

Paving the long road to EDIS: how to improve national Depositor Guarantee Schemes

Executive summary

- The EU need to restart negotiations on EDIS, as this is the best way to finish the last pillar of the Banking Union. It will create conditions for trust and for a cross-border market for savings.
- In the meantime, targeted changes to the way national DGSs are governed would help create a more integrated banking market. This should become part of the EU's review of the banking industry's competitiveness.

In this paper, we outline three specific recommendations:

1. Addressing the disproportionate divergence between target sizes in different Member States
2. Allow for the transferability of funds paid by a bank to a DGS when changing DGS affiliation.
3. Harmonise the way national DGSs systems finance the increase of covered deposits when new banks enter a DGS.

The imperfections of the current DGS system

The current system of deposit guarantee schemes (DGS) in the EU is based on the 2014 DGS Directive. In 2015, shortly after agreeing on that Directive, the European Commission proposed to introduce a European Deposit Insurance Scheme (EDIS), suggestion full mutualisation by 2024, aligning the build-up of EDIS with that the Single Resolution Fund (SRF).

Regrettably, and despite continuous political signaling in favour of Banking Union in the context of the EU's competitiveness and financing needs, no progress has been made on this crucial leg of the Banking Union project. Progress would add to the EU's overall credibility, a valuable asset in today's geopolitical environment.

We continue to strongly believe a fully mutualised EDIS should be the goal if we want a real Banking Union. Not only will it create conditions to build trust between national regulators, it will also support a pan-European market for savings products and ensure that all EU depositors will be treated equally in case of bank failures, creating a much stronger insurance mechanism.

Before tangible progress towards EDIS is possible, we believe addressing inconsistencies in the financing of national DGSs would at least ensure that national DGS systems do not unduly prevent effective and fair cross-border consolidation in the European banking sector, which is key to improving the EU's banking sector competitiveness.

The three following items should be urgently addressed:

1. **Harmonize DGS target size** - Addressing the disproportionate divergences between target sizes between different EU countries (ranging from 0.5% to 2.71% of covered deposits¹).
2. **Allowing transferability between DGS funds** – currently, once a bank has transferred money into a national DGS, none of the paid in capital (except for what has been transferred in past 12 months) can be transferred to another EU DGS in case of a corporate restructuring. This hinders cross-border M&A and management efficiencies (e.g. through branchification) without yielding any financial stability or depositor protection benefits.
3. **Change calculation methods that cause entry/exit unlevel playing field** – national DGS systems are very different in the way they finance a sudden increase of covered deposits, notably when a new bank enters the DGS. Depending on the system, either the newcomer or the incumbents pays for the funding

¹ EBA Deposit Guarantee Schemes data: <https://www.eba.europa.eu/activities/single-rulebook/regulatory-activities/depositor-protection/deposit-guarantee-schemes-data>

increase. This creates distortion in the market.

As a guiding principle, DGSs should at all time offer adequate protection to depositors. At the same time, DGSs do not have to be a barrier to cross-border integration. In our view, the public policy goal should be that banks changing their corporate structure, being involved in M&A or for other reasons should be able to restructure their DGS coverage in “budget neutral” way. Harmonising these financial aspects of DGS funding will also serve as a steppingstone to facilitate future negotiations over EDIS or any intermediate forms of mutualization, including in the form of liquidity support, co- and re-assurance.

Our recommendations

1. Harmonize DGS target size

- The DGS Directive sets a clear target level for DGS funding: 0.8% of covered deposits held by the member banks of a national scheme. This is in line with the 0.8% target for the SRF.
- In practice however, we see that at least 7 EU Member States currently deviate from this target level. The target level can be revisited in the future.
- The differences in target level are also substantial from the lowest 0.5% (France) to a high of 2.71% (Romania).
- These differences do not take into account that parallel depositor protection systems like IPS exist in some countries.

Recommendation

- Establish either a binding target level, or a strict range between which countries can set their targets.

2. Allowing transferability between DGS funds

- **When a bank changes its DGS affiliation within the EU, only the funds transferred to the fund in the past 12 month can be transferred to another EU DGS.** Since almost all EU DGSs have reached their target levels, the amount paid in the past 12 months will typically be very limited or even non-existing.
- **This disincentivises both branchification and subsidiarisation – incl. in the context of cross-border M&A – as this entails transferring covered deposits to a different DGS.** This makes this provision a significant barrier to progressing the EU Single Market for retail banking and the Banking Union. Concretely, it means a bank can lose an amount between 0.5% and 2.71% of its risk-adjusted covered deposits to a local DGS as part of a change in corporate structure not affecting the total amounts of covered deposits within the EU. This would come on top of also having to contribute to another DGS.
- **This stimulated inertia in the European banking landscape.** In the short term, a change in DGS affiliation means that a DGS from which the bank leaves will be overfunded (given deposit outflow is not matched by deposits transferred). In the longer term, this can benefit incumbent banks because they do not need to increase contributions as deposit grow organically, further stimulating inertia in the European banking system.

Recommendation

- In case of a change in DGS affiliation because of a change in corporate structure such as branchification or subsidiarisation a risk-based transfer of funds between EU DGS should be made possible to ensure adequate depositor protection in both affected DGSs.
- The European Parliament’s report serving as the negotiating position on the review of the DGSD as part of the CMDI package contains an amendment that captures this idea. You will find this amendment – which some suggested improvements – in the annex.
 - In its [biennial report on financial integration](#) the ECB shows support for this approach: *“Pending the establishment of a fully fledged EDIS, rules governing the transfer of Deposit Guarantee Scheme contributions should be reviewed to align such contributions with transferred risks when credit institutions change affiliations within the EU, ensuring that financial stability is preserved across the system.”*

- We urge legislators to adopt this approach as part of the CMDI package.
3. **Change calculation methods that cause entry/exit unlevel playing field**
- **The financing of the entry of a new bank into a national DGS system differs radically between Member States.** Depending on the contribution model that is applied, either incumbent participants or newcomers will be financially rewarded or punished relatively to their competitors. This fragmented landscape, combined with limited transparency over the detailed metrics related to required contributions, can cause an impediment to cross-border M&A and can discourage branchification. It may also unfairly punish or reward incumbent banks.
 - **There are roughly two different contribution calculation models applied in the EU.** In the “stock-based system” the newcomer that causes the increase in covered deposits in a DGS needs to contribute the lion’s share of additional contributions. On the contrary, in the “flow based system” incumbent banks share the cost of welcoming additional deposits from another bank into the DGS. There is no requirement for new entrants to individually contribute for any new deposits brought to the fund.
 - EU law does not require different DGSs to follow a similar approach, which has led to these discrepancies. EU DGSs – or the public bodies in charge of them - often also offer limited transparency as to how the financing works.

Our recommendations

- We believe the “stock based system” - which obliges a bank that brings additional covered deposits to a DGS to pay the lion’s share of the increase of the DGS’s funding – is fairer and more market neutral as a general system. The “flow based system” unduly punishes incumbent banks for an increase in covered deposits.
- We would welcome a harmonised methodology of the calculation across all DGS systems. This can be achieved by updating the EBA’s Guidelines on methods for calculating contributions to the DGSs.
- National DGSs should be more transparent in providing details on how precisely these transactions work, as this is a crucial factoring in calculating the cost of a corporate restructuring or M&A.

ANNEX 1: Relevant DGS Directive provisions on DGS transferability

Current DGS Art 14(3)	EU Parliament Position on DGS Directive in CMDI package (here)	ING suggestions (in red compared to EP position)
<p>3. If a credit institution ceases to be member of a DGS and joins another DGS, the contributions paid during the 12 months preceding the end of the membership, with the exception of the extraordinary contributions under Article 10(8), shall be transferred to the other DGS. This shall not apply if a credit institution has been excluded from a DGS pursuant to Article 4(5).</p> <p>If some of the activities of a credit institution are transferred to another Member State and thus become subject to another DGS, the contributions of that credit institution paid during the 12 months preceding the transfer, with the exception of the extraordinary contributions in accordance with Article 10(8), shall be transferred to the other DGS in proportion to the</p>	<p>3. Member States shall ensure that where a credit institution ceases to be member of a DGS and joins a DGS of another Member State, or if some of the credit institution's activities are transferred to a DGS of another Member State, the DGS of origin shall transfer to the receiving DGS <i>an amount that reflects the additional potential liabilities borne by the receiving DGS as a result of the transfer, taking into account the impact of the transfer on the financial situation of both the receiving DGS and the DGS of origin relative to the risks they cover.</i> ■</p> <p><i>EBA shall develop draft regulatory technical standards to specify the methodology for the calculation of the amount to be transferred to ensure a neutral impact of the transfer on the financial situation of both DGSs relative to the risks they cover.</i></p> <p><i>EBA shall submit those draft regulatory technical standards to the Commission by ... [12 months from the date of entry into force of this amending Directive].</i></p> <p><i>Power is delegated to the Commission to supplement this Directive by adopting the regulatory technical standards referred to in the second subparagraph of this paragraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council.';</i></p>	<p>(d) paragraph 3 is replaced by the following:</p> <p>'3. Member States shall ensure that where a credit institution ceases to be member of a DGS and joins a DGS of another Member State, or if some of the credit institution's activities are transferred to a DGS of another Member State, the DGS of origin shall transfer to the receiving DGS the contributions due for the last 12 months preceding the change of DGS membership, with the exception of the extraordinary contributions referred to in Article 10(8) <i>an amount that reflects the additional potential liabilities borne by the receiving DGS as a result of the transfer, and the commensurate reduction of liabilities borne by the DGS of origin. This shall take into account the impact of the transfer in terms of new target size for both DGS and the risk covered by the respective DGSs on the financial situation of both DGSs relative to the risks they cover.</i></p> <p><i>EBA shall develop draft regulatory technical standards to specify the methodology for the calculation of the amount to be transferred to ensure a neutral impact of the transfer on the financial situation of both DGSs relative to the risks they cover.</i></p> <p><i>EBA shall submit those draft regulatory technical standards to the Commission by ... [12 months after the date of entry into force of this amending Directive].</i></p> <p><i>Power is delegated to the Commission to supplement this Directive by adopting the regulatory technical standards referred to in the second subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council.';</i></p>

amount of covered deposits transferred.		
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Annex 2: EU DGS compared

Our assessment shows many differences in deposit guarantee schemes across Europe. Depending on the specific set-up, a scheme can be a decisive detriment to new market entrants and cross border mergers and acquisitions. Plus the mere fact that deposit guarantee schemes, including their target sizes, differ per country, creates unpredictability and an extra layer of complexity to strategic business decisions. . Despite a minimum **target size** of deposit guarantees funds is set at European level, Member States can and do decide on higher levels. Whilst **methodologies to calculate the contribution** to the funds are prescribed in EBA guidelines, countries have full flexibility to choose the model for contributions. And there is discretionary room to set **additional or extraordinary contributions**. See table 1 below for an overview of the observed jurisdictions.

	Netherlands	Italy	Belgium	Spain	Germany ²
Target level	0.8%	0.8%*	1.8%	≥ 1.0%	0.8%
Funding level EOY '23	0.77%	0.63%	1.6%	0.91%	0.68%
Full by (exp.)	July 2024	July 2024	Unknown	End 2024	July 2024
Cov. Dep. (bln, EOY'23)	595.2	730.6	337,6	889.1	786.9
Funds (bln, EOY '23)	4.6	4.6	5.4	8.1	5.3
Contribution model	Stock based	Stock based?	Flow based	Flow based	Flow based*
*		Additional voluntary credit line of EUR3.5 bln (3yrs)			Minimum set at EUR 20.000

² Covers the EdB, of which ING is part of. The private German DGS for covered deposits >100k is not shown here.

Annex 3: Stock vs Flow based DGS systems

In general, a stock based model is favourable to incumbent participants whereas a flow based model is more favourable for new entrants. In a typical stock based model, participants pay an individual fee based on their own deposit base and a collective fee based on market share and risk characteristics. In a 'flow based' DGS contribution system, contributions required to cover a rise in deposits is shared among all banks based on their relative size and adjusted to the risk profile of the bank. There is no requirement for new entrants to individually contribute for any new deposits brought to the fund. Any increase caused by a new participant to the fund will be borne by all existing banks. See for examples box 1 and box 2. The rule that only the last 12 months of contributions transfers from the one to the other DGS (e.g. when a subsidiary is branchified) can be seen as an impediment to such a transfer, even more so now we are in the situation that deposit guarantee funds are full/ nearly full. The amount of the last 12 months contribution typically will be very low.

Stock based	Flow based
<p>Box 1 - Banks have to pay up 0.4% of their deposit base/ growth as "individual contribution". The "collective contribution" is 0.4% of the pro rata risk weighted deposit base or growth. Once the fund has reached its target level, additional contributions to keep the fund fully funded are calculated on a quarterly basis and need to be paid up every quarter. New entrants have to pay up their individual contribution in full and immediate. The new entrant's share of the collective contribution is based on its risk-weighted share in the covered deposit growth. If a new entrant caused 50% of the total covered deposit growth, it pays $50\% * 0.4\% = 0.2\%$ of the total covered deposit increase. In practice, this means that new entrants will pay 0.8% of the covered deposits they bring into the DGS, in most cases.</p> <p><i>Assume existing bank with a market share of 30% adding €50bn new deposits as a result of branchification EU sub:</i></p> <ul style="list-style-type: none"> - Individual contribution: €200mln - Collective contribution: (close to) €200mln - Total one off contribution: (close to) €400mln - Other banks collective contribution: (close to) zero 	<p>Box 2 - In Spain, the target level of the fund is equal to or above 1% of covered deposits. The managing board of the fund, makes a public statement that the target level has been reached and that contributions cease. Increases of the deposit base going forward, either due to organic growth or due to new entrants, are paid by all banks, pro rata their market share and risk level. As long as there is no shortfall below the 1% coverage level, no new contributions are required.</p> <p><i>Assume existing bank with a market share of 30% adding €50bn new deposits as a result of branchification EU sub, and DGS target level needing top-up to restore >1% coverage:</i></p> <ul style="list-style-type: none"> - Contribution: €150mln ($30\% * 1\% * €50bn$) - Other banks contribution: €350mln ($70\% * 1\% * €50bn$)