ING VIEWPOINT

Banking Union needs a European Deposit Guarantee Scheme

"The introduction of the European Banking Union is an important step. Thanks to the establishment of single supervision and the setup of a single resolution fund, the likelihood and possible impact of future banking crises are significantly reduced. However, to also achieve the objective of decoupling banks and sovereigns, it is essential to complete the Banking Union. Organising deposit insurance at the same European level is vital to ensure free flow of liquidity across Member States, further strengthen financial stability and safeguard healthy competition."

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Summary

- Deposit insurance is a valuable tool to ensure stability of the banking system. By assuring depositors access to their funds even if a bank fails, it is an important safeguard avoiding a run on a bank.
- Yet, to fully break the link between banks and national sovereigns, a system at supranational level is needed, alongside the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM). If this is not put in place, countries (sovereigns and national DGS funds) remain the ultimate backstop to the banking system. This will hamper further financial integration in the Eurozone.
- ING therefore supports the objectives of a European Deposit Insurance Scheme (EDIS) and calls for a more ambitious timeline in the implementation of the EC proposal. The set-up of the Single Resolution Fund provides a good example how mutualisation can be achieved faster.

National DGS's maintain the vicious circle between banks and sovereigns ...

- The Banking Union was developed to break the interdependence between national sovereigns and their domestic banks. The SSM and SRM are important steps in this direction.
- However, given the liquidity backstop-function of a national sovereign vis-à-vis its domestic DGS, it is fundamental that the Banking Union is completed by establishing a DGS at the same level where the competence and authority for banking supervision and resolution lie.
- Given supranational supervision and resolution in the Eurozone, the DGS too should be supranational.

... and impede the emergence of a single European market for banking services

- Without a European DGS, national authorities will continue to play a role in the oversight of banks that are active within their borders. They will remain focused on their national interests and preferences, given that national resources remain at stake. This will then continue to hamper free movement of liquidity and deposits across member states.
- Therefore, a DGS at the supranational European level is a *prerequisite* for Banking Union to function and a true single market to come about, not a policy option to be considered afterwards.

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The role of the deposit guarantee scheme has been diminished ...

- The European banking sector's regulatory and supervisory framework has changed fundamentally in recent years.
- As a consequence, banks have become much better capitalised and risk profiles much more moderate. In addition, thanks to recovery and resolution measures and the introduction of the bail-in principle, according to which investors in bank debt instruments will be charged if a bank fails, it has become much less likely that the DGS will ever have to be called upon again.

... and taxpayers do not need to worry about the deposit guarantee scheme's funding

- Currently national DGS's are funded by banks, ensuring coverage up to €100.000 for all deposit holders. Hence, the *solvency* of the DGS is a private sector responsibility. A *liquidity* backstop is needed to guarantee the DGS liquidity at all times and provide bridge financing in times of great stress. Any shortfall in the DGS will eventually be funded by banks.

Conclusion

- The revised DGS directive[1] aims to create a system of national DGS funds that is more aligned than in the past. Moreover, full implementation of the BRRD[2] across Europe is important to ensure a properly harmonised framework for recovery and resolution of banks. But alignment of national DGS's and recovery and resolution frameworks is not sufficient.
- The European Deposit Insurance Scheme (EDIS) as proposed by the European Commission would function fully by 2024. Between 2017 and 2024, risk sharing is mutualised very gradually (Table I).
- In the first phase (re-insurance), EDIS will only be called upon once national funds have been exhausted. In the second phase (co-insurance), EDIS will gradually complement national DGS's. Only when EDIS fully absorbs losses, by 2024, banks and their sovereigns are truly decoupled.
- An accelerated setup of EDIS is thus required. The current set-up of the SRF might serve as an example (Table II). In the SRF, in 2018 already 60% of losses are mutualised. In the Commission's EDIS proposal, this share of mutualisation is only achieved by 2022. This means Europe remains exposed to the risk of national bank runs and the imposition of capital controls for way too long.
- Just like any other DGS, a European DGS will need a liquidity backstop. This should equally be provided at the European level (e.g. in conjunction with the ESM). The strict liquidity only character of this backstop should prevent permanent fiscal transfers via the backdoor of the DGS.

[1] Directive 2014/49/EU on Deposit Guarantee Schemes

[2] Directive 2014/59/EU on Bank Recovery and Resolution

Table I: Building up of the European Deposit Insurance Scheme

Year	**Step 1: Re-insurance** *Share of EDIS in excess losses**	**Step 2: Co-insurance** *Share of EDIS in total loss (uncapped)*
2017	20%	
2018	20%	
2019	20%	
2020		20%
2021		40%
2022		60%
2023		80%
2024		100%

Table II: Building up of the Single Resolution Fund

Year	**Step 1: National compartment**	**Step 2: Mutualisation into SRF**
2016	100%	0%
2017	60%	40%
2018	40%	60%
2019	33,3%	66,7%
2020	26,7%	73,3%
2021	20%	80,00%
2022	13,3%	86,7%
2023	6,7%	93,3%
2024	0 %	100%

* Excess losses = losses in excess of what national DGS should hypothetically be able to absorb. The EDIS-contribution is also capped in the co-insurance phase. Figures shown summarise EDIS-contributions in case of payout or resolution. Next to this, EDIS may also provide liquidity assistance to national DGS's.

Source: http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52015PC0586&from=EN

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