Analysis

# New European Deposit Insurance Scheme to be introduced soon

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AUTHOR



Jyrki Haajanen

In November 2015, the European Commission proposed that a new European Deposit Insurance Scheme be established. The new scheme was to be launched at the beginning of 2017 and the reform include an 8-year transitional period. During this period the responsibility for pay-outs was to gradually be transferred from national level to the European Deposit Insurance Scheme by 2024.



## Aiming at a more efficient overall solution

The European Deposit Insurance Scheme (EDIS) would be established by amending the Regulation on a Single Resolution Mechanism (the SRM Regulation), adding provisions on a new deposit insurance scheme. The new scheme would come into force on the basis of the Regulation, and no separate national legislation process would therefore be necessary.

According to the Commission, transition to a common deposit insurance scheme should enable a more efficient overall solution than the present national Deposit Guarantee Schemes (DGSs). The aim is a situation where the home country of a bank would be irrelevant to the depositor. Another key objective is to break the connection between deposit insurance and budget risk in the home country. In the new scheme, risks related to the common deposit insurance would be distributed throughout a larger group of operators, and thus deposit insurance would more resemble traditional insurance business.

On the whole, the Commission proposal has been favourably received, although critical voices have also been raised. The Bank of Finland has expressed a positive attitude to the project but has emphasised the importance of progress in other legislative projects for increased financial sector stability and decreased risk. It has also advocated the removal of problem assets from bank balance sheets and increasing capital adequacy before the transition to mutualised insurance.

## Towards common deposit insurance in three phases

The EDIS would be limited to Member States in the Banking Union. Member States outside the Banking Union could participate in the new deposit insurance scheme only by joining the Banking Union.

The plan is to accomplish the EDIS in three phases:

1. In the **reinsurance phase**, national DGSs could, in a payout event or when requested to contribute to resolution, require a maximum 20% of their liquidity shortfall from the common Deposit Insurance Fund. However, no requirement of pay-outs could be directed to the joint fund until all resources of the national fund had been exhausted. In addition, the national fund must be able to show that is has fulfilled the timetable for fund collection required in the Bank Recovery and Resolution Directive (BRRD Directive). The reinsurance phase would start at the beginning of 2017 and continue for three years.
2. The **co-insurance phase** would begin after the reinsurance phase and continue for four years. In the co-insurance phase, national DGSs could request the common Deposit Insurance Fund to pay for part of the costs in such a way that the proportion financed by the common fund would increase annually by 20 percentage points. In addition, use of the common fund would require the national fund to have fulfilled the BRRD Directive requirements on collecting deposit insurance premiums. However, the national fund would no longer have to use all its resources before turning to the common fund.
3. The **full insurance phase** would commence after the co-insurance phase, which, according to the Commission's timetable, would be in 2024. In the full insurance phase, the common Deposit Insurance Fund would cover the liquidity needs of participating DGSs arising from a payout event or losses incurred from contributing to resolution.

## Including also a common Deposit Insurance Fund

The new European Deposit Insurance Scheme would also include a common Deposit Insurance Fund formed by contributions collected from credit institutions. The Commission proposes that the Deposit Insurance Fund would in 2024 contain assets corresponding to 0.8% of insured deposits, amounting to a total EUR 44 billion.[1] The final size of the fund would depend on the 2024 stock of deposits.

The national DGSs would directly invoice credit institutions for contributions on behalf of the Single Resolution Board, and the credit institutions would pay the contributions directly to the common fund. The method would differ from the stipulated procedure for the Single Resolution Mechanism, where national resolution authorities raise contributions, as specified in the SRM Regulation, from the credit institutions and transfer them to the Single Resolution Fund by virtue of a separate intergovernmental agreement.

The regulation would contain provisions on a 'funding path', which national DGSs would follow to ensure that they remain within the insurance cover offered by the Deposit Insurance Fund through the different phases. The Commission, after consulting the Single Resolution Board, may approve a temporary derogation from the funding path for a Member State.[2]

In practice, the system of contributions would be cost neutral to the banks, because they would be able to deduct the contributions paid to the common Deposit Insurance Fund from their obligations to the national deposit insurance fund. The Finnish Deposit Insurance Fund already at this time contains assets exceeding the 0.8% limit stipulated in the BRRD Directive, so the contributions to be collected for the common Deposit Insurance Fund would not cause the banks additional costs.

If the assets of the common Deposit Insurance Fund would not, after the reinsurance phase, be sufficient to cover resolution in a payout event, extraordinary ex-post contributions would be collected from the credit institutions. The common Deposit Insurance Fund would also have the right to agree with DGSs in Member States outside the Banking Union on the requesting or granting of loans. In addition, it would have the option to request loans from other alternative funding sources. However, as yet there has been no agreement on a back-stop mechanism. In practice, a clear back-stop mechanism would be necessary in order to ensure confidence in the scheme also in a case of a wider systemic crisis. The European Stability Mechanism (ESM) has been proposed as one possible alternative. However, use of this mechanism would require a change to the Treaty, which would require unanimous acceptance by all Member States.

## Notes

1. The amount is calculated on the basis of the position in 2011. ↑
2. The phase of the business cycle, the pro-cyclical impact of the contributions or the position of contributions at national level may justify a derogation. ↑

## Keywords

banking union, deposit insurance fund, deposit insurance scheme, EDIS