Portuguese Banking Association Position on the European Commission Proposal for a European Deposit Insurance Scheme (EDIS)

The Portuguese Banking Association (APB) welcomes and generally supports the European Commission's proposal for a European Deposit Insurance Scheme (EDIS), published last November.

The European Commission's plan to establish an EDIS, fully mutualised by 2024, is a long-awaited proposal as it will create a truly centralised scheme for deposit protection in the Eurozone. The existence of an EDIS is an essential element to complete the Banking Union, reinforcing depositors' trust and the stability of the Eurozone financial system, and contributing to end the bank-sovereign nexus.

Although substantial progress in terms of reduction of financial fragmentation and weakening of the banks-sovereign link has already been achieved with the first two pillars of the Banking Union – the Single Supervisory Mechanism and the Single Resolution Mechanism – the establishment of the third pillar is critical to ensure that bank crises are adequately managed irrespectively of the health of national public finances. As long as national deposit insurance schemes remain the back-stops to banks and sovereigns remain the back-stops to national DGS, the link between banks and their home sovereign will not be definitely broken.

I. The EDIS Proposal

The APB supports the evolutionary path and the calendar put forward by the Commission in its proposal, as they ensure full deposit insurance by 2024. By that time, the Single Resolution Fund (SRF) should also be fully funded, thus ensuring that an adequate funding capacity is in place at European level for both resolution and deposit insurance.

1. The EDIS phased approach

The Commission proposal for an EDIS combines re-insurance and co-insurance phases as sequential steps towards a full insurance scheme by 2024. Each one of them is essential to the end in view and thus incomplete on its own. Any partial solution that falls short of the final objective of full mutualisation should not be envisaged as only full insurance will guarantee an equal level of protection for depositors across the Banking Union.

The first stage – the re-insurance system (from 2017 to 2020) – certainly paves the way for a common deposit guarantee scheme at the European level. However, its reach will be very limited in terms of risk sharing as the recourse to the Deposit Insurance Fund (DIF) will be dependent on prior depletion of the national fund and will be capped. During this phase the importance of national deposit guarantee schemes (DGS) will still prevail.

The relevant step forward towards a fully mutualised deposit scheme will be taken with the move to the co-insurance phase (from 2020), where pay-outs will be shared between national DGS and the DIF in a progressive way until deposits in the Banking Union are exclusively guaranteed by the common Deposit Insurance Fund in 2024.

2. Membership scope of the EDIS

All financial institutions contribute to the Single Resolution Fund regardless of whether their resolution strategy involves or not the recourse to the SRF. Similarly, the APB advocates that all financial institutions should contribute to the DIF, irrespectively of their probability of being liquidated. Additionally, as in the case of SRF's contributions, the risk indicators of individual contributions should reflect the "probability of recourse" to the DIF.

3. Contributions to the EDIS

It is of the utmost importance that the key principle of cost neutrality for banks set-out by the Commission in its proposal on EDIS is guaranteed at all times, which means it needs to be ensured that there is no duplication of contributions to the national DGS and to the EDIS.

Although the EDIS proposal establishes that ex-ante contributions paid to the DIF shall count towards the minimum target level that participating DGS must reach in accordance to the DGSD (art. 74c), it leaves the option to Member States to maintain the current level of contributions at national level.

The set-up of this compensation provision as an option, instead of a mandatory requirement, does neither assure the cost neutrality nor does it provide for situations where the level of the national DGS is already above the targeted minimum. Therefore, special provisions should be designed on this matter, particularly if there are State budget implications involved.

Regarding the payment of contributions to the EDIS, the Commission proposal sets out in its Article 74 (c) (2) that "*Credit institutions shall pay the invoiced amount directly to the Board*". Given that banks may have also to pay contributions to their national fund according to the DGSD building up requirements, we believe that all contributions should be paid directly to the national DGS, which would then forward the relevant part to the DIF. This would reduce the operational burden and costs for banks of having to deal with two different contribution processes. Additionally, for cases where the national DGSs are already fully funded or even above the target level, annual contributions to the DIF could be ensured by the national DGS existing funds, reducing the burden on banks.

As far as the risk-based method for contribution calculation is concerned, we support the Commission's proposal of an approach based on the degree of risk at individual institution level and the twofold approach that combines a risk-based national approach during the re-insurance phase with a risk-based European approach afterwards.

Finally, we urge the Commission to review its proposal in order to allow ex-ante contributions to be partially met through fully collateralized payment commitments as already provided for in the DGSD.

4. Need for a common fiscal backstop

As the Commission rightly points out in its communication of 24th November, 2015 – "Towards the completion of the Banking Union" – although the new prudential and crisis management frameworks should reduce the likelihood of bank failures and increase the protection of taxpayers from costs of bank resolutions, they don't eliminate totally the risk of public funding being required to enhance the financial capacity of resolution funds. As such, the Commission reiterates the need for the set-up of a common fiscal backstop to be used as a last resort.

Similarly, a common backstop financial facility should also be available for the EDIS. Although the new resolution framework (the bail-in, the depositor preference and the SRF) limits the probability of failure and the use of deposit guarantee funds, the size of the DIF might be insufficient in the event of a large systemic crisis. Even though it would be a last resort mechanism, we understand it would enhance the credibility of the common deposit insurance scheme and increase the overall level of confidence in the system.

II. Risk Reduction Measures

At the time of the launch of the EDIS proposal, the Commission also proposed to examine additional measures that it considers necessary for risk reduction in the banking sector. The Portuguese Banking Association welcomes and fully supports measures aimed at strengthening the resilience of the financial system. These measures should be worked out in parallel with the EDIS step-by-step Commission's approach, to avoid unnecessary delays in the implementation of the third pillar of the Banking Union.

1. Need to complete the DGSD transposition and to harmonize heterogeneous rules

We strongly support that the DGSD transposition should be completed in all Member States before the re-insurance phase begins. We also favour the elimination of existing discretions in the DGS Directive and support an harmonization of rules across Members States, such as those related with the "Temporary High Balances" (in terms of the amount of additionally covered deposits, the length of the coverage period and the circumstances in which such additional coverage applies). The need for this harmonization should not prevent entering the re-insurance phase as we understand it will only be critical at the later stage of co-insurance.

2. Need for a greater convergence in insolvency law and restructuring proceedings

It is also advisable to seek further convergence in insolvency law and restructuring proceedings in Europe as the lack of harmonized procedures in this field can have significant impacts on the outcomes of bank liquidations.

Although acknowledging the importance of this issue and the need for more harmonization in the field of insolvency law and restructuring procedures, APB does not consider that it should prevent EDIS from entering the co-insurance stage.

3. Revision of the prudential treatment of sovereign exposures

The APB firmly believes that the revision of the prudential treatment of sovereign exposures should be separated from the EDIS discussions. Any initiative to review the treatment of sovereign exposures at European level should wait for the Basel Committee's work on this field to be concluded.

In its work programs for 2015 and 2016, the Basel Committee has identified the review of the regulatory treatment of sovereign risk as one of the policy-related issues the Committee will be working on (a BCBS consultation is expected to be launched at the end of 2016/beginning of 2017). As the BCBS recognizes, this is a sensitive matter and as such "The review will be conducted in a careful, holistic and gradual manner."

Europe should not anticipate the BCBS proposal, as it is essential to ensure that there is a level playing field in this important matter. Coordination in the adoption of such a change is essential to avoid fragmentation of financial markets and a competitive disadvantage for European markets.

III. Concluding Remarks

Reducing the link between banks and sovereigns is a key objective the Banking Union aims to attain. As long as deposit protection remains local, that link will remain strong and therefore the Banking Union remains incomplete.

An European Deposit Insurance Scheme is an indispensable element to complete the Banking Union. Moreover, an EDIS is the only tool that equalizes depositor insurance quality across Member States and gives an additional comfort to European citizens that there is a guarantor for their deposits with greater financial capacity than the national DGS.

The establishment of the EDIS should move forward in the sequential way and according to the calendar proposed by the European Commission, until full mutualisation is achieved by 2024.

Only full insurance will guarantee the break of the bank-sovereign link and an equal level of protection for European deposit holders across countries.

The APB welcomes and fully supports the adoption of risk reduction measures aimed at strengthening the resilience of the financial system. These measures should be worked out alongside the EDIS step-by-step Commission's approach to avoid unnecessary delays in the launch of the third pillar of the Banking Union.