WORKING DOCUMENT

on European Deposit Insurance Scheme (EDIS)

Committee on Economic and Monetary Affairs

Rapporteur: Esther de Lange
Introduction

On 24 November 2015, the European Commission proposed, with a legislative proposal\(^1\), a euro-area-wide insurance scheme for bank deposits. The proposal was accompanied by a communication that set out further measures to reduce risks in the banking sector in parallel.

The Commission’s proposal for a European Deposit Insurance Scheme (EDIS) envisages the creation of a deposit insurance system in three phases:

- **A reinsurance phase** (2017-2019), during which EDIS may provide limited funding for liquidity (20 % of its ‘liquidity shortfall’) and cover a limited share of the loss (20 % of its ‘excess loss’) of a participating deposit guarantee scheme (DGS) that encounters a payout event or has to contribute to resolution. National schemes could access EDIS funds only after exhausting their own resources.

- **A co-insurance phase** (2020-2023), during which Member States may request both funding for liquidity needs and loss cover from the Deposit Insurance Fund in case they encounter a payout event or need to contribute to resolution. The difference with the reinsurance phase is that funding is provided and loss is covered as from the ‘first euro’ and the share borne by EDIS gradually increases over the co-insurance period (from 20 % to 80 %).

- After the four-year co-insurance phase, participating DGSs would be fully insured by EDIS. **Full insurance** (from 2024 onwards) provides full funding of the liquidity need and covers all losses arising from a payout event or a request to contribute to resolution. The mechanism is the same as in the co-insurance phase, but with EDIS covering a 100 % share.

Figure 1 gives a graphical overview of EDIS proposal and its three-phase insurance model.

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The proposal, which amends the Single Resolution Mechanism (SRM) Regulation (Regulation (EU) No 806/2014\(^1\)), is based on Article 114 of the Treaty on the Functioning of the European Union (TFEU)\(^2\) and includes, besides the gradual approach described above, provisions on the constitution of the Deposit Insurance Fund (DIF) and its target levels (0.8% of all covered deposits by 2024), on procedural matters, on the role of the Single Resolution Board (SRB), etc. However, the establishment of the risk-based annual contributions to the DIF would, under the Commission proposal, fall to the Commission through a delegated act.

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\(^1\) OJ L 225 of 30.7.2014, p. 1

\(^2\) Article 114 TFEU falls under Chapter 3 (Approximation of Laws) of the Treaty and is the legal basis to adopt measures for the approximation of the provision laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market. There is an ongoing debate as to whether or not Article 114 could be used as the legal basis for the EDIS proposal.
With this legislative proposal, the Commission adopted a communication entitled ‘Towards the Completion of the Banking Union’, which had a list of issues to address in order to reduce risks in the banking sector. Given that the legislative proposal and communication were presented simultaneously and given the Commission’s subsequent remarks that ‘risk sharing and risk reduction need to go hand in hand’, it is clear that the legislative proposal and the communication should be seen as one package, despite their difference in legal nature.

The objectives of this working document are threefold: (i) to describe in general terms the linkages between the EDIS proposal and certain other legislative texts and existing structures; (ii) to explore the relevant key elements in the debate about risk reduction; and (iii) to determine a number of key questions for the future handling of this package.

I. General context

The interlinkages between the EDIS proposal and related legislative texts and structures are manifold:

- **Structural**, because of the positions that the proposal and other texts occupy in the development of the Banking Union: as EDIS is presented as the third and final pillar of the Banking Union, the proposal has been designed to fit EDIS into the structures already in place;

- **Institutional**, because the EDIS proposal would affect or confer new tasks on bodies regulated or created by other texts (national deposit guarantee schemes (DGSs), the Single Resolution Board (SRB));

- **Economic and financial**, because the operation of EDIS is presented as having a positive effect on financial stability and the functioning of the single market. EDIS is based on the presumption of having positive economic and financial effects owing to the dynamics coming with the law of big numbers in any type of insurance scheme. It aims to improve deposit insurance cover in participating Member States and to anchor trust at a constant level of funding. This should in turn have other positive effects through lower funding costs and a possible desired reduction in the bank-sovereign nexus in these Member States. However, particular attention should be paid to the effects of EDIS on the competitiveness of the banking sector participating in EDIS compared with those that (for the time being) remain outside of EDIS. Also, while EDIS would increase the level of risk sharing, essential elements of risk reduction have not yet been addressed and made concrete;

- **Political or strategic**, in the sense that the co-legislators may wish to condition progress on EDIS on developments elsewhere and vice versa.

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This document does not deal with linkages which are only of the latter category, but focuses on the first three categories.

The main structural and institutional linkages are summarised in graphical form in the 'bubble chart' in Annex 1. The chart shows that EDIS will rely strongly on the Single Supervisory Mechanism (SSM) and the SRB to function, implementing within the Banking Union the 'Single Rulebook' of, in particular, the Capital Requirements Regulation (CRR), the Capital Requirements Directive (CRD) and the Bank Recovery and Resolution Directive (BRRD), and that these mechanisms need to be fully functioning and credible. This can also be seen in Figure 2.
In particular, it can be seen that the functioning of EDIS as proposed could only be achieved if:

- **The Deposit Guarantee Schemes Directive 2014/49/EU**\(^1\) (DGSD) is fully implemented, as a minimum in the Banking Union participating Member States. This is because the EDIS proposal builds on the existence of DGSs in Member States and therefore requires that these schemes meet the provisions of that Directive. These DGSs will remain the schemes to which individual banks adhere and which will be called upon to pay out or otherwise act in the event of resolution or of deposits becoming unavailable. They will in turn – provided they respect the DGSD and adhere to funding requirements – be eligible to participate in EDIS.

Since the DGS Directive allows numerous national 'options and discretions' to Member States and/or to individual DGSs, there may be a case for further harmonisation (that is, further limiting of these options) given that some of them may vary the risk profile of DGSs. In any case, a stocktaking and evaluation should take place as soon as possible of the existing differences between national DGSs, including inter alia as regards the overall coverage level (Article 6), repayment (Article 8), financing (Article 10) and the use of funds for alternative measures such as ‘deposit book transfers’ (Article 11, all DGSD).

Furthermore, it is imperative to underline that trust only comes with funded systems, firstly because funds have to be available in case of resolution and/or a payout event, and secondly because EDIS can only be used by a national DGS if it adheres to the funding path.

- **The SRB has the capacity and discretionary powers** to carry out both the functions conferred on it by the SRM Regulation and the new functions which the EDIS proposal proposes to add. Under the proposal, the SRB would assume the role of operating EDIS and also of managing the associated Deposit Insurance Fund (DIF). The combination of resolution and deposit guarantee functions is shared in other jurisdictions, in particular the US Federal Deposit Insurance Corporation (FDIC).

A discussion may be needed on whether the SRB requires access to greater resources, possibly on a contingency basis (credit lines, etc.) while the Single Resolution Fund (SRF) is built up. Such questions may also arise in respect of the DIF.

- **The supervision of banks in the Banking Union functions correctly** (and is seen to do so) so that the supervisory information which is transmitted to the SRB by the ECB enables it to assess risks in a timely fashion and to exercise its functions. The system

\(^1\) **OJ L 173 of 12.6.2014, p. 149**
of supervision covers all banks in the Banking Union, even if only larger ones are directly supervised by the ECB.

- The resolution rules, and in particular the bail-in tool under which creditors rather than taxpayers meet the cost of resolution, operate as intended (and are seen to do so). This is because DGSs are required to step in whenever such bailing in would otherwise affect covered deposits. The operation of bail-in will therefore affect the possibility of EDIS being invoked.

More generally, confidence in the system and in those operating it will be of critical importance in achieving the results intended for EDIS. This requires as a necessary precondition the full implementation and application of the BRRD in all Banking Union Member States.

Proper transposition, implementation and functioning of existing Banking Union legislation (most notably the BRRD and DGSD) can be seen as a conditio sine qua non before the start of EDIS, as this is legislation that should in any case be functioning by now. It is therefore important to gain thorough insight into the current state of affairs in this area and to ensure that those Member States that have not yet properly implemented and applied these related pieces of legislation will do so before any start of EDIS.

Although a necessary starting point for progressing towards the start of EDIS, these elements alone are by no means a guarantee for EDIS’s viability. This will require parallel progress on both risk sharing and further risk reduction to continue during the preparation for and build-up of EDIS. This issue will be discussed in part II.

II. Parallelism of risk sharing and further risk reduction

Besides the transposition and full implementation of existing Banking Union legislation, one of the key questions surrounding the debate about EDIS is when and how much further risk reduction and/or harmonisation is needed while taking steps towards a harmonised European framework for deposit insurance. Some argue that enough has been done on risk reduction and no further measures would be needed. Others argue that further risk reduction is an absolute precondition before any agreement even on starting the gradual process towards a full EDIS can commence. Many underline that, as the creation of EDIS is foreseen as a gradual process, it is logical to continue work on risk reduction in parallel. Positions vary as to the conditionality between the different steps in these two processes, but a majority seems to be of the opinion that risk sharing and risk reduction need to be taking place at least ‘hand in hand’. This means that further steps in risk sharing can only be taken if preceded and accompanied by the necessary steps in risk reduction.

Central to the debate about risk reduction is the issue of moral hazard. This concept is used to describe the risk of an imbalance in the likely outcome of a system of risk sharing, as is
proposed under EDIS (in particular from the second phase onwards), which might lead to perverse or unintended incentives and adverse selection. Parties to the discussion may be reluctant to advance because of such effects. It can be observed that a degree of moral hazard is common to all insurance systems and in particular deposit insurance\(^1\); however, the goal should always be to minimise it. What is notable in the EDIS proposal is the pooling of institutions and individual DGSs with different risk profiles (and sovereigns) and an uneven distribution of risks, that have not previously pooled these risks and may have different perceptions of the riskiness or otherwise of their new partners. In some cases, the way in which a DGS operates enables banks to run / have oversight of the DGS and its fellow members which they would no longer have at the level of EDIS as a whole\(^2\). Addressing these issues and perceptions appears key to building trust and gathering broad support for the EDIS proposal.

The Commission lists a number of risk reduction measures in the communication adopted at the same time as the EDIS proposal which would be ‘needed in parallel with work to establish EDIS’. In brief these are:

1. Options and discretions (ONDs) in respect of micro-prudential rules (i.e. in the CRDIV/CRR);
2. Harmonisation of national deposit guarantee schemes;
3. SRB start-up and MREL TLAC (Minimum Required Eligible Liabilities / Total Loss-Absorbing Capacity) (since the SRB is close to be fully up and running, only the latter is addressed below);
4. Consistent application of bail-in rules under BRRD / SRM and of EU State Aid and Fund Aid rules;
5. Convergence in insolvency law and restructuring proceedings across Member States, handling of non-performing loans (NPLs) (these 2 issues are separated out in Annex 2);
6. Prudential measures addressing identified weaknesses, in particular leverage, stable bank funding and comparability of risk-weighted assets (RWAs);
7. Prudential treatment of banks’ exposure to sovereign risk.

In Annex 2 these measures are described further, alongside a table with more concrete

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\(^1\) See for example [http://bruegel.org/2016/02/european-deposit-insurance-a-response-to-ludger-schuknecht](http://bruegel.org/2016/02/european-deposit-insurance-a-response-to-ludger-schuknecht/)

\(^2\) See also the ECB’s public consultation on the approach for the recognition of institutional protection schemes (IPS) for prudential purposes, also referred to in Annex 2.
information on the state of play of these measures.

III. The way forward

The need to create synchronicity between the three pillars of the Banking Union and to ensure that deposits of European citizens are protected independently of where these citizens live are some of the central arguments underpinning the positive reception of the proposal.

However, given the many interlinkages with other, often highly sensitive, issues, the EDIS proposal is a controversial one and large differences remain as to which conditions need to be met for EDIS to advance as well as with regard to the design of EDIS. Overcoming these differences will be a matter of timing, conditionality and content: which steps can be taken when and under which conditions. The absence of an up-to-date impact assessment for this proposal is highly regrettable. Your rapporteur still expects the Commission to come forward with a thorough and up-to-date impact assessment. It is of vital importance to ensure that no Member State participating in EDIS is (perceived to be) worse off compared with its starting position.

A. Conditionality

Parties in the debate have expressed different and sometimes opposing views as to the amount of risk reduction needed in parallel to the gradual establishment of EDIS and the conditionality between steps in the field of risk reduction and those in the area of further risk sharing. However, most parties to the debate have acknowledged that risk reduction needs to increase during the gradual setting up of EDIS. This would require clarity beforehand as to the risk reduction measures that are deemed relevant for the establishment of EDIS, as well as regular assessments to determine whether the risk reduction agenda is still on track and in parallel to the process of gradual and increased risk sharing through EDIS.

1. Preliminary steps

In your rapporteur’s view, a proper transposition, implementation and functioning of existing Banking Union legislation (most notably the BRRD and DGSD) can be seen as a condition sine qua non for the start of EDIS, as this is legislation that should in any case be functioning by now. It is therefore important to gain thorough insight into the current state of affairs in this area and to ensure that those Member States that have not yet (properly) implemented and applied these related pieces of legislation will do so before any start of EDIS. In this regard, a number of preliminary steps have been put forward by various parties to the debate, including inter alia a stocktaking and evaluation exercise concerning the differences between the national DGSSs and a review (some arguing for a full Asset Quality Review) of all the banks under the SSM.

The lack of an impact assessment continues to be a complicating factor in this sensitive
dossier. The Commission non-paper entitled ‘Economic benefits of the EDIS proposal’ only partially fills this omission. The significant need for a proper consultation-based impact assessment remains. In line with the Commission principles in the Better Regulation Agenda, your rapporteur reiterates the request for an impact assessment. Your rapporteur suggests that until that assessment is published, the (shadow) rapporteurs and other interested ECON members address their questions concerning the impact of the EDIS proposal to the European Commission (comparable to the working method based on ‘surveys’ as used in the Ad Hoc Working Party of the Council\(^1\)).

As for the legal basis, it is clear that there will be an ongoing debate as to whether or not Article 114 TFEU is a suitable legal basis for the proposal. Article 114 TFEU has been used for Banking Union legislation before, for example the SRM Regulation, in that instance combined with an Intergovernmental Agreement (IGA) for the funding of the Single Resolution Fund.

Your rapporteur is aware of the opinion of the Legal Services of the Council regarding the legal basis, which concludes that Article 114 TFEU is an adequate legal basis for the EDIS proposal. An opinion of the Parliament’s Legal Service could be requested, if deemed necessary, especially regarding the use of an IGA, which has been signalled as a possibility by the Council legal opinion and is opposed by the European Parliament, which wishes to safeguard the community method.

2. *Measures to be taken alongside the creation of EDIS*

Your rapporteur emphasises that the measures discussed in Annex 2, let alone the following points, are not to be seen as an exhaustive list. That being said, your rapporteur underlines the importance of the following elements.

a. **TLAC and MREL**

The bail-in tool is generally regarded as one of the vital tools for addressing the sovereign-bank nexus and the issue of too-big-to-fail. Regarding the EDIS proposal specifically, it is a key element to protect the DIF from being called upon and the same holds true for the SRF. The availability of bail-in-able liabilities is therefore key.

Summing up, one could argue that sufficiently high MREL requirements are needed to protect EDIS, in particular for medium-sized and big banks, the latter possibly requiring a substantially higher binding MREL than 8 % of total liabilities including own funds. In this regard, small banks are more likely than larger banks to be liquidated rather than going into resolution and thus would have different MREL requirements. It is important for the Commission to take this into account with regard

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\(^1\) Regrettably, neither the Council nor the Commission have shared these documents with Parliament via any official channel.
to its TLAC implementation proposal later this year. In any case, it is important that the setting of MREL is left to the discretion of the Resolution Authority / SRB, which needs sufficient intervention and monitoring tools at its disposal to ensure adherence by all banks to the set requirements.

b. OND and harmonisation DGSs

Temporary high balances (Article 6(2) DGSD), being one of the most significant national options under the DGSD. Member States are currently free to set the conditions, level and duration of the (additional) coverage provided. This is an issue which needs resolving, as the DGS Directive sets no upper limit to the amount above the compulsory €100,000 which can be covered by a DGS. As a consequence, this differs significantly by Member State.

These differences would lead to an unlevel playing field in the event of a call on the DIF. Possible ways to address this matter are either to include provisions on this issue in the EDIS proposal or to amend the DGSD, while taking due account of cost-neutrality and level-playing-field issues inside and outside the Banking Union.

Alternative measures (Article 11(3) and also 11(6) DGSD). While it should be clear that alternative measures can by no means be used to save a bank when it is against the public interest to do so, the use of alternative measures can have advantages from the perspective of the client and are often exercised by those DGSs that are also an IPS. It should therefore be discussed whether the use of alternative measures should be harmonised further, be kept as a possibility at the national level or be added as tools at the European level. This also raises the question of whether and how these measures continue to be / will be financed.

c. Insolvency

These measures centre mainly on the interlinked issues of resolution, insolvency and deposit insurance. All sides of this ‘triangle’ need to be sufficiently developed and efficient in order to make bank failure safer and the least cumbersome on the consumer / client / depositor / other creditors. A framework to address the issue of NPLs should be seen as a vital feature of this triangle. This also includes the problems that many banks endure with regard to other non-performing assets.

d. Sovereign debt

While any and all measures to address the issue of banks’ exposure to sovereign debt should be approached and handled very carefully and gradually, this has to be and will be a key issue in moving towards a fully-fledged European deposit insurance scheme. In the end, a better regulatory framework, be it European or international, would be needed.

As a general remark, it should be noted that the best way to deal with banks’ exposure to sovereign risk and the bank-sovereign nexus, is not any regulatory approach for the
banking sector, but for Member States to reduce sovereign debt levels. A strict and coherent implementation and enforcement of both the Stability and Growth Pact and the economic governance framework has the ability to reduce banks’ sovereign exposure risk significantly. It is, however, a reality that further steps in risk reduction need to be taken, especially when moving towards further mutualisation of risks between the Member States, as is the case in the EDIS proposal.

B. Timing

Several elements are at play when it comes to the timing of the EDIS proposal, not only the start and the gradual phasing-in of the proposal itself, but also the progress of the respective risk reducing measures that are linked to the proposal. There are several options to be looked at. Among those, three seem to have gained adherence.

1) To start and progress with EDIS as proposed by the European Commission in full;
2) To forego the reinsurance phase of the proposal and start in 2020 (as planned) directly with the co-insurance phase, albeit based on strict conditionality;
3) To start EDIS as planned or soon after the planned date, but with a (possibly lengthened) reinsurance phase with no automatic transition to further phases.

Realistically, it seems unlikely that EDIS could start and progress completely in accordance with the Commission proposal.

To forego the reinsurance phase, however, and start under strict conditionality in 2020 with co-insurance would mean the full insurance phase could start as planned in 2024. Yet, with the mutualisation of risks that the co-insurance and full insurance entail, this also brings the need for strict conditionality as regards risk reduction. With foregoing the reinsurance phase, this could mean – if not enough steps are taken – that European citizens will not have the possible benefits of a European deposit insurance scheme. An example would be in the case that the Basel Committee decided to take no further prudential measures on the exposure of banks to sovereign debt. In that scenario it would be difficult to address this issue only within the Banking Union or the European Union: to do so should however remain a possibility as the alternative would be that without progress we could also not start with the co-insurance phase of EDIS.

In that regard, the reinsurance phase could still prove useful, as it would provide liquidity support to national DGSs during the period in which they can make progress with the risk reduction agenda. Although for the reinsurance phase there are good parts already present in the Commission’s proposal, there then would be the need to redesign it, since there are several elements that would not enable it to fully function and function well.

In relation to timing, the case of the IGA on the transfer of funds to the SRF has shown the additional uncertainty that can stem from the need for ratifications by Member States.
regarding the timing and even the overall entry into force of the legislation.

C. Other issues

These issues are all closely interlinked.

1. Funding / contributions

As a general starting point, the gradual move from national DGSs to EDIS should be cost-neutral. Furthermore, specific work is needed concerning (risk-based) contributions. Besides the fact that risk-based contributions will always have a limited spread and can thus only do so much, your rapporteur regrets that the Commission has suggested with its proposal to leave this to level 2 measures.

Regarding the types of contributions accepted, in particular the issue of payment commitments, it is worth underlining that not including them makes the resources of the DIF more liquid and therefore more reliable in case they are called upon. On the other hand, payment commitments are already under the DGSD and the SRF and may give the banking sector some added flexibility. If the possibility of using payment commitments is maintained, they will need to be fully credible and thus always have to be directly and immediately payable.

On the principle of cost-neutrality, the wording of Article 74c as proposed by the Commission has raised some concern and needs further clarification.

2. Remit

Certain options for use of funds (in particular Article 11(3) and also 11(6) DGSD - ‘alternative measures’) are not payout events for the purposes of EDIS under the Commission’s proposal. As previously mentioned, while it should be clear that alternative measures can by no means be used to save a bank when it is against the public interest to do so, the use of alternative measures can have advantages from the perspective of the client and are often exercised by those DGSs that are also an IPS. It should therefore be discussed whether the use of alternative measures should be harmonised further, be kept as a possibility at the national level or be added as tools at the European level.

If the possibility of using alternative measures is to remain at the national level, as this is the level with most direct contact with the affiliated entities, the funding of such measures and the consequences for the need for budget-neutrality for the banking sector should be clarified

3. Governance issues

It will be important to have the best possible arrangement for the stewardship of the funds collected in the DIF, whatever the legal basis for its establishment. Its investment strategy would need to be prudent, and arrangements for collecting contributions to be sound and
efficient. Most of all, any expenditure by the DIF would need to be subject to appropriate controls. Finally, the rights of the DIF to subrogate to the rights of depositors in any insolvency or restructuring proceedings would need to be exercised thoroughly and in full.

4. Structure / design

In general, your rapporteur is of the view that, if a system works well, there is no need to change it. Whether or not this would mean that national systems could co-exist alongside a possible European deposit insurance scheme in a role beyond that of a mere paybox is to be debated.

Once again, certain elements of the national DGSs have proved to create stability and anchor the desired trust in the safety of deposits. In that respect, it is laudable that the Commission is taking the approach that national options, such as those referred to in Article 11(3) and 11(6) DGSD, remain as available tools. These systems, however, would then need financing and this would question the budget-neutrality of the proposal for the banking sector.

Another issue is that the introduction of EDIS would lower the perceived advantage for DGSs to increase their funding levels beyond the target level of 0.8%. The EDIS proposal is envisaged by the Commission to harmonise deposit insurance within the Banking Union, but there should always be an incentive to go beyond 0.8% of covered deposits.

IV. Conclusion

This Working Document has tried to describe in general terms the linkages between the EDIS proposal and certain other legislative texts and existing structures, to explore the relevant key elements in the debate about risk reduction and to determine a number of key questions for the future handling of this package. Many ECON members have expressed their willingness to work towards completion of the third pillar of the Banking Union, but most of them have also argued that certain conditions need to be fulfilled if progress is to be made. It has become clear that concrete positions vary widely, and finding agreements on this highly sensitive dossier will require the right balance in terms of timing, conditionality and content. This task is further complicated by the lack of a proper impact assessment. Ensuring as much as possible cost-neutrality for the banking sector and a level playing field between Banking Union Member States and non-Banking Union Member States will be, among others, two key elements.

Next steps proposed by the rapporteur:
- An impact assessment from the European Commission
- Concrete steps in the area of risk reduction
- More clarity on the calculation of the risk-based contributions
- Finding a broad majority position in both the Council and Parliament on:
  - Concrete timing of the phasing in of EDIS
○ Conditionality of the risk reduction
○ Content / design of EDIS
BRRD creates the BRRD regime for the BU, with a single resolution authority (SRB) and single resolution fund (SRF). National resolution authorities cover smaller banks.

SRMR requires resolution of failed banks including bail-in of creditors rather than taxpayer bail-out.

DGSD approximates rules on deposit insurance, €100k common protection. Allows several national variations.

EDIS would create the DGSD regime for the BU, with an insurance scheme providing full insurance from 2024, run by SRB. Separate DGSSs will still exist, ie no single DGS for the BU.

CRD4/CRR apply the G20/Basel III accords & set minimum capital, leverage and liquidity requirements for banks. Many national ‘options & discretions’.

SSM applies the CRD4/CRR regime to banks in the BU, with ECB as the competent authority. National authorities supervise smaller banks.
ANNEX 2: WORKSTREAMS IDENTIFIED IN COMMISSION COMMUNICATION OF 24 NOVEMBER 2015 "TOWARDS THE COMPLETION OF THE BANKING UNION"

It may be helpful to divide the risk reduction measures identified in the Commission communication into 2 blocks. Division between them is not clear-cut but broadly one can distinguish certain types of measures, which we shall term 'Block A' as being those which

- concern the (further) implementation of banking union structures and institutions as summarised in Annex I;
- can at least partially be addressed at BU level only;
- and/or concern implementation of or modest adjustments to legislation which is already in place rather than entire new initiatives.

By contrast the other measures, which we term 'Block B' are broadly those which

- go beyond the implementation of banking union structures and institutions, either because they have wider EU28 or global significance or because they require bank-by-bank assessments and decisions;
- as a consequence cannot be addressed in the BU independently of wider developments (EU28 / global); and/or
- require substantial new legislative initiatives.

It should be said at the outset that the issues mentioned below here are not exhaustive as to the possible issues which can affect EDIS. Some others have been identified in Council work (for example, non-exhaustive, accounting standards, misconduct risk, deferred tax assets, level 3 assets, (general soundness of) economic policy etc.) but will not be considered here.

**Block A: risk reduction measures related to existing Banking Union structures, legislation and institutions**

1. **Options and discretions (ONDs) in respect of micro-prudential rules (i.e. in the CRDIV/CRR)**

Because many of these ONDs affect the level and more specifically the quality of required capital and liquidity in banks, it is clear that they could potentially affect likelihood to fail and therefore, in cases where failure could threaten to touch covered deposits, the use of EDIS. The Commission is currently looking into e.g. reducing the exceptions to the large exposure regime (Art. 400 (2) CRR), the more favourable risk weighting for Public Sector Entities (Art. 116 (4) CRR), an accelerated deduction of stock of DTAs (Art. 487 (2), (3) CRR) and other ONDs.
Many ONDs will lapse by 2018. In addition, the application of the ECB Regulation (which only covers ONDs, applicable to all institutions, which can be exercised by the Competent Authority (ECB for significant institutions)) and the ECB Guide on ONDs will lead to more harmonisation. A possibility to tackle the remaining ONDs is the general CRR review on which a COM proposal is expected in November 2016.

Two other issues have been identified by the ECB as worthy of attention. First, it is understood that they have looked at the issue of valuation so-called 'level 3 assets', namely those without observable inputs for valuation purposes. Secondly, ECB issued a separate consultation on the approach for the recognition of institutional protection schemes (IPS) for prudential purposes. This is of particular significance in the EDIS context because some IPS are recognised as DGS under the DGSD.

More information on ONDs can be found [here](#).

2 Harmonisation of national deposit guarantee schemes

The DGSD includes options and discretions (on one count, 36 different ones affecting all aspects including contributions, target level, use of means). Since each difference may affect the likelihood or size of a payout, there are question whether all these options can be maintained in the BU - preferable to address ex ante rather than ex post as is being done in SSM, while adhering to cost neutrality and maintaining a level playing field between banking sectors inside and outside the Banking Union. Certain options for use of funds (in particular Art 11(3) and Art 11(6) DGSD - “alternative measures”) are not payout events for the purposes of EDIS under the Commission's proposal.

4 Consistent and effective application of bail-in rules under BRRD / SRM and of EU State Aid and Fund Aid rules

The first cases to be decided under SRM have not yet arrived. Attention has been given, in respect of past cases, to compatibility of BRRD and State aid rules. Overall, however, there is considerable commonality between them, including the shared basic principle of bail-in of shareholders and subordinated debt before public funds can be used. The BRRD & SRM have in addition the ‘8% rule’ by which Resolution Funds cannot be accessed until at least 8% of total liabilities including own funds have been bailed in.

Consistent and effective application of bail-in is necessary both for acceptance and credibility of the system and in order to provide right incentives and tackle the moral hazard issue associated with insurance schemes. As noted in the previous heading, in terms of economic / financial linkage to flows under EDIS, in certain situations, insistence on a given level of bail-in (rather than recourse to the Single Resolution Fund, for example if the SRF was depleted) could increase the likelihood that covered deposits are reached in the creditor hierarchy and therefore that EDIS is called upon. Equally, inability to bail in certain eligible liabilities could have the effect of forcing bail-in further down the creditor hierarchy, possibly reaching covered deposits and therefore DGS / EDIS. This may be most likely to happen where eligible
liabilities are not subordinated, and rank pari passu with liabilities the resolution authority would seek to protect (e.g. trade creditors). This latter point reinforces the need for BRRD to be fully and properly implemented so that bail-in can function reliably. Finally, given that the Commission will have to pronounce on any use of State aid or Fund aid (SRF) in resolution, it is important that they are seen to do so even-handedly and objectively.

**Block B: risk reduction measures going beyond existing BU structures, legislation and institutions**

The next section of this document focuses on the remaining measures identified by the Commission. These other measures do not address or concern the structures and institutions that make up the BU, they concern other more general laws and structure (insolvency, Capital Markets Union) but also individual, bank-specific requirements which would potentially need to be applied across the EU28.

3. **MREL and TLAC**

Under the BRRD / SRMR, the SRB, like other EU resolution authorities, is required to set MREL for each bank it covers. The level of MREL should be set at a level which allows the bank to be resolved in a way that meets the resolution objectives and, in appropriate cases, allows it to comply thereafter with the conditions for authorisation.

In general, if a minimum level of MREL is not set high enough and consequently there are insufficient eligible liabilities in resolution, this increases the risk that covered deposits (which are not eligible for this purpose) could be reached in the creditor hierarchy and therefore that a call on the DGS / EDIS could be made. While Art 108 BRRD, by raising the creditor ranking of covered deposits, has reduced this likelihood, institutions with higher retail depositor funding would be more likely to give rise to claims against EDIS if placed into resolution and if they do not have sufficient liabilities eligible for bail-in to cover losses.

By 1 January 2019 the EU will be required to implement the FSB's TLAC requirement for G-SIIs (Minimum TLAC must be at least 16% of the resolution group’s RWAs as from 1 January 2019 and at least 18% as from 1 January 2022). Because liabilities need to be subordinated in order to be eligible for TLAC, this may trigger changes to insolvency law (see below), although subordination can also be achieved by other means (structural through issuance by a different legal entity, and contractual through the legal conditions of the liabilities). The Commission is expected to present a proposal on TLAC implementation in November 2016.

5a. **Insolvency law**

In the CMU context, the Commission proposes to look at EU28 corporate insolvency laws in order to ease movement of capital. Making insolvency regimes more efficient can also make it easier to deal with NPLs / asset transfers (see next item). There are separate issues of insolvency law, specific to insolvency and balance sheets of
banks, concerning (a) the alignment of the creditor hierarchy in insolvency law with that of the BRRD in order to avoid "No Creditor Worse Off" (NCWO) claims in resolution and (b) using change to insolvency law as means to respect TLAC subordination requirement.

All these issues have linkage to outcomes of bank resolution and therefore to EDIS. More predictable and efficient insolvency regimes have the potential effect of

- reducing the likelihood of calls on EDIS through more efficient processes / liberation of capital and effects on growth (macro effects);
- making it easier to apply NCWO and therefore to ensure that creditors and not DGS meet the cost of resolving banks;
- easing the recovery of assets by the DGS / EDIS in insolvency proceedings when they subrogate the rights of depositors.

The Commission is expected to present a proposal on insolvency law in November of 2016.

5b. Handling of non-performing loans (NPLs) and other non-performing assets

It is clear that existing high levels of NPLs (and other, for example, ‘stranded assets’) on banks' balance sheets could lead to weakness / possible failure / resolution thereby potentially triggering EDIS payout. The likelihood of this depends, inter alia, on the treatment and provisioning of the NPLs, which can be argued to also have linkages to real economy financing. Dealing with NPLs in line with BRRD/SRMR and state aid rules, should promote lending/growth in credit-constrained markets given that lending is still partly national in nature.

More information on NPLs can be found here.

6. Prudential measures addressing identified weaknesses, in particular leverage, stable bank funding and comparability of RWAs

Like all measures addressing adequacy of bank capital, this initiative (which is linked to wider, global developments in Basel) have a link to the likelihood of bank failure and therefore to payout under EDIS (cf item 1 on ONDs). By promoting bank health and increasing the reliability of regulatory measures, the measures can be expected to have an overall positive effect at macro-economic level. One question is whether there is any reason to believe these measures overall affect one set or type of banks disproportionately and could thus affect the level of moral hazard in the EDIS.
7. **Prudential treatment of banks’ exposures to sovereign risk**

In general, any and all measures to address the issue of banks’ exposure to sovereign debt should be approached and handled very carefully and gradually.

First, zero weighting of sovereigns and the lack of diversification incentives leads to too high and concentrated holdings of (domestic) sovereign debt unmatched by bank capital. This therefore creates too high exposure of banks to the risk of sovereign default, which could in turn lead to bank failure and therefore the use of EDIS funds. Given the increasing concentration and overall variations in national levels of bank exposure to the home sovereign, the pooling of these risks could be held to worsen issues of moral hazard.

Second, and looking from the sovereign rather than bank perspective, risks can arise from the over-reliance on the domestic banking system by highly indebted sovereigns. Such situations mean that bank weakness may affect sovereigns, even producing a so-called "feedback loop". Such concerns are likely to have an overall macro effect as well as increase the vulnerability of individual sovereigns and institutions.

Several options for tackling this problem have been advanced: in particular the introduction of non-zero risk weights and the introduction of large exposure limits, diversification requirements or measures of concentration. The different options will likely produce different effects. Further options have also been discussed, e.g. greater disclosure requirements, hybrid solution (preferential risk weighting up to a certain threshold, higher risk weights above), or zero risk weighting if a portfolio of sovereign bonds is sufficiently diversified.

More information on sovereign risk weights can be found [here](#).
<table>
<thead>
<tr>
<th>Who?</th>
<th>Current state of play</th>
<th>Future steps and timescale</th>
</tr>
</thead>
<tbody>
<tr>
<td>ECB/SSM as regards ‘supervisory discretions’ (in the Banking Union)</td>
<td>ECB/SSM has listed micro-pru ONDs and proposed a common approach for some of them</td>
<td>ECB Regulation on the exercise of options and discretions available in Union law was published on 24 March 2016 (ECB Regulation 2016/445 of 14 March 2016). It harmonises the exercise of 35 'horizontal' (i.e. that apply to all banks) options and discretions contained in the CRD IV package and the Liquidity Coverage Ratio delegated act. It was accompanied by an ECB guide which provides guidance to supervisors as regards case-by-case options and discretions (i.e. exemptions granted on a case-by-case basis to individual banks). ONDs could form part of a 'CRDV' package with the aim of harmonising the supervisory framework, not only for further risk reduction; exact scope of such legislative proposal still unclear, COM has announced proposal for November 2016.</td>
</tr>
<tr>
<td>COM (DG FISMA) as regards ONDs in level 1 legislation (CRD IV/CRR)</td>
<td></td>
<td></td>
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</table>
2. Harmonisation of national deposit guarantee schemes

<table>
<thead>
<tr>
<th>Organization</th>
<th>Directive Details</th>
<th>Implementation Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>COM (DG FISMA)</td>
<td>Directive had to be transposed into national law by 3.7.2015. On 10.12.2015 the Commission requested 10 Member States to do so. As of 22.1.2016 21 MS have fully implemented, 2 partially. Currently there is wide variations in funding of DGS.</td>
<td>MS must ensure that, by 3.7.2024, the available financial means of a DGS shall at least reach a target level of 0.8% of the amount of covered deposits of its members (possible derogation to 0.5% under Art 10(6)).</td>
</tr>
<tr>
<td>EBA</td>
<td>National options exist in particular on levies (Art 10(4)), lower taregt amount (Art 10(6)), alternative measures (Art 11(3)).</td>
<td></td>
</tr>
<tr>
<td>National DGS</td>
<td>EBA adopted guidelines on contributions and on payment commitments in May 2015, and issued draft guidelines on cooperation agreements between DGS in July 2015.</td>
<td></td>
</tr>
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</table>

3. SRB start-up, MREL and TLAC (presented together in COM communication but separated out in this document)

<table>
<thead>
<tr>
<th>Organization</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>ECOFIN Council</td>
<td>SRF operational as from 1 January 2016, as the IGA is applicable amongst participating MS (with the exception of Lux). Public bridge financing arrangement agreed at ECOFIN on 8.12.2015; first Loan Facility Agreements with MS signed. Common backstop in discussion with MS. Contributions for 2015 transferred to the SRF. Methodology for the calculation of ex-ante</td>
</tr>
</tbody>
</table>
3b. MREL and TLAC

<table>
<thead>
<tr>
<th>Basel / FSB</th>
<th>TLAC termsheet adopted by FSB on 9.11.2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>COM (DG FISMA)</td>
<td>Delegated Act (RTS) on MREL adopted by COM on 23.5.2016</td>
</tr>
<tr>
<td>EBA</td>
<td>COM now conducting MREL Review / TLAC implementation technical discussions with MS.</td>
</tr>
<tr>
<td>SRB</td>
<td></td>
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</tbody>
</table>

On MREL / TLAC integration, technical discussions with MS and COM from February to June 2016

SRB aims to set MREL for significant groups by end 2016.

EBA are required to prepare a report on the consistency between MREL and international standards by October 2016.

COM has committed to submit a legislative proposal on TLAC/MREL in 2016.

TLAC to apply from 1 January 2019.

4. Consistent application of bail-in rules under BRRD / SRM and of EU State Aid and Fund Aid rules

<table>
<thead>
<tr>
<th>Commission (DG COMP/DG FISMA)</th>
<th>Cases pre-2016 not decided by SRB but by national authorities, under regular state aid/BRRD framework. (Non bail-in provisions of BRRD in force since 1.1.2015.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SRB</td>
<td>Generally, bail-in in these cases dictated by competition rules rather than resolution law. COM took final decision on HSH Nordbank on 2 May 2016 (text of decision not yet available).</td>
</tr>
</tbody>
</table>

Dependent on cases arising.
5. Convergence in insolvency law and restructuring proceedings across Member States, handling of NPLs (presented together in COM communication but separated out in this document)

<table>
<thead>
<tr>
<th>5a. Insolvency law</th>
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<tr>
<td>COM (DG JUST - general case)</td>
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</table>
| Mentioned in the CMU Action Plan (i.e. foster convergence of insolvency proceedings)  
COM (DG JUST) has launched a public consultation on an effective insolvency framework within the EU (open from 23 March 2016 to 14 June 2016); such consultation will be used to identify which aspects may be dealt with in the legislative initiative.  
Issue of insolvency hierarchy in banks is part of TLAC discussion (requirement for TLAC capital to be subordinated). D has already amended its law, F, IT considering doing so but with different models |
| Legislative initiative on business insolvency addressing the most important barriers to the free flow of capital announced for Q4 2016  
On banks, joint team of COM, ECB, SRB working on the issue in 2016. |
5b. Handling of NPLs

| SSM as part of its regular supervisory action COM (ECFIN/FISMA) within the framework of the semester (Country Specific Recommendations (CSRs) etc) | SSM sent questionnaires to certain banks in October and December 2015
The necessity to bring down the level of NPLs was mentioned in the 2015 CSR for AT, BG, HU, HR, IE, IT, PT and SI.
COM published the draft 2016 CSR on 18 May 2016. As announced in the COM’s communication of November 2015, these primarily target the high level of NPLs in a few Member States (i.e. IE, HR, IT, PT and SI in the Euro Area and BG) and call for action. | SSM were awaiting responses for end-February. Indication from ECB was that 'this will take time'
The draft 2016 CSR will be discussed in the 17 June ECOFIN with a view to endorsement by the European Council on 28-29 June and final approval by the ECOFIN on 12 July 2016. |

6. Prudential measures addressing identified weaknesses, in particular leverage, stable bank funding and comparability of RWAs

| Basel COM (FISMA) EBA | Leverage: work ongoing in Basel. The definition of leverage ratio (LR) under CRR has been amended by a Delegated Act. | Basel consultation paper on the LR methodology was announced for Q1 2016. Report on appropriateness and calibration of the leverage ratio (LR) to be published by the EBA by October 2016 (Article 511 CRR); COM to report and possibly table a legislative proposal on the basis of the EBA report by end 2016. COM will have to decide on the appropriateness of a mandatory LR requirement. |
### Net Stable Funding Ratio (NSFR):

In accordance with Article 510 CRR, the EBA published a report in December 2015 on the impact assessment and calibration of the NSFR recommending its introduction in the EU.

RWA: the Basel Committee is developing specific proposals to reduce excessive variability in RWAs across jurisdictions and banks for both internal rating-based and standardised approaches.

**NSFR**: If appropriate, COM to submit a legislative proposal by end 2016 (Article 510 CRR)

Leverage, NSFR and RWAs could form part of a 'CRDV' package, exact scope of such legislative proposal still unclear, COM has announced intention to present proposal in November 2016 and to include only those international issues which have reached final agreement in Basel (most likely not RWAs, leverage ratio buffers).

### Prudential treatment of banks’ exposures to sovereign risk

<table>
<thead>
<tr>
<th>Basel EFC COM (FISMA)</th>
<th>Work on-going in Basel</th>
<th>EFC report to be finalised in June 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ESRB report on the regulatory treatment of sovereign exposures published in March 2015</td>
<td>Basel document for public consultation to be published end 2016</td>
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<td></td>
<td>Dedicated EFC high level working group (HLWG) set up in 2015, the April ECOFIN held a first discussion on the various policy options on the basis of a progress report of the HLWG.</td>
<td>Question whether this could conceivably form part of a 'CRDV' package referred to in line 6 above..</td>
</tr>
</tbody>
</table>