EBA WORK ON DEPOSIT GUARANTEE SCHEMES

MATTERS FOR CONSIDERATION REGARDING EDIS

This information note covers the following questions:

1. What is the role of the EBA in the area of deposit guarantee schemes?

2. What are the main regulatory products developed by the EBA in this area?

3. What are the main issues addressed by the EBA Guidelines on risk-based contributions?

4. What are the implications of the EBA's Guidelines on risk-based contributions for the European Deposit Insurance Scheme?

5. What other technical considerations are there arising from the EDIS proposal?

1. What is the EBA's role in DGSs?

- Article 46 of the EBA Regulation: "*The Authority shall* ***contribute to strengthening*** *the European system of national deposit guarantee schemes…with the aim of* ***ensuring that national deposit guarantee schemes are adequately funded****…and* ***provide a high level of protection to all depositors*** *in a harmonised framework throughout the Union*"

How?

❑ **Rulemaking:**

Furthering the single rulebook by issuing Guidelines, recommendations and regulatory technical standards (where empowered)

❑ **Monitoring:**

Ensuring compliance, monitoring application of the Single Rulebook and pursuing breaches of Union law if necessary (e.g. enjoining Bulgaria to trigger deposit guarantee in 2014)

❑ **Reviewing:**

Conducting peer reviews of stress tests and identifying best practice. Assessing risk-based contributions methodologies applied by Member States

❑ **Mediating:**

Where disputes arise between Authorities on cross-border issues, provide mediation (e.g. disputes relating to the conclusion or application of cooperation agreements between DGSs in cross-border pay-outs under Article 14(5) DGSD)

❑ **Analysing:**

Collecting information on covered deposits and available financial means, which allows the EBA to provide analysis for policy-making

❑ **Training & Advice:**

Organising training and exchange of technical experience between Authorities.

Governance?

- EBA decision-making involves Supervisors and Resolution Authorities, many of which are themselves in charge of administering or overseeing DGSs
- In addition, BoS members can be accompanied by DGS representatives in decision-making

2. What are the main EBA DGS regulatory products?

❑ Rulemaking

1. **Funding**:

   i. ***Risk-based contributions:***

   Article 13(3) DGSD – Requires EBA to issue Guidelines to specify methods for calculating the contributions to DGSs. This is currently the only EU-level legislation on the topic of risk-based contributions for DGSs.

   Guidelines adopted 28 May 2015.

   Objectives of the Guidelines: (i) Ensure there is adequate funding for DGSs and that the target level is reached in the timeline envisaged; (ii) Capture the risk profiles of members so the most risky institutions pay more; and (iii) Promote a level playing field within the Internal Market.

   ii. ***Payment commitments:***

   Article 10(3) DGSD – Requires the EBA to issue Guidelines on payment commitments.

   Guidelines adopted 28 May 2015.

   Objectives of the Guidelines: (i) Ensure payment commitments are a reliable source of DGS funding; and (ii) Promote a level-playing field within the Internal Market.

2. **Cooperation agreements**:

   Article 14(5) DGSD – Requires cooperation agreements between DGSs to facilitate cooperation in cross-border situations, particularly cross-border pay-outs and transfer of activities. EBA to mediate on conflicts.

   Guidelines issued 15 February 2016, pending translation.

   Objectives of the Guidelines: (i) Lay down minimum standards and provide a template to avoid multiplication of different cooperation agreements; and (ii) Facilitate EBA mediation. Possibly EBA's multilateral scheme will be complemented by further technical specifications coordinated with European Forum of Deposit Insurers.

3. **Stress tests**:

   Article 4(10) DGSD – Requires stress tests of DGSs every 3 years. EBA must undertake peer reviews of the results every 5 years starting in 2017, facilitated by EBA's own initiative Guidelines.

   Consultation Paper published 6 November 2015, Guidelines to be adopted May 2016.

   Objectives of the Guidelines: (i) Ensure stress tests are consistent and credible as assessment tools of the resilience of DGSs; and (ii) Ensure that peer reviews are conducted on comparable data.

3. What are the main issues addressed by the EBA Guidelines on risk-based contributions?

Content of risk-based contributions Guidelines

- Article 13(3) DGSD requires the risk-based contributions Guidelines to include:
  a. "a calculation formula,
  b. specific indicators,
  c. risk classes for members,
  d. thresholds for risk weights assigned to specific risk classes,
  e. and other necessary elements"

Risk-based contribution elements

- In order to achieve their objectives, the Guidelines contain certain **mandatory core elements**, as well as several **flexible and/or optional elements**.
- The application of the Guidelines, along with any other risk-based contribution methods employed by Member States, must be reviewed by the EBA by 3 July 2017, and at least every five years thereafter.

A robust calculation formula

A key **mandatory element** is the calculation formula:

- The standardised formula ensures a level playing field
- An **optional element** caters for Member States whose DGSs can engage in failure prevention
- The formula targets the level of covered deposits (or risk-weighted assets as appropriate) in an institution (a proxy for size and DGS exposure) and riskiness (based on specified indicators)

$$C_i = CD_i \times CR \times ARW_i \times \mu$$

C_i	= Annual contribution for institution ‘i’
CD_i	= Covered deposits of institution ‘i’
CR	= Contribution rate
ARW_i	= Aggregate Risk Weight of institution ‘i’
μ	= Adjustment coefficient

A parameter can be added to the formula to capture the specificities associated with DGSs that have a failure prevention mandate (e.g. institutional protection schemes)

$$C_i = CR \times ARW_i\ (CD_i + A_i) \times \mu$$

A_i	= The amount of risk-weighted assets in institution ‘i’

Comprehensive risk indicators

Another important **mandatory element** of the Guidelines is the specification of risk indicators and weights:

- The DGSD requires banks to pay different contributions depending on their risk profile
- The Guidelines specify **8 mandatory risk indicators** – some of the measures are those commonly used to capture the likelihood of bank failure, while others capture the potential losses for the DGS in the event of failure
- An **optional element** allows the adjustment of weights, and caters for Member States who wish to add further risk indicators based on the specificities and risk profiles of their national banking sectors

1. CAPITAL	**18%**
i. Leverage Ratio	9%
ii. Capital coverage ratio or CET1 ratio	9%
2. LIQUIDITY AND FUNDING	**18%**
iii. LCR	9%
iv. NSFR	9%
3. ASSET QUALITY	**13%**
v. NPL Ratio	13%
4. BUSINESS MODEL AND MANAGEMENT	**13%**
vi. RWA/Total assets	6.5%
vii. RoA	6.5%
5. POTENTIAL LOSSES FOR THE DGS	**13%**
viii. Unencumbered assets / Covered deposits	13%

LIKELIHOOD OF BANK'S FAILURE

POTENTIAL DGS LOSS

The Guidelines ensure contributions capture riskiness

- A key element of the reform brought about by the new DGS Directive was to harmonise the funding of DGSs and tie the contributions required to the risk profile of the contributing member institution
- The Guidelines cater for risk differentiation by allowing adjustments where risk profiles are different because of specific circumstances (e.g. IPSs, smaller entities etc.).
- The Guidelines allow DGSs to distinguish between big and small members, risky and less risky members, on the basis of a number of elements:

Mandatory risk differentiation

❑ **Calculation formula:**
Differentiates on basis of size (level of covered deposits or risk-weighted assets as relevant) and riskiness (aggregate risk weight)

❑ **Risk indicators:**
Employs commonly used measures of risk to categorise banks and derive aggregate risk weights

❑ **Risk weights:**
Specifies minimum weight attributable to each risk indicator

❑ **Variation bands:**
Generally, riskiest banks' contributions weighted 150% of the average, least risky weighted 50%

Optional additional risk differentiation

❑ **Calculation formula:**
The formula has been adapted to allow it also to cover DGSs which have a failure prevention mandate

❑ **Small/less risky institutions:**
Additional risk indicator for low risk entities can allow their contribution levels to be lowered

❑ **Risk weights & risk indicators:**
Additional risk indicators are available, and a calibrated adjustment of weights assigned to different risks is possible

❑ **Minimum contributions:**
DGSs can specify that all institutions must make a minimum contribution

Some national discretions remain

- The Guidelines have been developed in a context where DGSs and funding are still on a national level
- The Guidelines provide a robust framework that ensures **consistency, proportionality, and risk differentiation**, but leave to **National Authorities choices** to best fit their own circumstances:
  - Weights for risk indicators – additional 25% weights to distribute
  - Possibility to introduce additional indicators – such as core earnings ratio, large exposures etc.
  - Business cycle adjustment – reducing or increasing contributions annually to avoid pro-cyclicality
  - Risk classification method – sliding-scale or bucketing approach options to capture sectoral structure
  - Variation bands – risk multipliers generally between 50% - 150%, exceptionally wider range
  - Minimum contributions – ensuring minimum contribution from all entities if desired
  - Reduced contributions for IPS members – recognises risk mitigating impact of IPS
  - Reduced contributions for low risk sectors – allows national low risk sectors to pay less
- At present Member States and DGSs are provided choices and discretions; when EDIS is in place, greater harmonisation between participating DGSs is likely to be required

Risk-based contributions – timeline & compliance

28 May 2015 – adoption of Guidelines.

As of 22 September 2015 – National authorities notified their intentions to comply or not with the Guidelines – 25 Member States already complied or intended to comply at this date.

31 May 2016 – Latest deadline for Member States to implement risk-based contributions as per the Directive. This is also the latest deadline for implementing the Guidelines.

3 July 2017 – EBA to conduct a review of the Guidelines, as well as every 5 years thereafter. The first review, only 1 year after implementation, will take the form of an overview of calculation methods implemented so far, an analysis and possibly proposals for change.

EBA's ongoing role

- EBA must be informed on an ongoing basis of own risk-based calculation methods implemented.
- EBA must review the Guidelines every 5 years
- EBA must monitor compliance with the Single Rulebook including Guidelines

4. What are the implications of Guidelines for EDIS?

- Currently, apart from the DGS Directive, the EBA's Guidelines are the only elements of the EU Single Rulebook on DGSs.

- All DGSs and Designated Authorities in the 28 Member States, as addressees of the EBA's Guidelines, have a binding procedural obligation to "make best efforts to comply". They are not obliged to comply but they must report whether they do comply, or explain why they do not (*comply or explain*).

- This ensures increasing convergence within the EU, which is also a precondition for further Banking Union integration in this area.

- When a European Deposit Insurance Scheme is established:

  - The EBA's regulatory products will continue to apply to the national DGSs in all 28 Member States

  - The EDIS, as a "body which administers a deposit guarantee scheme", even if it does not assume DGS functions (e.g. complaints handling), would in principle be an addressee of the EBA's Guidelines; however, this issue would benefit from further clarification

  - The DGSs and Designated Authorities of the EU would also be bound by the delegated acts of the Commission (according to the original EDIS proposal) on risk-based contributions, which would be of a binding character. It is not clear how they could both comply with this substantial obligation and the procedural obligation stemming from the Guidelines, unless the delegated act is fully aligned with the Guidelines – this represents a risk for the Single Market

5. Further technical considerations – Funding

1. Payment commitments

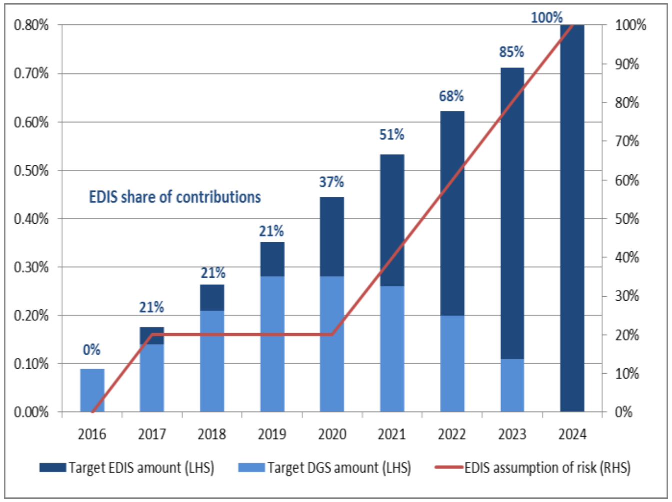
i. DGSs are currently not obliged to accept payment commitments but where they do so, the EBA guidelines ensure minimum consistency on the modalities and ensure this mechanism does not foster pro-cyclicality

ii. Whether EDIS should accept payment commitments is currently considered; the modalities of this, if it does accept them, should be in line with the Guidelines

2. Pace of EDIS funding

i. Under current proposal, EDIS attracts funding in the reinsurance phase more quickly than it assumes risk. For instance, in 2020, EDIS will attract c.37% of funding, while assuming only 20% of risk (20% contribution to a pay-out)

Current proposal:



3. Stress tests

The DGSD requires DGSs to periodically carry out stress tests of their systems with the EBA to conduct peer reviews of these stress tests. The EBA Board of Supervisors approved Guidelines on DGS Stress Tests on 20 April 2016, but the existence of EDIS will need to be taken into account: how will it impact on the stress tests DGSs conduct? Will EDIS be subject to stress testing itself, and if so, what types of tests given its relatively limited functions?

5. Further technical considerations

4. EDIS and the single market in banking

The single market in banking requires equal depositor protection across the EU. In order to enhance confidence-building solutions for DGSs outside the Banking Union, it may be appropriate to consider providing EDIS with an open architecture, or allowing for forms of affiliation also for DGSs outside the Banking Union. Otherwise, there is a risk that in case of a crisis deposits could fly to banks perceived to be backed by stronger schemes (such as those affiliated to EDIS).

5. Scope of DGSs versus SSM/SRM

i. EDIS would apply to "*credit institutions affiliated to participating deposit-guarantee schemes*".

ii. However, DGS membership is not 100% harmonised. In principle DGSs cover banks falling under the scope of CRD and CRR, which are also in the scope of SSM – SRM. Some DGSs also cover some entities not covered by CRD such as credit unions or 3rd country branches. The impact of these divergences in scope on potential liabilities for EDIS should be considered.

6. Cross-border cooperation

The DGSD contains a number of cross-border principles such as a home country responsibility for depositors at branches, a role for host DGSs to pay on behalf of the home, or the obligation for DGSs to conclude cooperation agreements with each other. By progressively integrating funding, EDIS will reduce the risk of cross-border conflicts related to insufficient funding (for instance as occurred in the Icesave case). However possible conflicts remain, if only because DGSs remain formally separate and because EDIS does not extend to operational aspects (e.g. calculation and treatment of claims). Many questions arise: who will sign the cooperation agreements inside and outside the Banking Union; will the EBA continue to mediate inside the Banking Union; what is the role of EDIS in cross-border situations?

THANK YOU VERY MUCH

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