragile and struggling with non-performing loans, while others seem to have preserved their healthy balance sheets, mutualizing the deposit protection would easily lead to mutualization of risks and to unfair allocation of burdens.

While the Commission underlines how an EDIS would enhance customer confidence, we believe that this is a very selective perception related to the situation in those Member States, where customers lost confidence. Our perception is that where customer confidence remains intact, the EDIS rather generates concern. If depositors of credit institutions in Member States with a good economic situation were faced with an unfavorable development due to the shared risk within the Banking Union, this could hardly help achieving one of the major goals of EDIS – enhancing confidence concerns. Thus the consumption of the financial basis of national protection schemes as a consequence of outside shocks should be avoided by all means. Mutualization of funds, without prior risk reduction measures in place, will have negative effects in those Member States, where the confidence of the population is still intact.

Against this background, it is of utmost importance that the **“health checks” of all the banks in the European Union, except those which were already subjects to the ECB’s AQR**



and stress test back in 2014, are performed and necessary remedies are applied before the introduction of any EDIS-like mechanism.

Discrimination of business models and risk profiles

By implementing the Banking Union, the ECB undertook a differentiation of banks in Europe into significant and less significant ones. About 130 major banking groups (consisting of about 1.200 individual banks) are thus directly supervised by the ECB and approximately 3.400 less significant institutions (LSIs) remained to be supervised by the national supervisors. Two main reasons for that differentiation are the different business models and risk profiles of the banks. Especially regionally operating banks base their business on the principles of self-responsibility and promotion of the local economy. Any collectivization within the Eurozone burdens in particular such banks because they can only compete in the market-arena when Institutional Protection Schemes (IPS) or other solidarity mechanisms remain fully in place. EDIS would have burdens against small and medium-sized banks, although these credit institutions have been the stabilizing elements during the financial crisis when they kept on lending to the local economy. IPS which have functioned well for many decades must not be *de facto* replaced by EDIS which neither convinces in its theoretical design, nor seems to be compatible with the level of integration within the Eurozone.

Moreover, we believe that the proposal discriminates against small banks organized in an IPS, since it does not provide any possibility for Institutional Protection Schemes recognized as DGS to continue the execution of any “alternative measures” once the EDIS is entering in its final stage. These systems have proven their efficiency and credibility in the past.

Legal considerations

Given the limitations of the current Treaties, the set-up of EDIS which progressively leads to a full-scale mutualization mechanism is inevitably surrounded by legal skepticism. Taking into account the fiscal implications of the Commission proposal on EDIS, the legal base must be carefully contemplated. To the extent such a proposal is based on the existing Treaties, there is not much of a difference if the envisaged mutualization occurs now or in 8 years.

The legal concerns are further complemented by the Commission’s failure of convincing consideration of the principles of subsidiarity and proportionality. Having said that, we refer to the express commitment of the Commission to ensure better regulation and to focus its efforts on “[...] those areas where only joint action at European level can deliver the desired results” while looking “[...] for the most efficient and least burdensome approach”¹. In this context the legitimacy for action at European level regarding EDIS is disputable, since **the DGSD mechanism has not been yet fully implemented, nor evaluated, thus, there is hardly**

¹ Mission Letter from the President of the European Commission to the Commissioners



any evidence that it has failed to achieve the intended results. The lack of publicly available impact assessment for EDIS merely confirms this.

Such an approach may not only undermine the legal certainty and create distrust in the EU regulatory achievements, but in practical terms may eventually discourage the efficient work already done at national level. In the light of the Commission proposal on EDIS, it has to be mentioned that many of the provisions stipulated by the DGSD and implemented into national law would become obsolete and therefore in retrospect, the financial burden resulting from DGSD and its implementation would be disproportionate and not justified.

EACB Comments on the Design of EDIS

We believe that the move towards a common deposit insurance mechanism should only be done in consideration of a number of prerequisites in a strict order of priorities. **In particular, the existing measures have to be effectively implemented, the harmonization further strengthened and sound risk-prevention measures put in place.**

If found necessary at all, ***such a system should only be devised as a reinsurance mechanism with strong moral hazard safeguards.***

Its operations should be limited to provision of financial support to DGSs in case of large shocks, under strict conditionality and with a first-loss tranche born by the national DGSs. That would ensure that the responsibility for losses is not washed away somewhere between the national and the European level and that as an end result it would not practically affect the depositors in virtuous jurisdictions. Additionally, it would still require that the national DGSs are effectively built-up and remain well capitalized, while also not completely disregarding their knowledge and experience in national banking sector.

Ex-post contributions

As a reinsurance system would intervene in cases where national means are depleted and the DGS is compliant with the DGSD, it should be limited to situations where an important institution has failed. It should thus occur in exceptional circumstances, provided that the SSM and SRM are correctly monitoring those firms. Rather than permanently mobilizing a large standing pool of ex-ante funding, it would be much more efficient for the reinsurance fund to be provided with a credit line for liquidity purposes, with the ability to recoup any losses that it might suffer from the industry ex-post. If however, ex-ante contributions were to be required, they should be reimbursable in order for each institution to adjust permanently its contribution to the reinsurance fund according to the risk it represents (for example if it owns less deposits than previously). It would also reduce the costs for the industry and its probable transfer to depositors.



Any EDIS-like mechanism must remain cost-neutral to the industry. It should be designed in a way that does not place additional burdens to the banks on top of the current requirements to contribute to national DGSs or IPSs.

The overall financial charge on banks must not be increased since it would negatively affect their lending capacities and is therefore highly problematic against the background of the EU Agenda on Jobs and Growth.

Administration of EDIS

The Commission should provide a clear and reasonable institutional solution on the management of EDIS and administration of the DIF. There must be credible safeguards to ensure strict separation between the SRF and the DIF with a legally sound decision-making mechanism in place. Additionally, we note that the proper management of EDIS would cause additional administrative burden and logically additional administrative expenditures which at the end of the day will be covered by banks' contributions. This is again contrary to "cost neutral" design of EDIS.

If found necessary, such a system should be designed so as to ensure a level playing field between all European Union Member States without discrimination against the banks based inside the Banking union or against the existing business models.

There should be no discrepancies regarding the implementation of the DGSD in Banking Union Member States and non-euro area Members States. Therefore, there should be equal treatment EU-wide of the legally permitted actions (measures) of the national DGSs, the accepted forms of contributions, the possibilities regarding the target funding level, the acceptance of the payment commitment, etc. **The single rulebook may not be twisted by additional layer of regulation for a subset of countries.**

DGS and EDIS mandates

The Commission proposal on EDIS stipulates relatively narrow mandate of the European mechanism. In particular, it provides only for a pure pay-out function and resolution related financing. Under the DGSD, however, the mandate of the national DGSs is broader, where the latter may revert to alternative measures, including a full suite of early intervention measures. In particular, the Commission should investigate the use of DGS financing in early intervention to ensure a level playing field in the entire European Union.

Target level

The Commission proposal on EDIS mandates all DGSs within the Banking Union to set a target level of 0.8%. DGSs outside the Banking Union under the DGSD can still apply for a reduction of the target level to 0.5%. Thus, there would be a substantial difference in treatment between



DGSs, which would preclude a level playing field and will decrease the capacity of the banks based inside the Banking union to keep on financing the economy. If EDIS aims to achieve risk and loss sharing through a larger combined pool of DGS funds in addition to the available bail-inable liabilities and resolution financing for bank failures, then it could be logically argued to maintain the possible reduction of the target level to 0.5%.

Payment commitments

Financial instruments in the form of payment commitments which were introduced under the DGSD are not provided for under the Commission proposal on EDIS. This creates the danger that banks subject to the EDIS regulation are burdened beyond the intention of the DGSD, which in turn would lead to a strong inequality between banks within the European Union and will decrease the capacity of the banks based inside the Banking union to keep on financing the economy.

IPS and other mutual guarantee scheme

For the Banking Union Member States, the building up of EDIS would leave the major risks with the national deposit guarantee scheme within the first years while shifting a gradually increasing part of contributions to a new fund. This is particularly relevant in the case of networks of cooperative banks connected in an institutional protection scheme or a cooperative solidarity mechanism (e.g. Art 10 CRR, Art 113 (7) CRR) which ensures their solvency and liquidity. For their rating and for their image in public, the adherence to an institutional protection scheme and other cooperative solidarity mechanisms, disposing of a credible amount of funds, is crucial.

The EDIS draft regulation makes the work of an IPS, respectively the use of so called alternative measures of an IPS or DGS, dependent on additional financial contributions and therefore significant burdens the relevant member institutions of the IPS or DGS. This would not only be a violation of the level playing field compared to the institutions in the Member States outside the euro area but also completely ignores that the money necessary to prevent a failure of an institution by carrying out alternative measures is much lower than a payout to depositors. If such mutual guarantee schemes have to set additional funds (additional contributions beyond the level of 0.8 %) in order for them to implement alternative measures, they will be placed on unequal footing with their non-Banking Union counterparts which would not be subject to the same limitations.

Therefore, it is essential that EDIS explicitly allows the work of an IPS, respectively alternative measures, and expresses this by considering the membership within an IPS in risk factors of the contributions to EDIS. Alternatively, DGS/IPS should be exempted from the scope of EDIS and not be covered by such a mechanism.



Contact:

The EACB trusts that its comments will be taken into account.

For further information or questions on this paper, please contact:

- Mr Volker Heegemann, Head of Department (Volker.Heegemann@eacb.coop)
- Ms Teodora Magdalinceva, Legal Adviser (Teodora.Magdalinceva@eacb.coop)